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EBOOK

MANAGING CHANGE TO AVOID HITTING A WALL

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Do you recognize this situation?

Momentum slows to a near standstill.

The business landscape shifts and you're confronting unexpected challenges, ranging from new trends to marketplace disruptions. Competitors are starting to pull away and your tried-and-true approach is no longer helping you keep pace. Areas of the business where fundamentals are no longer being managed are only aggravating the situation.

Nothing is more frustrating than "hitting the wall." Inevitably, however, most great athletes and businesses alike do. For simple illustrative purposes, the retail industry provides some great examples. Think Circuit City, Blockbuster or Woolworth's. You likely shopped at all of them at some point and watched in disbelief as they quickly fell off the map. While these are big companies and dramatic examples, there is no denying that missteps in managing change caused them to hit the wall so hard they were never able to recover.

Change is part of doing business. Managing through change is always a juggling act. The critical thing for every business leader is to recognize the need for change. Embrace it, and innovate through it.

Don't ignore the warning signs and wind up with the wall looming.

As operationally oriented professionals focused on finance, HR, technology and operations, we see these situations all the time. While every business situation is different, we see common missteps that strongly impact business efficiency and flexibility and contribute to wall-hitting scenarios. This ebook examines issues that frequently trip up a business, and provides tips for avoiding common change-related pitfalls.

Warning: the wall is closer than it appears

If managing through change were easy, more businesses would succeed. Run a quick Google search on business failure rates, and the top results from popular blogs and business journals will show that as many as 9 out of 10 businesses fail. Small Business Administration data isn't quite so dramatic, but it is eye opening: Only half survive an attempt at adaptation to a significant change for more than five years, a third for 10 years and a quarter for 15 years or more. Even for long-established companies, well-intentioned change efforts can quickly backfire with poor or misguided planning. Another example you're probably familiar with is JCPenney. In 2013, the press was full of stories about how Ron Johnson, who took over as CEO in 2011, nearly destroyed the company by abruptly changing JCPenney's longstanding approach to business, primarily by eliminating its sale and coupon strategy. The ads were well done, but failed to convince the market that the elimination of coupons was the way to go.

Business survival rates of attempted adaptation to a major change:

5+ years: Roughly half
10+ years: Roughly one third
15+ years: Roughly one quarter

Many businesses go off track when decision makers lose objectivity or lack perspective. Sometimes it's related to overconfidence and gut feelings. "It feels right" or "we know our market and are confident everything will work out", or our favorite, "we've always done it this way," are common refrains. Other times it could be a failure to ask the right questions due to limited expertise or lack of experience in a key business area, or failing to get a fresh perspective about using a tried-and-true strategic framework in a changing marketplace.

Cultural factors can also be problematic. For instance, situations where close-knit team members either walk the same line as the owner or CEO through fear or group think, or simply don't have enough outside experience to advocate for change.

Regardless of the cause, to get back on track, leadership has to recognize that the company is in trouble. The example below highlights some key warning signs.

Signs of trouble ahead

- Operating profits are negative or on a downward slide
- Net worth is negative or is on the way to being negative
- Earnings do not represent a reasonable return for the risks assumed
- Stagnancy (operational and financial)

Urgent attention required

- Declining or static revenue
- Declining gross margins
- Declining working capital
- Compliance issues

Avoiding the wall: key high-level considerations

The number of companies that fail is a statistic that should be sobering. Let's spend some time talking about companies surviving and thriving. What sets them apart?

Successful companies over the long haul often share a few key similar cultural characteristics.

1) Those responsible for managing change in key areas are aware of their responsibilities and empowered to fulfill them

The reasons for this are obvious. If people don't understand their responsibilities, tasks will inevitably slip and the organization will pay the price. Where this gets tricky is when your organization doesn't have expertise, or the right level of expertise, in key areas. It can also be an issue when the CEO micromanages many areas of the company instead of setting goals and objectives and defining a timeline and accountability for achieving them. In these environments, things that need to be addressed will be overlooked.

2) Change management is a constant focus

Every executive should know his or her company needs to be constantly adapting to the evolving marketplace to remain relevant and competitive. At the same time, it's important to guard against becoming overwhelmed or overconfident. We can say with good authority that nobody has all the answers. Good leaders know the perils of ignoring hard questions and are always asking them.

