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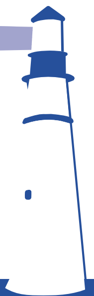

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Editor

The New Paradigm in Management

By Russ Robb,
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As a Managing Director of Atlantic Management Company in Portsmouth, N.H., we are keenly aware of the importance of management when assessing a company for a corporate valuation or for purposes of buying or selling a company. Interestingly, if a company has had too much turn-over at the top it is a sign of instability and conversely, if there has been no "new blood" at the senior level for many years, then there is the possibility that companies will become stable and complacent.

Arguably, one of the best business books I have read in years is the recently released publication: *Why Smart Executives Fail* by Sydney Finkelstein. The author states: "A real danger in companies is operating in the status quo mode. Flexibility and open mindedness are two of the core principles for effective strategy, and leadership. Many leaders are not able to cope with change and are seemingly unwilling to deal with change. The business formula that worked in the past is not necessarily valid today.

It is important that senior executives measure themselves to external benchmarks rather than by some internal standard. Smart executives succeed by learning from the mistakes of others, by understanding the underlying causes of failure and how to be alert to them, and by creating organizations that are open – minded enough to acknowledge and learn from their own mistakes." Sydney Finkelstein goes on to explain that there are 4 major episodes in business in which executives are most vulnerable:

- Creating new ventures
- Dealing with innovation and change
- Managing mergers and acquisitions
- Addressing new competitive pressures

Most executives are intelligent, capable, charismatic, hard-working, but as Finkelstein explains: "The very characteristics that enable executives greatness are also responsible for eventual failure such as hubris, arrogance, or a need for power and control." For many of us who have vested interest in the welfare of a company, we should remind ourselves of Niccolo Machiavelli's observation: "There is a common failing of mankind, never to anticipate a storm when the sea is calm."

Gilreath Consultantcy = "Due Diligence" Retained Search for the Private Equity Sector

Are Your Customers Flakey?

By Lee Levitt
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Most customers are a bit like snow flakes. They seem to appear out of nowhere, they're all different, and they disappear too soon. However, they differ in two important ways…first, unlike snow flakes in the Northeast, we almost never have too many customers. And second, while we have no ability to make snow fall, we do have the ability to *create customers.*

All it takes is the right ingredients. To create snow, we need the right mix of temperature, altitude, wind currents and a little moisture. To create customers, we need pain, budget and the right message. We also note that given sufficient pain and the right message, budget becomes less of an issue.

Most emerging companies focus not on pain or the right message, but on "features and benefits." Product companies tend to teach their budding salespeople the details of their products rather than how to sell more effectively. In company after company, we find that new salespeople are actually quite effective at selling- they don't have any product knowledge to share, so they continue to ask questions of their prospects:

I don't know the answer to that question, please tell me why this is important to you.

Then, as they become more familiar with their own product offerings, the typical sales person shifts to presenting their knowledge and demonstrating their expertise:

That's a great question. Let me walk you through the differences between these two models and show you how technically advanced they both are.

Most technically oriented prospects eat up this technical discussion, using it to educate themselves and to prepare for interviewing the next prospective supplier.

On the other hand, most high level business customers tend to recoil, politely, from this regurgitation of product facts and move on to other suppliers that can hold a business-focused discussion.

And it's the latter group that typically makes the important buying decisions. Oops.

Exploring pain is a practiced skill for a salesperson. Mike Bosworth, the author of *Solution Selling*, suggests that companies should not leave this to chance, but instead develop a series of informal scripts for salespeople to use.

Bosworth's Solution Selling methodology then takes this approach one step further, with the salesperson exploring the "solution state" with the prospect, helping the prospect to develop a vision of how life would be different (better) if the proposed product or service is acquired. Prospects are highly motivated by this powerful combination of fully explored pain and a vivid picture of how life could be.

Appropriate company messaging provides a strong foundation for solution selling. For example, Court Square Data Group, a Springfield, Massachusetts-based IT services firm "helps drug companies to bring drugs to market more quickly." Contrast this messaging with a Boston-based messaging switch vendor – "we can move any kind of data between any applications."

Court Square's message rings strongly with their client and prospects - senior business people at pharmaceutical firms. On the other hand, the message from the switch vendor resonates only with the low level technical people tasked to handle data integration. A large population, yes, but difficult to target and with no spending authority.

Most companies leave all this to chance…expecting the prospective customer to make this leap of faith on his or her own. Which they never do. And just like the snow on the ground in the Northeast last winter, for these companies, prospects will appear, and then just as quickly disappear.

