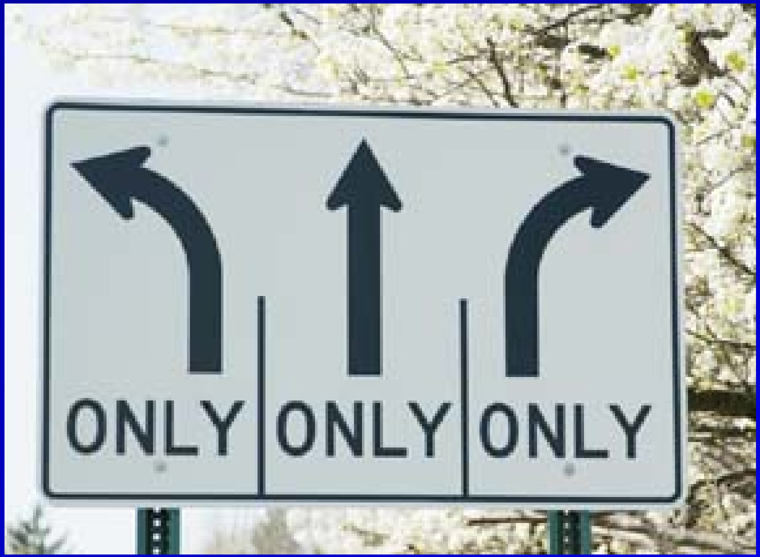
Situation Assessment

Business Recovery

- Prospects warming up
- Pain is concentrated
- In sectors where expectations lost touch with reality – telecommunications, media and technology

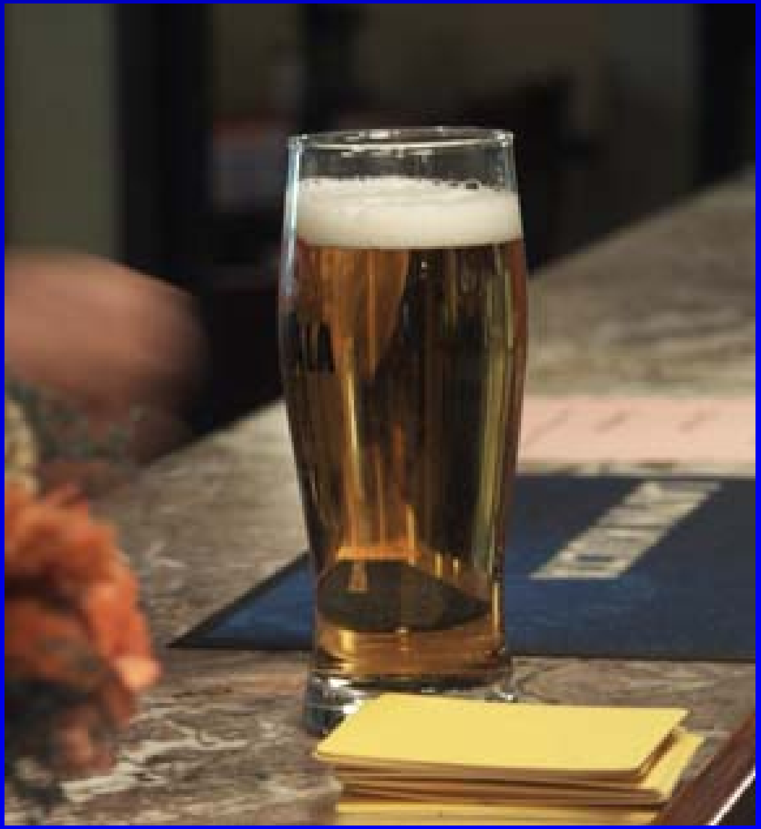
Business Recovery



- Economic slowdown taking its toll on a wider range of companies that prospered in good times but are finding it tough in more severe times
- Insolvency practitioners formerly reviewed as undertakers are now reborn as company surgeons
- Arranging financial life-support systems for companies while they separate those of its activities that have a future from those that do not

Business Recovery

- Principal cause of failure – bad management
- Quarterly reporting and short-term investors lead to pressure on executives to deliver
- When things start to go wrong, lack of a supervisory board made it easier to achieve targets through creative accounting



Business Recovery

- Combining the role of chairman and chief executive in a single role resulted in boards failing to rein in bosses when strategies failed to keep pace with reality
- Jean-Marie Messier, ex-chairman of Vivendi, created amazing results in a raging bull market
- More challenging times mean you need to care more about cash flow and market share
- Every day some 1990's business icon slips out the back door, while a new CEO with a new strategy walks in front door

Business Recovery

- CEO no longer a job for life
- Average life expectancy of a CEO in OECD countries is 2.75 years
- Boardroom clean-outs are a good thing
- Key skills needed: communication, attention to detail, teamwork and old-fashioned leadership
- New team: What makes money and what does not

