CHAPTER 1

New CEO Activities

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You have just been hired or promoted into the chief executive officer (CEO) position. How do you succeed in this role? You are in charge, so you can set any priorities you want. What activities should you pursue first, not only to succeed but also to avoid any risks to which the company is subject? This chapter addresses your immediate priorities, measurement systems, strategy and budget formulation, and other activities that you should address during your first few months on the job. If you follow these steps, you will have a good knowledge of the company's strengths and weaknesses and of the proper strategic path to follow to improve your chances of success over the long term.

Immediate Priorities

What should you do during your first few days as CEO? You are likely to be overwhelmed by a variety of immediate crises that threaten to consume all of your time. Nonetheless, you need to make room for the investigation of several key items, to see if the company is in any financial or legal difficulty. If it is, these issues override any others confronting you, since they potentially can put the company out of business in the near future.

Without question, your first step is to go over the company's cash position and short-term cash forecast with the chief financial officer (CFO). During the review, look for the next items.

- *Customers*. Unusually large overdue payments from customers, which may indicate a variety of customer selection, customer service, or product-related problems.
- *Suppliers*. Unusually rapid payments to suppliers, which may indicate cash-on-delivery payment terms, or short-payment situations caused by a history of slow payments in the past that suppliers no longer tolerate.
- *Payroll*. Large bonuses and commissions that indicate unusually high compensation plans.
- *Capital expenditures*. Imminent planned payments for expensive fixed assets, which may indicate that existing assets are worn out and need replacement.

C01 04/13/2011 20:29:29 Page 2

- *Debt*. Large impending debt payments indicate the need to refinance as soon as possible.
- *Cash balance*. The most obvious item! Is the cash balance very low in relation to the size of operations? Is the company continually relying on a line of credit to meet its cash requirements?

If there appears to be a problem, either set up a periodic meeting to continually review cash or ask to be notified when the cash position reaches a certain trigger point. You do not want to have your time consumed by a series of status meetings, so the latter option is usually the better one. If cash appears to be a problem, it becomes the focus of your activities until the problem is resolved.

Another concern is any existing tax liabilities. If a company has been in financial straits, it is possible that the previous CEO authorized a delay in income tax or payroll tax payments to the government. If so, the government will impose large fines and penalties; a few states even make the CEO personally liable for unpaid payroll taxes. Given the downside consequences, it is worth your time to investigate whether these payments have been made.

The situation will be easier for you if the company already uses a third party to process payroll, since the third party will ensure that payroll taxes have been paid. To verify that income taxes have been paid, you may want to bring in auditors to review the company's books.

A company of any size is likely to be subject to the threat of lawsuits at any time, many of which have no great probability of every reaching an unfavorable settlement. Rather than wading through the details of all possible or actual lawsuits, have corporate counsel summarize just those having both a reasonable probability of success against the company and a large settlement amount. Your main concern is that a lawsuit may exist whose settlement will seriously affect the finances of the company.

In addition, look for any legal situations in which the company could potentially lose its rights to major competitive advantages, such as patents. Further, investigate whether there are any scenarios under which company officers could be charged with crimes for the company's prior actions.

If the company has a history of violating government regulations, it is possible that it may be subject to impending fines of considerable size. Further, if it has violated environmental laws, the government may be authorized to shut it down entirely or to bring such crushing fines to bear that it will have to be liquidated. The company's legal counsel should be able to inform you about the status of these matters. You may need to delve into the specific notices received to satisfy yourself regarding the severity of any violations.

If there is a large amount of outstanding debt, meet with the CFO and discuss when the principal amount of the debt is due for repayment. The CFO should have a plan for how to refinance the debt, either with replacement debt or the sale of stock. Further, discuss whether the company is exceeding any covenants imposed under the debt agreement or whether there is a reasonable chance that it will do so in the near future. Lenders often are willing to negotiate around covenant violations, but an impending debt repayment that the lender is not willing to renew is a much more serious matter.

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A final issue is to meet with the audit partner and see if the company's audit firm believes that it may issue a "going concern" opinion as part of its audit of the company's financial statements. This opinion means that the auditors do not believe the company has the financial results or resources to stay in business. Lenders do not like to see a going concern opinion and may not renew outstanding debt if the company receives such an opinion. It is possible to avoid a going concern opinion by obtaining additional financial resources, so this is not necessarily a death knell for a company.