3) They know when to ask for help

Leadership in any company is generally well aware when they lack key skills or expertise in an area or department. In growing and established businesses alike, it's inevitable that gaps will exist for all kinds of reasons, ranging from budgets to staff transitions to business priorities and needs. The challenge that many leaders struggle with, however, is knowing when to seek out help to prevent gaps from growing into serious liabilities or drags on performance.

Following are some leading indicators of issues in finance, technology, and HR that we see contributing to systemic wall-hitting company performance issues. If you see or even sense red flags in any of these areas, it's a good idea to take action, including asking for help if you need it. If you are flying red flags in all of the areas, you had better hurry.

7 essential questions

1. Where do we stand from a product and competitive standpoint relative to competitors?
2. Are sales and profits consistently increasing year over year?
3. Are we achieving our annual financial plan?
4. What is our three-year strategic plan and do we have the right blueprint and resources to achieve it?
5. Does our strategic plan include financial benchmarks for evaluating performance?
6. Has our strategic plan been vetted by independent board members or outside experts?
7. Are we regularly and objectively assessing what is working and not working in the strategic plan?

Finance

Poor financial fundamentals in some form or another are not unusual or anything to be embarrassed about. Factors such as rapid company growth, often without seasoned financial leadership, can leave CEOs scrambling to fund expanding operations and keep them humming. Workarounds may not be ideal for the long haul, but they work for the moment and there are plenty of other things to fix and think about. It's important not to make a workaround the final product.

While poor financial reporting is not unusual, it can be deadly to your business when it results in underlying fundamental problems not coming to the attention of leadership. Cash is to business what water and carbohydrates are to a long-distance runner. There are a million different fueling strategies and ways to manage your pacing. The problem is that you can often cruise along for long periods, feeling great while unknowingly (or even knowingly) using the business equivalent of a junk fuel strategy to pour poor quality revenue into the engine.

Poor quality revenue might bolster the top line and create commissions for your sales team, but at the end of the day it presents collection risks, higher delivery costs, and other hidden cost problems. Accurate and timely financial reporting is required to call these issues out for action.

Financial management must be a leading-edge challenge: you have to change your business to match the market or environment. Clear visibility through quality financial reporting into key metrics is critical. The frequent challenge decision makers run up against is that absent fact-based quality financial reporting, limited perspectives or hopeful mindsets distort reality.

Ultimately, far too many companies wait until they are undercapitalized or too reliant on debt to ask for help. That's why, unless you have a seasoned CFO on your team, it's almost never too early to get an outside perspective and recommendations for process improvement from a qualified professional (which will mostly likely pay for itself many times over). Here are a few common issues we see that are good indicators you could benefit from financial process improvements.

Focusing on the wrong numbers

Red flags

- Losing money during rapid growth
- Fixating on revenue while overlooking the bottom line

We will focus on gross margin for illustrative purposes. It's not uncommon for very smart people to get distracted by one set of numbers, such as revenue growth, while overlooking other much more important key performance indicators, such as gross margin. This can quickly become a problem—even for rapidly growing companies. It takes 2.5 times as much revenue at 10% gross margin as it does at a target 25% gross margin. Think of all the time and effort that goes into delivering on and managing the infrastructure surrounding revenue and what it means to spend 2.5 times as much time for the same margin? There is a real expense in time, materials, salary, and other infrastructure to that.

The issue: unsustainable imbalances

We've seen companies growing substantially, winning most of their competitive bids and seemingly doing great from many perspectives, end up in receivership or bankruptcy because they simply were losing money at an increasing rate of speed by having the wrong pricing strategy. For example, one of our clients went from being profitable one year to receivership the next because industry prices were dropping rapidly and its (too) large inventory holdings were devaluing just as quickly, leading to poor gross margins on sales. We've also seen companies improperly account for the true additive value of new business by neglecting to include the overhead costs of a second shift.

Key takeaway: beware over-simplicity

The main point is that while a growth trend or business uptick is exciting, it's important to always keep sight of the big picture and what success really means. Success requires as much attention to the margin and profitability as to top line growth. Viewing something like revenue growth for its own sake in the hope that will somehow result in success is not the way to manage your business.

Overlooking SG&A expenses

Red flags

- Expenses as percent of sale increasing
- Budgets underestimate SG&A

Selling, general and administrative (SG&A) expenses, such as non-direct or overhead payroll, benefits, commission, marketing, rent, insurance and utilities, are generally considered to be controllable and should be based on sales levels. Generally speaking, they should also either be stable year over year or even declining as a percentage when the business is growing. SG&A as a percentage of sales is a critical consideration. Not only is it important to your management of the business; investors and bankers use this measure as a way to evaluate how effectively companies utilize cash.