Business Recovery

- Shedding or closing sacred cows that were part of a grand design which no longer fits the current difficult times

- Principles of good management are unchanging and universal, but the markets and environment in which companies operate are in a constant state of flux

Warning Signs

- Companies fail because they are not looking where they are going
- They do not monitor their own performance
- They do not spot changes in the business environment
- It is not change that causes corporate failure, it is management mistakes
  Argenti
- Argenti designed the A score 30 years ago

Warning Signs

- Three phases of Corporate breakdown
  1. Emergence of gaps and imbalances in the company's management and consequently its internal and external monitoring systems
  2. These defects lead to poor business decisions
  3. Company starts to show the symptoms of failure (Staff turnover to cash flow crisis)

- Most striking when dealing with an autocrat

Warning Signs

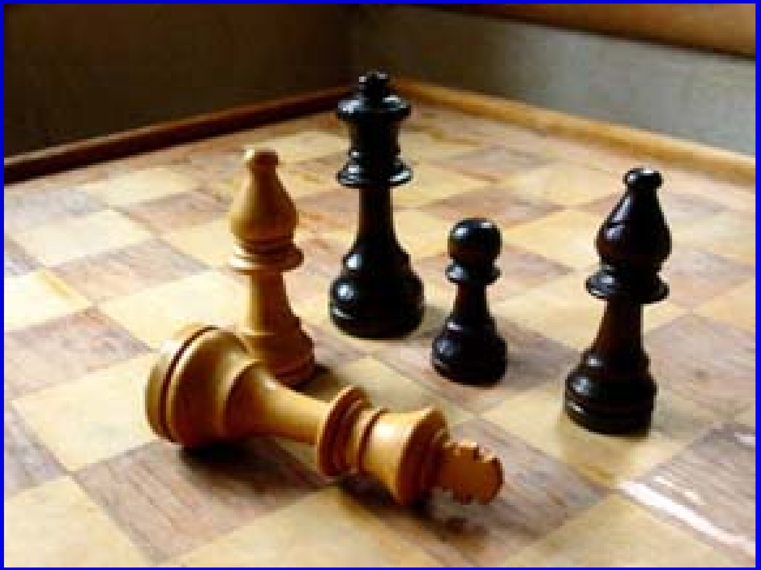
- Overbearing leader is often a prime trigger of corporate failure
- Not because strong personalities are anathema to success
- But because strategic decisions become even riskier when the decision makers eyes and ears are closed

Warning Signs

- It is important to distinguish between an autocrat and a dynamic leader
- The autocrat is the company
- He does not listen to others and he does not share authority
- Merging of executive roles, rise of passive directors and skewed skills at board level

Warning Signs

- Team input diminishes, the weaknesses of the individual at the top become the weaknesses of the entire company
- Key to the process of adjustment is planning
- Planning places responsibility on the shoulders of management



Warning Signs

- Critical role of planning in surviving a downturn
- A clear sign of management laxity is a culture of blame

Warning Signs

A Score : Is the company ok ?

Defects	43
Mistakes	45
Symptoms	15
	100

Pass mark is 25 or below

Warning Signs

Defects

Autocrat	8
Combined chairman & chief executive	4
Passive board	2
Unbalanced skills	2
Weak finance director	2
Poor management depth	1
No budgetary control	3

Warning Signs

Defects cont'd…

No cash flow plans	3
No costing system	3
Poor response to change (aging product, Plant, equipment, marketing, directors, etc.)	15
Total for Defects	43
Pass mark for defects	10

Warning Signs

<u>Mistakes</u>

High leverage	15
Overtrading (expansion under-financed)	15
Big project	<u>15</u>
Total for Mistakes	<u>45</u>

Warning Signs

Symptoms

Financial signs	4
Creative accounting	4
Non-financial signs	3
Terminal signs	1
Total for Symptoms	12

Warning Signs

- Z score measures financial stability
- Score of lower than 1.8 predicts impending insolvency
- Altman's Z score for Enron was below 1.8 for four years in a row
- Based on five financial ratios
- Return on total assets, sales to total assets, equity, working capital

Warning Signs

- Even solid financial ratios don’t mean your ok
- In a Dun & Brad study of 3000 failed companies
- 64% reported increased sales in previous year
- 70% reported increased sales per employee in previous year
- 60% reported increased profitability in previous year
- There are usually other symptoms

Warning Signs

- Other symptoms include
- Staff turnover
- Delayed investments
- Panic solutions
- Such as new product launch without market testing

Management is Critical

- How well do you know your management team ?
- Do they have the necessary skills to deal with the situation ?
- In crisis, ability to make quick decisions, sort through lots of information and determine what’s critical, communicate well and then act
- Typical business reviews lack management focus