Once you have reviewed all of the immediate priorities, set aside some time to think about the company's position: Were you brought in to supervise a sinking ship? Can it be rescued? Is the job so impossible that it would be better to leave now? These are uncomfortable questions, since any new CEO wants to be successful in his or her first job. However, if the task is simply impossible, it may be better to discuss the issue immediately with the board of directors and focus on either selling or dismantling the company.

If, however, the review of immediate priorities reveals no glaring problems, you can proceed to the next task, which is measuring the basic operations of the business.

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Measure the Business

The next step is to gain an overview of the company's financial results. You should schedule time with the CFO to go over the company's financial statements for the past year and the current year to date. If possible, have the CFO provide the current-year information as a trend line by month, so that you can see any changes in results. For example, if ten months have been completed in the current year, the financial report should contain ten columns of results, one for each month. When reviewing this information, you should look for these items:

- *Compare cash to profits.* If the company is reporting profits, is it also reporting a similar amount of increases in cash? There are many reasons why this may not be the case, such as capital expenditures and working capital needs. Be sure that you understand the differences between these two numbers. If you do not, there is a chance that financial shenanigans are creating profits that are not translating into real cash flow.
- *Review the revenue trend by component.* Usually multiple products and services comprise revenue. Are certain components of revenue changing dramatically? How much of it is caused by seasonality and how much by new product introductions or changes in demand?
- *Review the cost of goods sold trend.* Separate the cost of goods sold into its fixed and variable components. Review the trend of the fixed costs; they should stay relatively flat, unless the company has changed its operations recently. Also review the trend of variable costs as a percentage of sales. If this percentage is increasing, you may have a problem with increasing component costs that are not reflected in increased product prices.

C01 04/13/2011 20:29:29 Page 4

- *Review the selling, general, and administrative trend lines*. These costs are mostly fixed, and so they should not change much over the short term. If there are significant trend changes, delve into the details of the specific expenses causing the issues.
- *Review the debt trend line*. An ongoing and unremitting increase in debt over time is a cause for great concern. If this is the case, and irrespective of what the stated profitability may be, the company is bleeding cash. Conversely, if the debt level is seasonal, the increase in debt is a standard outcome of the business and is not an issue.

In addition to this trend line review, have the CFO create a basic set of performance metrics and present them to you on the same trend line. Some of the key metrics to review presented next.

- *Accounts receivable turnover*. This is the net annual credit sales divided by average receivables. If the rate of receivables turnover is slowing, you have a collection problem that is impacting your cash balance. The problem may not be inadequate collections activity; it is entirely possible that the company has a variety of product or service issues that customers are unhappy with and for which they are not paying. You may need to find out exactly which customers are not paying and why, which may require further action.
- *Inventory turnover*. This is the cost of goods sold divided by inventory. Inventory turnover can be a serious problem, especially if a company does not have strong inventory controls, obsolescence reviews, and inventory disposition processes. A low inventory turnover number likely represents a quagmire of problems that may take a long time to repair and are consuming an inordinate amount of cash.
- *Accounts payable turnover*. This is total supplier purchases divided by average accounts payable outstanding. If turnover is clearly lower than supplier payment terms would normally indicate, it is likely that the CFO is prolonging payment intervals in order to avoid additional debt. This is not a good idea over the long term, since abused suppliers can drop the company or insist on very restrictive payment terms.
- *Gross margin ratio*. This is the gross margin divided by revenues, and is best viewed on a trend line. Any decline in this ratio is cause for serious concern, since it means the company is unable to pass changes in its production and purchasing costs through to its customers via price increases.
- *Debt service coverage ratio*. This is net annual operating income divided by total debt service payments. It measures the ability of a company to meet its debt obligations. If the ratio is anywhere near 1:1, even a slight decline in profits could lead to a loan default.
- *Quick ratio*. This is current assets (less inventory) divided by current liabilities. The ratio should be above 1:1, and gives an indication of a company's ability to meet its immediate accounts payable obligations. It is not a perfect indicator of liquidity, since the remaining balance on a company's line of credit can also be used to pay accounts payable, but it does give a general indication of liquidity.

