L O N E   M O U N T A I N   A S S O C I A T E S

For Investors and Board Members

James E. Goulka

Lone Mountain Associates
5908 E. Montgomery Rd. Cave Creek, AZ 85331
480-588-8213 phone   480-659-8416 fax   www.lonemountain.net

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You can read the signals: the company you have invested in or on whose board you sit is heading for some rough times. If you are lucky or farsighted, you have some time before you get there; if not, you are already facing mounting problems and you've lost confidence in existing management's capacity to deal with the issues.

Having acknowledged the problem, either by superb insight or by reality slamming you in the face, you now have to do something to save the investment of capital, human effort, and the idea that brought them together. That "something" has 3 essential components:

- Analysis
- Strategy
- Implementation

ANALYSIS

If existing management refuses to acknowledge or cannot address the issues confronting the company, replacing the leadership becomes necessary. Such a convulsive act usually requires approval by the board and consensus among board members that this change is the best way to proceed. A clean slate business environment and condition assessment, describing and dimensioning the impending problems the company faces and its capabilities to meet those problems, serves to provide a basis for thoughtful decision-making and minimizes the risk of making decisions based upon temporary blips, the fashion of the day, or personal animus.

The assessment should contain analyses of:

- Near term cash flow, to determine how much time is left under prevailing conditions before the company runs out of cash.
- Major, immediate cash flow improvement actions and their impacts.

- Competitive landscape and the position of the company within it.
- Major dynamics within that landscape—new ideas, trends, and competitors.

- Estimated life cycle of the company's current products and services.
- Pipeline of new products and services.

- Validation of existing exit strategies.
- Updated valuation of the enterprise.

- High level assessment of the human resources within the company.

While existing management may know the details of the situation, this type of assessment is best performed by an independent consultant, who can dispassionately evaluate, not defend, the situation.

STRATEGY—ACTUALLY TWO STRATEGIES

The assessment provides insight into the company's current condition, which forms the baseline for strategy. The next step is to redefine the objective of the enterprise in light of its current condition and the competitive environment it faces. This may require a significant shift in expectations, both in scale and in actual output. The glorious market share envisioned at the founding or most recent funding of the company may no longer be achievable within the investment horizon or, indeed, ever. An achievable objective, one recognizing the competitive reality, is essential for choosing strategies that have a potential for success.

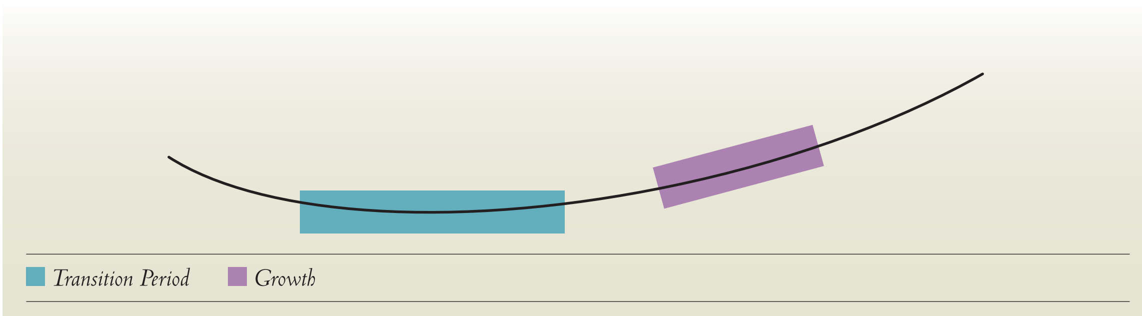
With a clear understanding of where the enterprise is today and a reasonable objective defined, the question "is it worth the effort to get there?" can be answered. Measured against investor hurdle rates and acknowledging the scarcity of capital, time, and human energy, investors and board members can decide whether continuing to invest these scarce resources in the company is justified.

If the answer is positive, the next step is the development of strategies to achieve the objective. Because the company is currently heading in the wrong direction, strategy formulation requires two components:

- Strategy to change direction
- Strategy to grow

In reality, company employees cannot just stop doing one thing and immediately do another simply because they are told to do so. Individual behaviors change as motivations and understanding of motivations change. More importantly, companies are comprised of multiple individuals, whose working relationships are complex, and some of whom may not possess the skill sets required to achieve the new long range goals of the company. Consequently, the transition phase must be understood as distinct from, though strategically related to, the new growth strategy. In essence, the objective of the transition strategy is to reach a stable starting point to implement the new growth strategy.

This can be represented graphically:



The transition strategy has all of the hallmarks of any corporate strategy, including identifying necessary resources, establishing benchmarks and milestones, and identifying cash flow requirements. It has, though, an inherent additional sense of urgency because it is intended to stop counterproductive effort and wasted expenditure of financial and human capital.

Essential to a transition strategy are the questions regarding value:

- What is the expected value of the strategy? Does it meet the required hurdle rate?
- What is the value of each of the alternatives?
- What triggers significant change in value sufficient to adopt alternative strategies?
- What are the possible exit strategies?

REDIRECTION, TRANSFORMATION OR TURNAROUND?