What does selling have to do with the CEO?

Everything, actually. Without sales, there is no business. And in today's difficult climate, the entire organization must be involved in selling. Selling needs to be driven from the top. It's the single most important priority…and if the CEO isn't driving this, then nobody is.

What should the savvy CEO do?

The savvy CEO will immerse herself in the day to day goings-on of the selling process. She won't "get in the way" of the sales team, or usurp the authority of her sales management. But she will meet with clients and prospects regularly and fully understand both the drivers and mechanics of the sales process in her company.

Once she understands what drives customers to buy from her company, she will focus on the various conversion points… where suspects become prospects, where prospects become clients, and where clients leave. In a typical company, there's perhaps a half dozen or more of these conversion points.

Understand the conversion percentages, determine how to increase those percentages over time, continue to monitor the conversion rates, and your business will develop strong, sustainable revenue streams.

And your customers will more closely resemble the ever-present New England granite rather than ephemeral snowflakes.

Run the Company or Build Value for Yourself

By Glenn Oken, Partner
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Keith Olivit was one heck of a manager. He was President of Adva-Lite, the nation's largest manufacturer of pen lights (the cylindrical lights that physicians traditionally shine in a patient's eyes and which later became a popular ad-premium giveaway). Adva-Lite was a division of Dorcey International, and under Keith's leadership, it became the low cost producer of pen lights, with product costs that were half those of the nearest competitor! For their efforts, Keith and his excellent team had a salary and bonus to show for their industry dominating efforts, and hoped for stability and job security as Dorcey International came to a strategic decision to divest of Adva-Lite.

Keith did not realize that he was in a far stronger position than he had believed. Provided that there was not a strategic suitor for the company who was willing to pay an inordinately high price for the division, or if the seller cared enough about the management team to give them a chance to buy the division at a reasonable price, Keith was in the cat bird seat.

The business world is populated with

well funded, experienced private equity funds eager to back a strong incumbent management team in acquiring a niche leading, profitable company meeting certain criteria that portend stability of profits. Moreover, these funds do not run companies, and accordingly, rely heavily on and generously motivate management with current income, bonuses, and most importantly, significant ownership.

Florida Capital Partners (FCP) backed Keith and his team in the acquisition of his division. Management put up virtually no money, and received 25% of the company, while gaining FCP as a very well funded partner for growth, whose reason for being is to invest additional equity intelligently to grow portfolio companies. Uniquely, when FCP invests additional equity in a portfolio company in support of internal growth initiatives or add-on acquisitions, it does not reduce management's ownership. So, while Keith was sweating over the retention of his job, he was about to realize his dream of building value for his efforts with daily operating control, and an eager, experienced, and well heeled financial backer.

There usually comes a time in every private company's life when a partial or total change of ownership is contemplated. Aging owners, divesting parent companies, or the need for a strong partner to capitalize on internal or acquisition driven growth initiatives lead company owners to seek a partial or total sale. Often management does not realize that they have the ability to be the buyer with the appropriate backing, and that they do not need to have any meaningful dollars of their own to go from someone who runs the company, to a significant owner who can build value for himself or herself.

There are many different private equity funds out there with different criteria. Management's position is strongest when they are running a company that is already profitable with proven and stable cashflows, strong and defensible market share, in a non-hypercompetitive, less cyclical industry.

Once a manager realizes that he is in a position of strength, he or she should be very particular regarding his choice of prospective equity sponsors. There is no substitute for a long track record with excellent references who will speak to a fund's history as effective, fair, generous, and fun partners for growth. The fund does the manager no good unless it can close the transaction, so captive funding, experience, and a history of very accurately and honestly assessing their internal level of interest, and ability to close are imperative. A good partner will be willing to provide management contracts that clearly spell out a manager's rights and protections. References should describe a good partner as one who offers the best equity value for management, which includes:

- The initial equity to management (in the tax efficient format of common stock vs. options)
- Limitations to or the elimination of dilution to management's ownership if additional equity from the fund is invested
- A conservative capital structure so the manager is not managing with the handicap of an overleveraged balance sheet and liquidity shortages

Naturally, the most important variable in an equity partner is the trustworthiness of the people in the fund. Do references confirm that the fund principals are people of their word, in good times and bad? Do you like and respect them? What have they done for management in those instances when things did not turn out well, and they had to write off their investment?