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C01 04/13/2011 20:29:29 Page 5

Note that the ratios listed here are few in number and oriented toward short-term results. The intent of reviewing them is not to delve into the efficiency and effectiveness of specific aspects of the business but rather to determine at a gross level whether the company can generate a profit, whether it can pay its bills, and whether it has enough cash to maintain its operations. If you want to add other measurements that give an expanded view of a company's operations, refer to the more extensive set of measurements in Chapter 11, Performance Measurements.

You now have a rough idea of the company's general performance in the recent past. The next step is to predict how it will perform in the near future. There are three key parts of this prediction:

1. *Sales forecast*. This should be a weekly update from the sales manager, at whatever level of detail you want. It is best to not settle for a simple grand total, since you gain no visibility into where the sales are coming from. A better alternative is to obtain sales by product line, region, distribution channel, or store—whatever makes the most sense given the structure of the company and how it sells products or services.
2. *Backlog report*. You want to know if there are any significant changes (especially downward) in the sales backlog. You may be comfortable with a monthly update to the backlog, but consider starting with a weekly update, just to see how much the numbers vary in the short term. If a few customer orders comprise a large part of the backlog, you should know when these orders ship as well as what the backlog numbers look like without these orders included.
3. *Flash report*. The flash report is a weekly update of what the income statement will look like at the end of the month. This report contains the revenue information from the sales forecast and the accounting staff's best estimates of expenses.

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It should not take long to at least initiate the steps noted here to measure the business—you can delegate all of the required tasks in a day, and have the results back a few days later. You may want to dig into certain details of the business, so multiple iterations are perfectly acceptable, as you learn more from the measurements about the operating characteristics of the company. The result will likely be a somewhat modified set of reports, with varying delivery intervals.

Now that you have a rough feel for the company's financial numbers, let us spend some time with an even more critical item: people.

Get to Know the Company

There are a number of groups of people with whom you should build relations, some more than others. The unique characteristics of each company will dictate which group is most important. For example, the CEO of an airline should spend considerable time with the pilots; the CEO of a technology company wants to have regular discussions with the engineering staff. Also, the form of interaction depends on your comfort level; some like one-on-one interaction, others prefer formal group

C01 04/13/2011 20:29:30 Page 6

visits, and a few even work alongside their employees. How you choose to interact is up to you. What we present here are the specific groups of people to meet; you choose the method.

- *Administrative assistant.* A good administrative assistant is incredibly valuable for delegating a broad array of tasks as well as a gatekeeper who keeps lesser issues from ever coming to your attention. You should block out a large amount of time during your first few days to sit with your administrative assistant and discuss exactly which issues can be delegated and how they should be settled. This can include going through every event in your day (and every e-mail) to determine whether your assistant could have handled it for you. It may take time to become comfortable with such a high degree of delegation, but it is very worthwhile and will save you an immense amount of time.
- *Senior managers.* As the CEO, your effectiveness ultimately is determined by the effectiveness of your management staff, so you should build close relations with all of your direct reports. There may not be a need for a formal managers' meeting as long as you can replace it with continual informal ones that keep you apprised of all key activities. Part of your initial goal in meeting with these managers is to build trust: You can rely on them to get the job done, and they can rely on you for support and the resources they need.
- *Staff.* In a larger company, you have no hope of meeting everyone, but you should block out time to at least gradually cycle through the company, meeting with selected groups of employees. This is partly so that they have an opportunity to meet with you and partly so that you can convey whatever message you may have at a level that is more personal than an e-mail or corporate memo. Meeting with the staff is more important for knowledge services companies, such as consulting, where nearly every employee is highly trained and is closely involved with customers—these people are essentially subject matter experts, who are described in the next point.
- *Subject matter experts.* Every company has a core group that is responsible for its key profit-making activity. Examples of these people are the sales staff, engineers, and consulting staff. You should make a special effort to build relations with this group, for they likely know more about the company's detailed operations and prospects than you and so can provide both good advice and warnings of impending problems.
- *Customers.* Customers are the first to know if the company is having product or service issues and can also provide valuable counsel regarding possible new products or services. In companies that have only a few large customers, CEOs may feel that this is the most important group to deal with, and so they are continually on the road, meeting with key customers.
- *Suppliers.* If the company is dependent on a few suppliers for a few key supplies that are difficult to obtain, or if some suppliers build large product components for the company, you need to build relations with them. There may not be very many suppliers who fall into this category, but if you have any, you should accord them the same level of attention that you would to a key customer.