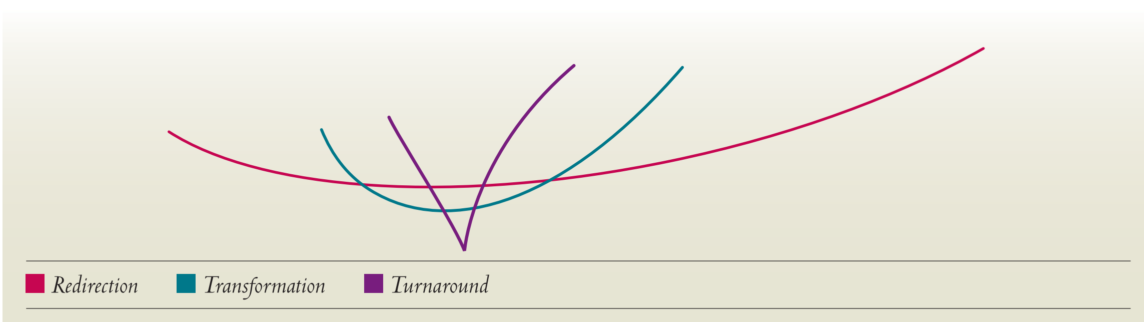
Redirection, transformation, and turnaround are all transitional strategies, alike in their character of change in direction and dissimilar in terms of profundity of change and urgency of timing.

Generally speaking, redirection is the gentlest of the change strategies, reflecting a need to change a limited portion of the company's activities. For example, the technology developed for bid4real.com enabled the digital display of information about real estate for sale combined with an auction functionality. The change strategy redirected the marketing program away from a focus on actual buyers and sellers of real estate to information intermediaries, such as newspapers. The strategy changed parts of the business model—sources of revenue, marketing programs, and pricing—rather than a complete makeover of the enterprise.

Transformation, by comparison, is a major redesign of the enterprise. For example, Encyclopaedia Britannica, Inc. was a direct seller of sets of books, mostly attached to 36 month financing. To compete in the new digital marketspace, the company had to be remade to fit the evolving demands of its retail customers. The product line was refocused to digital delivery, which, in turn, completely changed distribution channels. Financing of digital versions priced under $50 eliminated the necessity to provide consumer finance. Enormous reconfiguration of the staff and capital structure was required. The company shed thousands of employees and independent sales agents and hundreds of millions of dollars of debt.

Turnarounds such as K Mart typically are bleeding cash, rushing toward oblivion, and require exceptional change in a narrow time frame. Bankruptcy, debtor-in-possession financing, and reconstituted capital structures are the norm.

Graphically, the three degrees of change can be represented as follows:



Typically, the turnaround has the narrowest window to accomplish the change because it is deeper into the experience of difficulty and, therefore, closer to running out of cash. As long as companies have operating cash, redirections and transformations may have the luxury of more gradual change. This assumes, however, a relatively early insight into the strategic problems that the company will face. Allowing a company to continue along the wrong strategic path consumes cash, which narrows the window available to reshape the company.

Regardless of what the strategy is called or the depth of decline that has to be reversed, a transition strategy must address the current condition and competitive environment realistically and with a strong sense of urgency.

Furthermore, unless the company's strategic objective is solely to maximize its value in liquidation, its transition strategy must be linked to a longer term growth strategy, for it is only through growth that an enterprise will create the additional value necessary to meet investor return expectations. Consequently, a second, growth-toward-objective strategy must be fashioned, predicated upon a successful transition from decline to stability.

IMPLEMENTATION

Strategy is necessary to increase the probability of success. Without it, action is dependent solely upon intuition or luck. While one or both may be good enough for recreational gambling, neither of them is the base upon which substantial financial and human investment in complex enterprises is made. Yet, though strategy is essential, it is only a roadmap, and reading a roadmap is not the same thing as traveling to a destination. That the meaning of strategy is found in its implementation is truest in a transition strategy, for transition has the dual purpose of saving existing assets and positioning them for future growth. This double purpose complicates implementation for, in reality, transition implementation is to simultaneously shrink and grow—shrinking the counterproductive behaviors and growing those that will achieve success in the newly understood environment.

Transition implementation disrupts the status quo: it imposes uncertainty into an organization and then proceeds to reduce that uncertainty. Implementing a transition strategy requires a particular type of leadership, one that can motivate staff to share a vision that usually includes ending initiatives to which staff are already committed, terminating employees who are part of a social and productivity fabric, and making working conditions, temporarily, less pleasant.

Successful transition implementation includes the following:

- Taking complete control of cash.
- Ensuring the integrity of the accounting system and chart of accounts.
- Ensuring the integrity of data management, network and communication systems.
- Keeping good customers happy (at least sufficiently so to provide breathing room to accomplish the transition).
- Bringing creditors into the plan.

- Identifying and implementing cost savings initiatives.
- Redirecting product development and ensuring sufficient cash.
- Assessing the current staff capabilities for positioning for growth.
- Creating a staff termination plan that meets cost objectives and, within the financial constraints, is as compassionate as possible.
- Identifying unfilled staff positions in the growth strategy and hiring to fill them.
- Raising additional funding as appropriate.
- Measuring progress against a rigorous set of benchmarks and milestones.

LEADERSHIP

Implementing a transition strategy requires a particular set of skills. Simultaneously shrinking and growing, cutting and adding, leaving as-is and finding alternatives, hiring and firing, a transition leader must be comfortable doing uncomfortable things. He must also be able to communicate a vision that enables others to see the benefits of doing difficult things when the objective may be around a corner--not immediately visible—and join in to make the transition successful. These skills, particularly in the balance of their use, are different from growth management. Furthermore, a transition is intended to be transitory, of a limited duration, after which the company should be on a growth trajectory. These conditions—specialized skill set and limited time period—suggest the engagement of a a specialist advisor, one who comes in to help make the transition happen, and hands off the successfully redirected enterprise to a growth-oriented, product or market segment focused executive.

Lone Mountain Associates, LLC 5908 E. Montgomery Rd. Cave Creek, AZ 85331
info@lonemountain.net