

Mad Hatter Balancing Over-Optimism and Reality

by Jim McHugh



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You're probably wondering what the Mad Hatter has to do with a middle market company.

Well, consider this situation: You have an under performing portfolio company.

You've just attended a "Mad Tea Party"

(Board or management meeting), listened to outlandish expectations from the CEO about future performance, and left the meeting scratching your head about what you just heard. Unusual? Nope...lately, this seems to happen quite frequently.

Lewis Carroll introduced us to the strange Mad Hatter in his 1865 book *Alice's Adventures in Wonderland*. Carroll did not create the phrase 'mad as a hatter'; that phrase gained usage during the early 1800's from the unfortunate outcome of an industrial occupational disease. Hat makers or 'Hatters' produced fur hats with a complicated process that used poisonous mercury solutions. Years of exposure to these toxic fumes in generally poorly ventilated spaces produced brain damage, loss of memory and other assorted serious ailments.

Carroll used this serious ailment to create a crazy and whimsical character. We remember the Mad Hatter as the host of the Mad Tea Party. At the Mad Hatter's party there was a cast of characters and one telling exchange with Alice:

" 'Have some wine,' the March Hare said in an encouraging tone. Alice looked all around the table, but there was nothing on it but tea.' 'I don't see any wine,' she remarked.

'There isn't any,' said the March Hare.'

How many times has a corporate leader told you that there was plenty of wine about, but in fact, there was only tea at best? Your gut is screaming... "There is no way this company can hit those targets!". But your hope and the Mad Hatter CEO's enthusiasm get the better of you. I have seen this scenario repeated many times at under performing companies; there can be too much over optimism and not enough effort made at analyzing the facts and confronting reality.

So, you ask, 'What's wrong with being optimistic? What's wrong with aiming high?' Nothing, as long as the predictions are believable and achievable. In the

July 2003 issue of the Harvard Business Review there is an article entitled ‘Delusions of Success: How Optimism Undermines Executives’ Decisions’. The authors (Lovallo and Kahneman) warn of the negative consequences of ‘flawed decision-making’ based upon over optimism. They state ‘...when pessimistic opinions are suppressed, while optimistic ones are rewarded, an organization’s ability to think critically is undermined.’ Recognizing that people like to rally behind optimism, they say there ‘...needs to be a balance between realism and optimism.’

Jim Collins, in his acclaimed best-seller *Good to Great*, devoted an entire chapter (‘Confront the Brutal Facts, Yet Never Lose Faith’) to dealing with reality. His research proved that great companies were continually objective about their performance, their competitive position and their customers’ needs. Collins said “...breakthrough results come about by a series of good decisions, diligently executed and accumulated one on top of another.” That is, breakthrough results don’t happen by simply rallying the troops with a lot of hot air.

Collins also discussed the potential negative impact a charismatic leader can have on an organization. “Indeed, for those of you with a strong, charismatic personality, it is worthwhile to consider the idea that charisma can be as much a liability as an asset. Your strength of personality can sow the seeds of problems, when people filter the brutal facts from you. You can overcome the liabilities of charisma, but it does require conscious attention.”

How can you spot The Mad Hatter? In one recent engagement, I ran into a classic Mad Hatter who was functioning as a part-time Chairman/CEO for a struggling company with revenues around \$120 million (let’s call it “Company Stuck”). Company Stuck was in a restructuring phase and had the following characteristics:

- ▼ a huge debt burden, a history of covenant violations, and an impatient senior lender
- ▼ tight cash flow and some seasonality
- ▼ strong vendors that dictated purchasing practices
- ▼ a high overhead cost structure
- ▼ too much complexity in the product lines and business units
- ▼ old and bloated inventories
- ▼ mediocre systems and insufficient and untimely financial reporting
- ▼ low morale

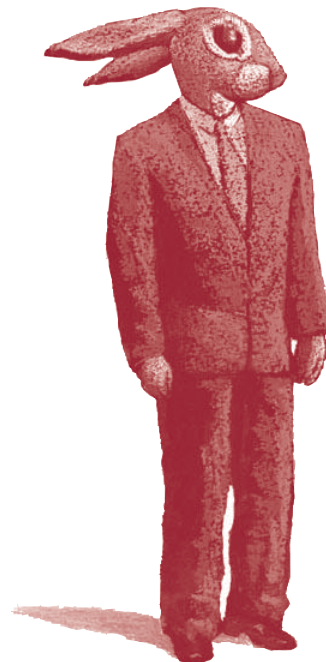
- ▼ a thin management team
- ▼ an unfocused strategic direction

Stuck’s CEO had a long corporate history of working for and running large corporations (note the word large) with ample resources, staff and other perks of power and prestige. Stuck’s CEO was an extrovert... a gregarious and affable guy who had accomplished many good things in his early tenure with Stuck.

But given the above conditions, there was considerable hard work needed to fix the business and radically change its direction. However, early this year in one discussion with management and the investors, the CEO said 1) expenses had been ‘cut to the bone’, and 2) revenue would increase 50% and EBITDA would triple in three years.

Huh? He made these broad, sweeping pronouncements without any reasonable action plans on how to back up the targets. He was now offering up expensive wine to the investors when there was only lukewarm tea available. Fifty percent revenue growth was equal to about \$60 million dollars additional annual revenue by year three. Where was this growth going to come from? The industry was experiencing modest, but not spectacular growth rates. Stuck was closing some of its weaker operating units. There would be no additional capital for acquisitions from the investors. The bank was not going to expand the credit line to accommodate growth; in fact, they were on a path to reduce the credit line. Funding for capital expenditures would have to come from cash generated by operations. In some product

lines, margins had started to decline from increased competition. In short, getting to the \$180 million level was not going to happen.



Following the company meeting where the grandiose and in my opinion, unachievable plans, were presented, I told the investors that I thought the CEO had gone from ‘being a leader to a cheerleader’. After challenging me on why I didn’t think a cheerleader attitude was beneficial to the business, they ultimately decreased his influence throughout the restructuring process.

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What are some ways to deal with your Mad Hatter? If you think there is too much 'wine' being offered up on an increasingly regular basis, then look to some basics:

- ▼ First, trust your own instincts and your gut.
- ▼ Challenge all the assumptions behind the strategic and annual plans.
- ▼ Understand the industry forces – think external, not just internal – data, data, data. Are customers and competitors consolidating? Is substitution occurring in your product lines?
- ▼ Understand in detail your competition across customer segments. Does the company have strong niche positions or is it just an “also ran” in each segment?
- ▼ Assess the strength of the R&D and product development efforts – where’s the future growth going to come from?
- ▼ Talk to some of the key customers – get their unfiltered opinions on the company.
- ▼ Determine if there are external relationships with lenders, vendors, and/or customers that are or will be impediments to future success.
- ▼ Look for more specifics on the details of execution – are there monthly and annual operating plans that articulate priorities and assign who is accountable and in what time frame?
- ▼ Follow up on the company’s performance on a very regular basis using the details of the operating plan as the discussion structure. Measure management on a regular basis.

What’s happened to Company Stuck? Stuck has been restructuring based upon the theme of ‘less is more’. Among the myriad of changes that have occurred, the most significant include: downsizing the business to the strongest, core operating units; reducing corporate expenses; establishing a clear strategic focus; improving liquidity and cash flow; creating a realistic and achievable plan for FY2004. “There is no worse mistake in public leadership than to hold out false hopes soon to be swept away.”– Winston Churchill

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