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C01 04/13/2011 20:29:30 Page 7

Of the people noted here, the only one who exists specifically to improve your job performance is the administrative assistant, so block out a considerable amount of your initial time to develop a strong working relationship with this person. Of the remaining categories of people, you should not meet with them once and assume that you are through for the foreseeable future. The CEO position can be considered a gregarious one, so you need to see people and be seen by them. Work out the best method for meetings—the concept of management by wandering around works for many CEOs, or perhaps you are more comfortable with ongoing status meetings. You will likely fall into a routine fairly soon. However, do not forget that customers and suppliers are just as important as employees, so include them in your discussions.

Develop a Strategy

The development of a strategy that has a chance of working is a lengthy process, since a number of issues must be factored into it. The details of strategy development are addressed in Chapter 2, General Corporate Strategy. In this section, we cover the primary activities that you should check off while creating an initial strategy for the company.

The CEO has a central role in strategy development, but you cannot participate effectively in the process until you know what the company does—not just an overview of its activities but rather a nuts-and-bolts level of familiarity. If you were promoted to CEO from within the company, you may already have this knowledge. However, if you were hired from outside the industry, you face a steep learning curve. The only way to gain this level of understanding is total immersion in every aspect of the business. The best approach is to meet individually with those people who have been with the company a long time and who have expert-level knowledge of their subject areas. Ask every question you can think of, and expect to come back with more questions as you learn more about the company. It is extremely helpful to not just sit in an office and ask questions but to see processes in action. Expect this learning task to take up a large part of your time during your first few months as CEO.

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Strategy development is not something that the CEO should engage in alone. The management team as a group has a much better understanding of the company's abilities and the industry in which it operates than any one person. Consequently, you should schedule a series of group planning sessions. During these sessions, the group needs to summarize the key competitive aspects of the industry, and the company's place within that industry. Arising out of these discussions will be a determination of what general type of strategy the company should follow: low cost, product differentiation, or niche (see Chapter 2, General Corporate Strategy, for details).

The management team's first pass at a corporate strategy will require considerable tweaking, for the team must begin a multi-iteration process of reviewing how well the company is capable of following it and adjusting the strategy (or the company) to meet the realities of how the company operates.

C01 04/13/2011 20:29:30 Page 8

Example

The strategy of ABC Company calls for a much higher level of focus on customers, but the company has only the most minimal customer service function. To make the strategy work, ABC can either back away from the strategy or provide staffing and more funds to the customer service function. If it chooses the latter path, it must block out enough time to upgrade the department properly before it can implement the strategy.

Another key issue in strategy development, and one that many companies completely ignore, is how company bottlenecks impact a strategy. Bottlenecks can take many forms and be located anywhere in a company. Examples of bottlenecks are restricted supplies, expensive machinery that limits production, and sales personnel who are not able to sell more product. The management team needs to know where the company's bottlenecks are located, how to work around them to achieve greater output, and how bottleneck management impacts the strategy.

Another concern is the amount of available resources. The management team needs to evaluate the capabilities of the employees to meet the strategy as well as any growth entailed by it. Resources also may be required for facilities and equipment. If new resources are needed, there may be an ordering, delivery, and installation interval that must be factored into the timing of when the strategy is to be implemented.

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Example

ABC International's management team develops a strategy to reorient the company's direction and focus solely on customers in the Iowa and Nebraska areas, where the market for its custom-designed farm implement products appear to be the highest.

However, ABC needs to establish 11 distributorships in the two states in order to have proper coverage of the customer base, and it estimates that a full year will be required before the distributorships have been assigned and all necessary training has been conducted. Accordingly, the management team adjusts its strategy to use an on-site sales force, to be supplemented by a group of distributorships.

Another concern with strategy development is accounting for any risks that have arisen or threatened the company in the past as well as any possible new risks that may arise from changes in the strategy. If a proposed change introduces a major new risk, the management team needs to consciously accept the risk, alter the strategy to avoid the risk, or build acceptable risk mitigations into the strategy.

C01 04/13/2011 20:29:30 Page 9

Example

Hubie Construction is considering entering the market for constructing buildings for local and state governments, which varies from its traditional strategy of building homes on speculation for homeowners. An examination of the prospective market reveals that Hubie must post a performance bond with any government accepting its construction bids. Hubie finds that it does not have the financial resources to post a performance bond and would be at risk of bankruptcy if even a single government triggered such a bond.