The issue: increasing expense ratios can jeopardize survival
We often work with companies that have incurred increasing expense-to-sales ratios often related to (but sometimes independent of) not right-sizing expenses in the face of decreasing sales. Even though increasing expense ratios can jeopardize company survival, at some point management often resists cuts because of an emotional barrier. In almost all cases, however, expenses can and must be reduced. A lot is on the line. Owners of small or middle market companies who have personally guaranteed the company's bank line of credit risk losing their equity in the business and even personal assets when they don't make the right moves to trim spending. If this happens, ownership will really wish they had pushed through the emotional objections and made the right expense reduction decisions when they actually had those options.

Key takeaway: monitor ratios closely, act quickly
The best and most proactive way to monitor the SG&A ratio is during the company's budgeting process. Monitor ratios no less frequently than quarterly and take action to bring them back in line if they increase over planned levels. Catching the problem earlier rather than later in each cycle goes a long way in addressing and enhancing your company's bottom-line performance.

Turning to outside sources rather than looking inward for cash

Red flags

- Frequently borrowing money or selling equity

Whenever a company needs working capital, many leaders default to outside sources. In many instances, however, they are overlooking far better internal options.

The issue: outside sources are more time consuming and expensive
There are many things that you can learn about your company from a financial statement that will help you make short and long term improvements to both improve your profitability and working capital position without borrowing more money or selling equity. In fact, we have never seen a company that could not produce additional working capital and profit from within its operations.

Key takeaway: take another look at your P&L statement and balance sheet; then look again
When you carefully review your profit and loss (P&L) statements, there are almost always multiple ways to stabilize funding, and improve and grow your company. Many of them are completely under your control, ranging from small price increases to negotiating better costs with suppliers to reducing expenses. Having an understanding of your financial statements and being willing to make changes, insures a good relationship with your financial partners and the need for less outside capital.

So far we've focused on expertise and process-related challenges. But what happens when you have the expertise, but you can't get the information you need to make informed decisions? Having the right tools to understand and assess what's really happening in your business and the marketplace is essential to managing through change and ongoing business success.

Technology

When your key indicators are lagging or systems are less efficient than competitors, it's only a matter of time before you start to fall behind. Yes, you may be able to get by on instinct or grit for a while, but eventually working with poor information and inefficiency will catch up with you. That's why technology strategy is so important for business today. Technology is the backbone of practically every kind of business, and poor strategies can manifest themselves in all kinds of ways, including:

- Lower productivity
- Unnecessarily high costs
- Customer service issues
- Compliance risks
- Cyber Crime

Yet we regularly find that companies fail to properly align their technology and business strategies and find ways to make do with outdated or inefficient systems, tools and processes. The reasons vary from cultural views about technology being a back-office function to lack of technology expertise in house to legitimate budget constraints. By accepting the status quo, or even scaling it back, these businesses continually cede ground to more tech-savvy competitors.

So how do you know if your technology approach may need an overhaul? Here are some common issues we see on the technology front that indicate trouble could be looming around an upcoming bend.

The wrong tools, poor integration

Red flags

- Poor reporting that requires significant manual work for individual reports
- Heavy reliance on spreadsheets for managing the business
- Long-standing requests for IT services
- People looking outside of IT for process solutions

Most technology decisions are prefaced either on improved access to information or productivity or efficiency gains. That means getting good returns from IT requires that you are either using the right tools in the right way for your business goals, or at least using existing tools in the best way.

The issue: postponing change can lead to bigger issues
The problem is that businesses frequently don't have the right tools for their needs, or their environment. For example, a tool like QuickBooks is great for small businesses, but it can only scale so far. Information integration and visibility are also critical considerations. At some point, a majority of efficiency and productivity gains from technology are tied to how well your systems and applications can share information for reporting and coordinate processes.

Key takeaway: Technology and technology strategy must keep pace with business needs
It's not unusual to have a near crisis, rather than a calculated business strategy, precipitate technology updates or upgrades, such as moving from QuickBooks to an ERP solution. Often times, businesses resist change until they get to a point where a lack of functionality or integration becomes a threat to ongoing operations. In today's fast paced marketplaces, the advantage goes to the businesses that understand good business and technology strategies go hand in hand.