While mergers and acquisitions are not in every manager's skill set, the required new information and knowledge are finite, and the right sponsor and attorney can make it easier for managers to make the most of a golden opportunity to go from employee to owner. As Keith Olivit commented, *"the wealth to be realized by owning a company with daily operating control and a strong equity backer is measured in considerable dollars, and just as importantly, in the satisfaction of controlling one's own destiny."*

Way to go, Keith!

The Leadership Exodus - CEOs Are Seeing It and Feeling It.

By Tom Sherwin,
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If you are a CEO or work closely with one then you know the last several years have put an incredible strain on leadership. What was, at the end of the last decade an abundance of leaders has today shrunken to a mere shadow of its former self. As a result, CEOs are carrying a heavier leadership load.

When the economy was strong CEOs had to literally fight for their position in what we call the Leadership Circle. Within the Circle were not only the CEO and VP of Sales, but the CFO, CIO and a host of others more commonly associated with low profiles. Everyone wanted a piece of the credit, a share in the outcome and the fame that came with being in the entrepreneurial limelight. Frankly, many CEOs did not mind as it was easy to share the limelight while their overall compensation was increasing.

With the decline in economic fortunes our CEO Coaching clients and those in our CEO Resources Forums are expressing their frustrations with

being left virtually alone in the Leadership Circle to face declining revenues, unhappy employees and customers with increasing demands.

What to do when your leaders become reluctant followers?

- Revisit the strategic plan to get universal commitment to the big picture.
- Let leaders know directly what you expect. Now is the time for them to step up.
- Consider team building as an education about flexibility in leadership styles to suit the needs of followers.

Use your external resources (i.e. your board, external advisors) to maintain perspective on your own leadership characteristics. Leaders follow their leader so you must set the tone.

Management: The Key to a Successful LBO

By Bob Fitzsimmons,
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The three most important elements of a successful management buyout are management, management, and management. At the Riverside Company, we focus on buying and building little leaders, companies that are leaders in some niche in the marketplace. Market leadership may result from having great products, a broad product line, superior manufacturing technology, or a strong sales force. But today's great product line may be the top of tomorrow's scrap heap unless someone is looking at the competition and trying to figure out how to stay one step ahead of their product offering. No matter what a company's current strengths and resources are, the only certainty is that someone else will try to take them away or find and exploit the company's weaknesses to gain a competitive advantage.

Even without competition, the environment in which companies operate is constantly changing – with changes in the customer base, end market, supplier base, regulatory environment, etc. So even when you buy a clear market leader, it's not likely to remain a leader for long without a sound management team marshalling the company's resources to respond to challenges and create a vision to stay one step ahead of the competition. As private equity investors, the most important thing we do is make sure that we have a great management team in place.

Small Portfolio Company CEO hiring Pitfalls

By Jim Gilreath

1-Lack of a written CEO job description or sign off by hiring partners on final specs.

2-New CEO has no prior full P&L management experience.

3-New CEO never worked in a small or mid-sized hands-on company environment.

4-Lack of in-depth reference checking on hired CEO.

Recommended Reading

How To Become A
Marketing Superstar

By Jeffrey J. Fox
Hyperion Books
www.foxandcompany.com

"This book is for any enterprise that invests time or treasure to get and keep customers"-Book introduction.

To submit an article, which we greatly encourage, or share your comments, contact Jim Gilreath, President, Gilreath Consultantcy, jim@gilreathsearch.com or Phone: 800/395/8771

Questions Private Equity Firms Should Be Asking About Interim Management

By Dennis W. Powers
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When is an Interim solution Appropriate?

There are many situations where use of an objective, experienced interim executive makes sense. Private equity firms frequently face management issues with portfolio companies. Interim management can work well, particularly when there isn't time to complete a retained search and the prospect of an exit mitigates in favor of a flexible solution, avoiding the expense of a signing bonus and "golden handshake" following a change of control.

Early stage companies typically lack bench strength needed to deal with out of the ordinary developments. An interim executive with the necessary experience can be introduced into the situation within 5 - 10 working days to lead the company through the period of transition and stabilize things until a permanent solution can be implemented.

Many positions are in transition where the skill sets that are needed today are different from what will be needed once things have been stabilized. The interim executive can manage the organization through the period of transition and then provide mentoring to the permanent executive based on knowledge gained during the interim assignment.

Companies can move on poor performers sooner, by inserting an interim executive who can advance the change agenda and cover the position until a permanent replacement can be identified. There is a scarcity of managers with top management experience. Interim executives can be used as mentors to assist with the development process until these people are ready for promotion.