Hubie now faces the strategic choice of avoiding the government construction market or of accepting equity contributions from new shareholders in order to have the resources to post performance bonds.

There are many factors involved in strategy development, and these are enumerated in greater detail in the next chapter. The key point for the CEO is that a well-developed strategy cannot be created in a one-day off-site planning session. The general strategy concept may appear during such a session, but it requires a great deal more thought to arrive at a strategy that will stand up to the realities of the market and a company's specific circumstances.

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Create a Budget and Related Systems

Once a strategy is in place, the management team needs to incorporate it into a workable budget, so that the company has a clear direction that enables it to adhere to the strategy. The CEO is not responsible for the day-to-day formulation of and follow-through on the budget—that task falls on the CFO or controller. However, as the CEO, you should examine the budgeting instructions being sent out to the company managers, to ensure that the instructions align with the strategy. You also should monitor the various iterations of the budget to see if they support the strategy. It is very likely that you will give feedback to the CFO regarding changes to the budget in areas where the managers submitting their budgets need further instruction.

A part of the budget that you *should* become involved with is the capital budget, primarily because it may involve a large amount of the company's financial resources. If a company is in a capital-intensive industry, it may place large bets on new factories or large equipment installations that soak up most of the company's available cash reserves or debt, so these investment decisions call for a great deal of analysis. In particular, you should know if a particular investment increases the capacity of a bottleneck operation or whether the bottleneck still exists elsewhere in the company; if the latter is the case, the investment may not improve the company's situation, so the investment should not take place.

In a great many organizations, the budgeting process takes up several weeks near the end of each fiscal year, after which the completed budget is placed in a

C01 04/13/2011 20:29:30 Page 10

drawer and ignored until it is time to create a new budget in the next year. You can avoid this by making adherence to the budget a primary responsibility of the CFO.

The CFO is responsible for ensuring that the company adheres to the budget, and there are a variety of controls for enforcing that this happens. For example, the accounting staff can establish responsibility for every revenue and expense line item and issue a budget versus actual report to the responsible parties at the end of each reporting period. Another control is to match compensation plans to the budget. As the CEO, you should talk to the CFO to ensure that these controls are in place and that they are operating effectively. If the controls were used in the past year and the company still ignored the budget, either the controls are not sufficient or they are not being enforced.

Once there is a budget that both you and the management team believe is workable and which dovetails with the strategy, the CFO should create a complete package of a summary-level strategy, detailed budget, compensation plans, and controls. The management team then presents it to their staffs. In a larger company, there are simply too many people for you to be deeply involved in these presentations. However, you can be involved in a supporting role. Your more important role is after the initial presentation of the package, when you need to continually reinforce the strategic message everywhere within the company, so that employees know that the CEO is backing up what their managers are telling them. It would not be too far-fetched to keep a copy of the plan and budget on your desk throughout the year, as a reminder that you must incorporate it into everything that you do.

Chapters 7 and 8, Budgeting Process and Capital Budgeting, respectively, show how the budget is formulated and how to evaluate a capital budgeting proposal.

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Review the Management Team

You must work through the management team, so your success is tied directly to their competence. If the team is incompetent, the areas for which it is responsible will not meet expectations, and you therefore will be held accountable by the board of directors for that failure too. Thus, you need a method for judging the management team.

An excellent tool for evaluating managers is the strategic plan and associated budget. It presents hard, factual targets that managers are expected to achieve, so it makes sense to wait until these items are in place before actively pursuing a management review process. Now that they are in place, consider the next steps to evaluate managers.

Step 1. *Create a review system.* The human resources manager is responsible for creating a system upon which you can evaluate the management team. This should be a detailed system that lays out specific expectations for each manager and for which the managers have complete ownership (i.e., they cannot blame other factors for not meeting their assigned goals). You should have a great deal of input into the review system, especially in regard to the weighting given to each review factor.

C01 04/13/2011 20:29:30 Page 11

Step 2. *Review managers.* Reviews of managers should not be an annual event, with no review activity during the intervening 364 days. You should issue feedback much more frequently, so that managers have an opportunity to improve their performance all year long. These meetings will be largely informal, involving a specific opportunity for improvement that you have noticed, with recommended actions to pursue. These frequent review intervals call for a large time commitment by you.

