

# The workout board member

*Why every company should have a turnaround expert on its board.*

**BY SUZANNE HOPGOOD**

**A** “WORKOUT” PROFESSIONAL — an executive-level person experienced in cleaning up corporate nightmares — belongs on every major corporate board.

Most business crises don’t happen overnight. They are a result of a series of bad decisions that cascade into a crisis. If the defective decision making announced itself with bugles and drums — if the looming crisis sent out invitations to the show — then even a mediocre board could respond appropriately. But problems tend to build incrementally, and the parties involved become accustomed to the signals that should prompt concern and dramatic action.

As a rule, the workout specialist on the board is a discomfiting presence — a glass-half-empty, gloomy soul who presumes and assumes the nightmarish potential of every business scenario. The board psychology, by its nature, assumes a certain status quo, a certain prettying up of existing business management at the margin. There is nothing necessarily incorrect in that approach. But the presence of a workout personality prepares for an alternative approach, a different sense of urgency, and a worthwhile safety valve in case of serious trouble.

## **Topping the list of concerns**

A workout professional focuses on several key criteria when evaluating where a company is in its history. At any stage along the way, the comfort of the moment can shield signs of trouble, which the workout mind is inclined to seek out and clean up.

The first and most important criterion is the company’s financial performance and cash flow. The cash flow statement indicates whether the company is generating positive, free and clear, cash flow — and whether that cash flow is coming from company operations or from outside sources such as floating debt or equity.

The second screen is the trend for revenue, profit, and cash flow from the past five years. If the performance is declining in these areas, the company is in trouble — the kind of trouble that needs more than a bit of tinkering. The workout professional is inclined to be less in love with the company’s overall industry environment if the enthusiasm isn’t justified. The “we’re much smarter than anyone else in our business” philosophy dominates many boards — and it can lead to catastrophe if you linger too long in a dying industry. Monitoring overall industry performance is essential; businesses cannot prosper in the long term if the industry in which they compete is declining. There is no level of superb management that is going to bring back the manual typewriter, or the carbon paper that went along with it. A workout professional on the board will continue to ask: What is the current status, and the long-term outlook, of the industry as a whole?

## **Strength of management**

The next area of concern in the workout analysis is the strength of the management team. While boards are slowly evolving into governing bodies more inclined to take a clear-headed look at the executive team, workout specialists have both the professional detachment and experience to challenge and purge the unsuccessful, with little associated angst. Is the CEO building a strong team that can execute

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the strategic plan, or is there constant turnover in the senior management team? Does the team have the experience, skill sets, and motivation to execute the company plan of action? It's not enough for the board and the CEO to craft a pretty plan if the team is not qualified, inclined, or able to deliver. Workout professionals may recommend analyses such as a review of management turnover compared with industry averages.

At one company where I was brought in as a workout CEO, the senior management turnover in the previous two years had been 100 percent. It is impossible to deliver even basic services at a company where the senior staff is undertrained and inexperienced. High management and general employee turnover is a signal that demands swift response — an awkward and uncomfortable action that is more likely to be suggested by a workout professional on the board.

Debt covenants tend to be the unseen elephant in too many boardrooms. Workout professionals are particularly sensitive to the enormous clout wielded by debt holders, if there is a liquidity or financial crisis. The board fiduciary responsibility is tugged in the direction of the debt holders during times of serious trouble — even if many boards remain

uncomfortable in that role. Workout professionals are familiar with the control that debt holders exert over such matters as sale of assets, bonuses, additional borrowing, and recognition of debt. It is important to understand the significance of debt covenants and the implications of debt default.

### Competitive position

The final major area that workout professionals tend to focus on is the competitive position of the company within its market. Does it have a niche in which it excels, in which it can extract a premium? Some companies can succeed by peddling commodity products, but boards and senior management of such companies often delude themselves with strategy that assumes a premium is due a company that does not sufficiently differentiate itself from competitors. On the other hand, handsome profits in a particular niche can attract competition in markets with low barriers to entry — a circumstance that companies are often slow to plan for, or even to admit may occur.