Failing to adequately understand and mitigate risks

Red flags

- No (or outdated) IT risk assessment
- No (or outdated) disaster recovery plans
- No (or outdated) data breach response plan
- No technology patch or upgrade strategy

All it takes is a look at the day's headlines to understand why it's a bad idea to ignore IT risk. On any given day you're likely to spot a new major data breach story, be it business or government related. The story of the day may even impact you personally.

The issue: potential brand damage, litigation, etc.
Unless you're under a regulatory microscope, it's easy to let IT risk management slip. But given the fact that a virus or hackers can quickly bring any business to its knees, maintaining a clear understanding of the IT risks you face has become a necessity for every business.

Key takeaway: ignore IT risk at your company's own peril
Not only is it important to have someone in charge of overseeing IT risk, it's critical that IT risk is measured and aligned with the company's overall risk appetite on an ongoing basis.

Commodity mindset

Red flags

- Operating model for IT is based on immediate challenges or "putting out fires"
- Business plans don't break down the potential for technology to improve performance

Depending on your business, it's not unusual to view technology as a commodity. In many growing companies, technology decisions are made at a departmental level based on immediate needs or pains rather than the big picture.

The issue: high/difficult-to-justify costs
When you take a step back, it's easy to see how technology budgets can get bloated with a mish mash of point solutions that may not play well together and are expensive to maintain and scale. Yet when you're looking to trim costs that doesn't mean that slashing the technology budget is your smartest move. Using the funds to automate various inefficient processes could deliver far more value.

Key takeaway: make business and technology strategy alignment a priority
Mapping out a technology strategy based on business goals will almost always result in better technology ROI than relying on infrastructures and solutions that are cobbled together on the fly or simply slashing your budget when the costs grow too high. The challenge, of course, is to act decisively before you need to.

With the right strategy, technology can be an engine for efficiency and growth. But the gains you can make with technology ultimately depend on the people using the technology—your teams. And when it comes to effectively managing human resources through change, businesses make all kinds of missteps.

Human resources

It's a truism we hear all of the time: a company's most valuable assets are its employees. Whether it's because of or in spite of this fact, HR is also an endless source of complexity. Executives and managers must constantly reevaluate how to improve productivity, determining whether new positions are needed, if existing positions still align with business objectives, whether pay and benefits are competitive, whether the company is complying with the law and on and on.

Even for companies that have an experienced HR leader and team, HR management is fraught with challenges related to staying abreast of rapidly changing regulation, as well as societal, technological, and generational changes impacting the work place. However, for companies without dedicated leadership, that are perhaps farming out HR tasks internally among an office manager or HR coordinator and other managers, HR policy and decisions can become confounding.

It's a significant yet very critical challenge to find and retain the right team. Additionally, HR departments must carefully weigh costs as well as compliance considerations and legal risks in setting policy. They have to consider the impact on morale, competitiveness, customer relations and other intangibles. Optimized HR is amazingly beneficial. At the same time, HR missteps can quickly weaken a company at any stage.

Here are some common HR issues we often see companies wrestling with that could indicate challenges ahead.

The termination quick fix

Red flags

- Thinking "at will" employment means low termination risk
- Focusing on paycheck size versus strategic goals

When revenue is dropping and leadership starts looking for ways to reduce overhead in a panic, job cuts are often at the top of the list. In cases where there are lots of redundancies, this approach makes sense. An experienced HR team understands and supports this. It's not unusual though for decisions to focus first on salary savings, sometimes at the expense of strategic business interests.

The issue: regulatory compliance risks
This is an ever increasing area of risk. Beyond costs and strategic considerations, companies without experienced HR personnel may not understand all of the compliance risks associated with terminations, even in states with at-will employment laws. Some considerations, such as employee age require you to make provisions for employees over 40. Utilizing objective rather than subjective criteria in the termination selection process is critical. Staff size also matters. Companies with 100 or more employees are subject to the Worker Adjustment and Retraining Notification Act (WARN Act), which requires advance notice of mass layoffs. Census is yet another consideration. The actual separation conversation, documentation and process a company uses may also significantly impact the ongoing severance negotiations and litigation following a reduction in force.