Step 3. *Identify prospective managers.* As a company expands and evolves, it always needs more managers. An excellent source of new managers is the existing staff, since they already have a considerable familiarity with company operations and have built their own networks within the company. Have the human resources manager develop a system to identify and groom these prospective managers; in addition, you should spend time with the human resources manager, reviewing the current circumstances of each candidate, and developing an action plan for each one. Only a large time investment in this area will yield a high-quality pool of managers in the future.

Step 4. *Replace managers.* Some managers will not work out, and you must replace them. The human resources manager should have a network of recruiters and other recruiting tools in place for identifying both internal and external candidates. You should know how this system operates and recommend adjustments to ensure that the company has the best possible pool of candidates from which to make selections.

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Simply judging managers based on their ability to meet or exceed their budgeted goals is not sufficient, since it ignores a number of other measures of manager performance, such as training their employees, employee retention, and idea generation. For example, a manager who meets his expense budget by grinding down his staff about expenditure and who is the core reason for high employee turnover is hardly one you want to keep for the long term. Consequently, you should use the budget as only one of several evaluation tools. The human resources manager can assist with the development of a more comprehensive evaluation system.

Strategy development, execution on that strategy, and manager development are likely to be the three areas for which a CEO is primarily responsible. Accordingly, you should block out a large part of your time to see to it that you have the right managers in place and that you fully support them in their jobs. Only by doing so can you succeed, since they are implementing your strategy-related directives.

Review Risks

Many CEOs are held to account when a risk becomes a reality and their companies are not prepared to handle the problem. In a larger company, there may be a risk manager who considers these general types of risk as part of his job. In a smaller company, there is no such person, so either the CEO or a consultant must engage in risk review.

C01 04/13/2011 20:29:30 Page 12

A good starting point for risk analysis is reviewing the industry news to see what sorts of risks have impacted other companies within the industry. Some of these issues may never have impacted the company, so you can profit from the misfortune of others by examining what happened to them and judging the probability that it also may happen to your company. In some cases, a new risk will appear that will be the harbinger of a new set of problems for the entire industry; in other cases, the problem really may impact only one competitor for a very specific reason and so is not a concern to anyone else in the industry.

Example

A competitor of ABC International builds a facility directly over a fault line and later sees the entire structure destroyed when an earthquake splits apart its foundations. This is not a risk concern that ABC's CEO needs to concern himself with, unless any ABC facilities also sit on earthquake fault lines.

Another competitor is subject to an audit by the Environmental Protection Agency (EPA) and eventually is fined a substantial amount for a variety of infractions. This is a greater concern for ABC's CEO, since the EPA may be targeting the entire industry.

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You also can internalize this analysis by examining the company's own history with various risks. This analysis should go back a number of years, since the more serious risks may arise only occasionally. This analysis should include a review of the cost to the company as well as how the company dealt with them in the past in terms of a mitigation strategy.

Example

An analysis of ABC International's insurance records reveals that one facility was partially flooded 15 years ago, because it is positioned on the edge of a floodplain. No risk mitigation strategy was adopted after the flood, because consultants concluded that such flooding would occur only once every 100 years.

A capital proposal in front of the CEO now contains a request to double the size of that facility. He needs to consider whether the risk of flooding requires relocating the expansion to a different site or whether flood prevention planning may mitigate the risk.

There may be risks in a company's contracts, such as requirements to pay large minimum fees to certain suppliers or to grant an extended product warranty period to a customer. Corporate counsel should conduct a review of all unexpired contracts to see if such risks exist.

C01 04/13/2011 20:29:30 Page 13

Example

A small database and software service company (Alpha Company) was in negotiations with a larger firm regarding a new services contract when a lawyer for the larger firm decided to review an old contract that already existed between the two companies. He found that Alpha Company had previously licensed a database from it and guaranteed a very large minimum payment amount. Alpha had been unable to resell the database, and neither party had noticed the minimum payment requirement. Thus, Alpha never made the payment, and the larger firm never noticed the shortfall.

The larger company elected to enforce the contract. Alpha Company did not have the financial resources to pay the minimum amount required by the contract and threatened to enter bankruptcy if the larger firm enforced its rights. The parties eventually settled for a minor sum.

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Once this review has been completed, work with corporate counsel and the risk manager to create a formal plan for risk mitigation. You should review this plan with the entire senior management team, to see if it is missing any risks and that the mitigation steps are sound. Then bring the plan to the attention of the board of directors and solicit additional input. These steps likely will require multiple iterations as well as a periodic review to see if the company's circumstances warrant the addition or deletion of any risks.

