

## The Arete Newsletter

January 2007

Happy New Year! We begin 2007 with the first issue of ***The Arete Newsletter***. By using this forum, we hope to provide some useful advice from time to time to our clients and friends. We would love to hear your comments and thoughts on any of these articles. Let us know if you would like to hear from us on any particular issue. Best of luck to you this year, and enjoy!

### A CEO's New Year's Resolutions

#### Moving your focus from the rear view mirror

The beginning of a new year is always a great time for company leadership to reflect upon the challenges, opportunities and successes of the prior year. However, once the team has had the chance to reflect upon its performance, good or bad, it is time to focus on the future and move beyond the rear view mirror. As is often said about company performance, past performance is no guarantee of future results. (That may be a good or bad thing depending on your prior performance!) For this edition of ***The Arete Newsletter***, we focus on forward-looking planning. And so, here are some New Year's resolutions that you and your team may want to consider.



#### 1. Complete your strategic plan

If you have not prepared or completed a strategic plan or reviewed your existing strategic plan within the last two years, do it now before the year gets away from you. A current strategic plan is critical to provide

- A foundation on which to base the future direction and growth of your business
- Benchmarks for assessing the progress of your business going forward

While you could simply continue last year's business tactics, relying upon the successes of the past, without a clear vision of where you will take the company and how you will get there, over time the enterprise will begin to drift, without direction; a sure formula for ultimate under-performance.

#### 2. Review your exit strategy

While developing an exit strategy is an element of strategic planning, it deserves mention on its own. It deserves mention because so often it is not well considered by the board, CEO or management team of small to midsize companies. Every company, I repeat, *every company*, needs to consider and develop a view of an ultimate liquidity event for or disposition of the business. This could be a sale of the company or business, a sale of the majority stockholdings in the company, a merger with a similar or related business, a buyout by management, or simply a liquidation and shutdown of the business. Timing of the event is variable; we could be talking about one, five, or ten years. Your strategic plan must be in sync with and drive the company toward that event. Simply hoping for such an event to happen quickly is not a strategy.

If you are the owner of a family-owned business, *you need an exit strategy*, even if it is the ultimate transfer of ownership to family members. This is an essential aspect of your own personal estate planning, no different than having a proper will in place.

If you are the CEO of a publicly owned business, *you need an exit strategy*, whether that be one that provides your major shareholders a liquidity event, such as a secondary public offering, that considers the corporate disposition if the company does not deliver on its strategic goals or fails to reach the number one or two market position in its target industry, or otherwise. (Obviously for larger corporates, this "exit" comes in different forms and does not necessarily result in a complete transfer of ownership.)

### **3. Keep a close eye on your current and projected operating cash, particularly in anticipation of a planned acquisition**

If you are planning for strategic growth through merger or acquisition activity you need to watch your cash very carefully and project your cash requirements with as conservative of view as you might consider reasonable. For purposes of your projections, you shouldn't ignore transaction costs of lawyers, accountants and other advisors, which can well exceed estimates as a result of any delay in deal timing. Appropriate cash management also would suggest that you over-estimate the price that you expect to pay for the business. And, consider your post-transaction integration and revenue ramp-up time--and then double it for planning purposes. *In other words, always plan for the worst and hope for the best.*

The reason why is obvious. Cash is not only *king* but it is *essential* for an ongoing enterprise; it is the water of the business. If you have room to borrow in your capital structure, do it when you don't need it immediately, because if you wait until you do need it, it will cost you significantly more, if you can get it at all. All the due diligence in the world prior to a transaction cannot take the place of the experience and understanding of a team when actually operating the business for a period of time. But if that experience indicates you have a higher than anticipated cash need after acquiring the business, whether that be for the short or long term, it may be too late to find the additional funding.

Of course, the opposite holds true as well. If your business is cash rich, good and thoughtful reason must prevail in looking at acquisitions. Too many poorly conceived acquisitions have been consummated in recent years by public companies who felt compelled to use their ample cash reserves, only to see the cash reserves depleted over time and the acquired businesses poorly performing or poorly

integrated into the main business.

#### 4. Review personnel and management incentive plans

You can be diligent about formulating your strategic and annual plans, you can have a very clear and articulated vision for the future the company, but all the planning in the world is easily derailed without quality and motivated staff and management team to execute the plan. Assuming you've chosen the right personnel, the wrong incentive plans for your team can sabotage all your best planning efforts.

Consider carefully your quota bearing sales incentive plans. Ask yourself what behavior the plans will drive. If the plan focuses only on sales/revenues, don't be surprised if sales of your lowest margin product or services lead volume with the resulting reduction in profitability. Consider also, among other issues, how incentive plan drivers impact not only current sales but the development of new product lines and offerings that might not offer immediate commission opportunities for the sales staff.



You also need strong and appropriate management incentives to motivate your executives to drive the day to day tactics and strategic positioning of the company. Without it, your firm and long-term plans will founder. Consider whether your executive incentive plan is carefully crafted to avoid unnecessary tension in the organization. For example, incentives for the sales executive focused only on revenues and incentives for operations or manufacturing groups focused on margin may create interpersonal or interdepartmental tensions that distract from selling and servicing customers. The "blame game" is easily instigated.

2007 is here. Prepare for your company's future success now. Have a great year!

*Arete Corporate Advisory team members have the experience to help you with your strategic and overall planning, your acquisition and disposition activities and other growth efforts. Call us today and let us delight you with the results.*

Email: [info@aretecorporate.com](mailto:info@aretecorporate.com)  
Phone: +1 305 767 4596  
Fax: +1 305 402 0524  
Web: <http://www.aretecorporate.com>

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