Key takeaway: seek an outside perspective before acting
Getting an outside perspective during the emotionally charged and difficult periods when terminations are on the board is always a good idea. When terminations for efficiency purposes are properly and consistently evaluated, companies often come out of the other side of terminations much stronger having used an approach that weighs employee skills and experience against strategic business needs and other factors.

Inconsistent or insufficient internal communication

Red flags

- Holding frequent executive meetings with no explanation
- Skipping or providing infrequent updates about newsworthy happenings or company objectives

To a large degree, the success and profitability of any business depends on paying proper attention to external factors, including clients, market standing and competitors. It's difficult to win external races and battles without motivated employees who are on the same page, yet leadership teams commonly fall short when it comes to internal communications.

The issue: morale and motivation
At the very least, frequent communications are important to ensure everyone is aware of and working toward the same company objectives. They are also important for morale (job security perceptions), and retention rates, which feeds back directly into external performance factors. After all, when it's obvious to employees that something is going on (generally everyone suspects the worst in an unknown situation), it can impact their performance in times of crisis (when good performance is needed most) or even lead top employees to jump ship.

Key takeaway: transparency pays
To keep all employees informed and engaged, a well-thought-out communication strategy is essential in good times and bad. While a centralized communications platform can prove invaluable, what's most important is clear and consistent communication about what's happening and what's needed from employees.

Inadequate hiring preparation

Red flags

- Hiring without strategic due diligence
- Improvising workforce plans and processes as you go, rather than establishing them ahead of hiring

Periods of rapid growth are exciting times. Without operationally focused, seasoned HR leadership guiding the process rapid hiring can also result in unnecessarily high costs as well as compliance issues.

The issue: potential compliance and process oversights

Designing a hiring plan and timeline to ensure that the company has the budget and awareness of critical functions that will maximize operational efficiencies is key. Finding talent and not compromising on skill and culture fit are often hard to do in a fast-paced environment, but the effort pays off in the long run. With an established hiring plan that demonstrates the impact of each position, along with proper job descriptions and compensation guidelines, businesses are more likely to hire and retain the right people at the right time.

Smoothly and effectively onboarding new people is challenging any time, but especially in a rapid growth mode. Efficient onboarding is predicated on things like offer letter templates, an employee handbook and accurate compensation benchmarking in addition to the first-day experience with the new manager and team. Infrastructure and processes are also essential considerations. The first few days for new employees are critical for setting the tone in their new position. It's important to spend enough time to ensure an optimal experience.

Additionally, from an employer compliance standpoint, execution of the day-to-day tactical activities related to hiring can make a huge difference in long-term employment issues. Proper offer letter templates, employee policies, defined PTO programs, performance expectations, government required employment forms and reporting, an employee handbook and a compensation program are some of the basics of any employer's foundation. HR system infrastructure and processes are also critical considerations.

Key takeaway: pause to establish HR systems and processes before growing
With a solid hiring plan, scalable HR systems and processes and place, it's possible to grow your staff while keeping HR personnel to a minimum.

Full speed ahead

With all that has to happen to keep your business strong, figuring out how to manage through change can be daunting. This is especially true when you are in the middle of the action and emotionally invested in existing approaches and plans. But hope will never get you back to the front of the pack. To find or keep your edge, you need to make sure you're focusing on the right issues using the best strategies and solutions. It's all about perspective and knowledge. That's when the insights of an outside senior-level experts may be the best move and investment you can make.

About vcfo

vcfo makes companies stronger through finance, HR, technology and recruiting support, enabling business leaders to focus on driving objectives and growth plans. We're more than just a financial consulting firm. We provide expert guidance and assistance with a suite of services across the operational spectrum.

vcfo has offices in Austin, Dallas, Denver, Houston and Seattle. For more information, visit www.vcfo.com or call 512-345-9441.

About Revitalization Partners

Revitalization Partners is an international specialty management services firm that provides hands-on interim executive management and advisory services to client companies. We specialize in under-performing, turnaround, bankruptcy and workout situations as well as repositioning companies faced with changing market and funding situations.

Revitalization Partners is based in Seattle, Washington. For more information, visit www.revitalizationpartners.com or call 206-903-1855.

[1] Frequently Asked Questions, U.S. Small Business Administration, January 2011.

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Founded in 1996, vcfo's original core offering was fractional or part-time CFO solutions. The company's services have long since evolved to include an integrated suite of finance, HR, technology and recruiting support, including outsourcing and consulting solutions that improve operational performance and optimize productivity.

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