If a weakness is identified in any of these areas, the first step is to determine how critical the problem is. In a range of trivial to devastating, boards must put the label on the problem, to marshal the

appropriate resources to make things right. One of the strengths of workout professionals is the skill and associated instinct to identify problems quickly. An examination of the lingering, nagging problems that have afflicted some high-profile companies suggests in part a board that was not roused to respond quickly and effectively to problems that would have drawn workout professionals like bees to honey. The initial giddy aftermath of a successful merger can often bury oversight instincts for far too long after the fact — putting the new organization in jeopardy that it is not inclined to acknowledge. The magnitude of the problem or problems must be identified quickly to determine whether, in the worst case, it threatens the very existence of the company. As workout professionals know all too well, this is not the time to be dainty. The first and most important question is whether the CEO is part of the problem or part of the solution.

The board may need to take immediate action to initiate the process of replacing the CEO and selecting an interim leader. As someone who has been

## 'Specs' for a workout director

**So, how does** one go about identifying one of these "turnaround" professional to join a board of directors?

- The "good governance" warning not to select the CEO's best friend with the lowest golf handicap is a bit overwrought, but is still worth heeding. The turnaround professional is a different kind of character — a bit less comfortable with, a bit less grateful for, and a bit less attracted to the networking aspects of boards and quite a bit more inclined to sniff out concerns and identify solutions.
- Identify the skill sets that you need before you identify a person with whom you might be comfortable. By adding an executive who has a totally different perspective, such as someone with turnaround experience, a board builds in a safety mechanism for identifying potential problems before others detect them. Choose the assembled package of skills that represents a legitimate, alternative problem-solving approach.

- Don't be seduced into the romantic nonsense of a swashbuckling turnaround cowboy. Initially, at least, you are looking for a board member, not a new take-no-prisoners CEO. Different turnaround professionals have different areas of expertise and different strengths. Select the board candidate who has the appropriate skill set to meet your needs.

- Don't let the CEO steal the recruitment process. You are looking for someone who may have a different relationship with the CEO than might a traditional board member. Don't allow excessive collegiality trump your responsibility.

Workout professionals often operate below the radar and don't necessarily pop up on traditional headhunter lists of board candidates. Cast a wide net. Talk to shareholders, both large and small. Utilize your peers.

— *Suzanne Hopgood*

brought into several difficult situations as an interim CEO, I believe that many boards are reluctant to take such a step — and tend to wait too long.

### **Familiar territory**

The most important skill that a workout person brings to a board is the ability to recognize a crisis when it is in its infancy — and to be comfortable with the often-uncomfortable actions that must be taken to address that crisis. The more quickly a crisis is identified, the more quickly it can be contained. All of this is familiar territory for a workout professional accustomed to being asked for clear-headed evaluations of a company.

Companies regularly disappear because their products have become obsolete or because they are unable to sufficiently differentiate their products or underprice the competition. This is not unusual. The difference between an embarrassing financial disaster and a planned departure from the market — maximizing shareholder value — depends in large part on how quickly boards recognize potential problems and do what is necessary to change the course of events. This, of course, draws on the skills for which workout professionals are best known. Negotiating a merger or sale is more likely to be beneficial to shareholders if initiated early on — before the company loses market share and prof-

itability. At an early stage, the board might also have the option of converting the cash flow stream into another successful business. All of this depends on an understanding of the situation when attractive options are still available — and on the strength of character to act.

### **Edgy attitude**

In a room full of board members, you should be able to identify the workout specialist without being introduced.

Those who chose — or are chosen — for such work exude less comfort and a bit more edgy attitude than people who are normally considered attractive candidates for board slots.

The skills these workout folks bring to the table are important, if not essential, for modern corporate boards. You may not want them to be a majority on the board — but to have none at all is a mistake, especially in the present corporate environment. ■

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