After the risk mitigation plan is in place, it will be apparent that the company cannot completely mitigate some risks and will need to obtain insurance to address these risks. Have the risk manager summarize the coverage and limits of all existing insurance, match it against the risk mitigation plan, and see if there are any shortfalls in the insurance coverage. If so, alter the existing insurance coverage to align more precisely it with the plan.

It is difficult to conduct a risk review as a discrete analysis with a specific beginning and ending date, because possible risks can arise at any time and must be considered at once, before they have the potential to become larger problems. Thus, the CEO needs to be prepared to review and revise the risk mitigation plan throughout the year. The steps noted here were only for an initial review, which likely will be the start of an ongoing analysis that never really ends.

Chapter 9, Risk Management: General Concepts, and Chapter 10, Risk Management: Foreign Exchange, go into considerably greater detail on a number of risk management topics.

Review Costs

Even the finest strategy and the best risk mitigation will not result in a profitable company if the CEO cannot maintain control over company costs. Consequently, the CEO should develop a system for setting cost expectations and ensuring that actual costs remain at or below the designated levels.

C01 04/13/2011 20:29:30 Page 14

The first step in creating a cost control system is to have a financial analyst develop operating metrics for every department that are based on industry or functional best practice benchmarks. By doing so, you can compare actual costs incurred to what other companies have experienced. This does not always mean that you should drive down costs everywhere in a company to meet these benchmarks. If the company strategy is to excel in certain areas, you may have to spend *more* in those areas, not less. Thus, a more intelligent cost review that is tailored to a specific company should follow these steps:

Step 1. *Obtain benchmark information and match to company results.* Perform this assessment as described.

Step 2. *Review largest variances.* There will be many variances between a company's expenditures and benchmark levels, but only a small number will be so large that there are significant potential savings from engaging in a cost reduction program. Itemize these large variances.

Step 3. *Compare large variances to strategy.* Of the large variances, which ones should remain or even increase, because the company strategy involves large expenditures in those areas? Itemize the remaining large variances.

Step 4. *Compare remaining variances to reduction capabilities.* Of any remaining large variances, how many require a significant amount of management attention? Is there enough management time available to enact the necessary changes?

This four-step program likely will result in only a few types of expenditures that can be safely reduced and for which the company has the resources to enact changes. If you follow this path, there may be only a few areas of cost reduction that really warrant extensive attention each year.

Irrespective of the targeted cost reduction program just noted, you also should have the CFO install a reporting system that assigns responsibility for every expenditure to a specific person within the company and reports costs to those people. With such a system, everyone knows how their assigned costs are positioned in comparison to the budget, and they know that the CFO will be making inquiries if expenditures exceed expectations.

It is also useful to have either a formal monthly meeting to go over expenditures with the entire management team or to work through the same topic on a one-on-one basis with each manager. Either approach yields the same result: Managers know that the CEO is concerned about expenses and will be making regular inquiries to see what is being done to keep costs down.

The basic rule of company costs is that, if they are not going down, they are going up. In other words, if you are not paying attention to cost suppression, costs always are expanding for any number of reasons. Thus, you must maintain an ongoing cost review to keep management focused on this key item, with a more targeted program for specific costs where there appear to be good prospects for substantial reductions. Chapter 12, Cost Reduction Analysis, contains an array of specific tips for how to reduce costs in a number of areas.

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C01 04/13/2011 20:29:30 Page 15

Summary

The circumstances in which a CEO will find himself at a new company can vary substantially; you may find that the situation requires you to take steps in directions quite different from the recommendations noted in this chapter. Nonetheless, the issues described here are fundamental ones that may cause trouble for you eventually if you do not tackle them. Consequently, even if you cannot deal with these recommendations at once, at least return to them when you have time. By doing so, you will have completed the baseline tasks that most CEOs find are not only useful to their own careers but also to the prosperity of their companies.

The issues outlined in this chapter are summarized in a checklist in the Appendix, New CEO Checklist, of activities that a new CEO should pursue.

In Chapter 2, General Corporate Strategy, we turn to a discussion of the general concepts of strategy, including the competitive environment, building defenses, choosing a strategy, and testing it for validity.

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