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What Public Companies Can Learn from Private Equity: *Pursue the Value Journey*

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"Our goal is to triple your investment in about five years and we have a track record to prove it!" Those remarks wrapped up the presentation by the general partner of an established private equity firm to a pension fund manager. As we all know, that return goal is much higher than anyone would expect from the S&P 500. The leaders at most public companies are more than reluctant to commit to deliver comparable returns to their shareholders. In addition, most public companies remain focused on accounting results, rather than any form of shareholder value metrics.

START WITH DISCIPLINED, AGGRESSIVE GOALS

Private equity fund managers generally set the priority goal to manage for value. Successful ones pursue the goal of producing annual returns over 20% to 30%, with discipline and speed. Additionally, private equity leaders master the detail of generally accepted accounting principles (GAAP) and understand their proper use and deficiencies. They have their own proven valuation frameworks and employ greater discipline in building value. Because private equity investors have more frequent and action-oriented communication with their portfolio companies, they develop and employ more realistic assumptions about the future than their public peers. Private equity leaders typically have a strong focus on capital allocation based on the relative cash flows generated by the businesses in which they invest. They drive the awareness that there is a cost of capital down to the front line worker level. See Exhibit 1.[1]

Professional money managers and business executives are generally sophisticated enough to understand the basics of discounted cash flow (DCF) models. Unfortunately, too many management teams of public companies remain wedded to simplistic valuation multiples of EPS. There they stay, until the difference between their stock price and their multiple-based expectations forces them to reformulate. At best, accounting multiples represent a starting benchmark for value builders.

Consider this comment from the former president of Hertz (while it was a subsidiary of Ford), after the private equity buyout: Ford used financial benchmarks like EBITDA and cash flow before the private equity buyout but those practices under private equity ownership "have been expanded broadly."[2]

Corporate insiders and outside investors and analysts value companies differently. Corporate leaders generally try to build value, but their incentives may be wrongly focused on value drivers that have only a weak link to corporate value (e.g., revenue and GAAP earnings per share (EPS)). In public companies, the link between incentives and corporate value becomes even more remote.

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EXHIBIT 1

Private Equity and Public Companies Speak Different Languages

Typical Public Company with GAAP Focus	Audience	Private Equity/ Value Builders
EPS-Speak	Outside Investors & Analysts	Value Creation (>20% TSR)
Revenue & GAAP Earnings	**Top Management**	**Exit or Intrinsic Value**
Budget vs. Actual	Middle Management	Cash Flow, Debt Reduction
Product Price	Customers	Customer Value Created
Budget vs. Actual	Front Line Workers	Value Drivers, Cost of Capital, and ROIC

It is rare to find the head of a public-company business unit who has any real sense of ownership of the performance and the intrinsic value of his business unit.

The way any company approaches value building is of great interest to its owners. There is a growing body of knowledge indicating that personal biases and hopes influence their perception of value. Since analysts and managers are all wired differently, it is not surprising that we all have different views on valuation and how the world actually works. People make their own decisions, and often defy the logic of the best economic model. However, value is not a "matter of opinion." The range of values results from the different ways in which cash flows are projected and corporate value is estimated. The final truth is in the cash that is ultimately generated and returned to the investors.

We have all heard, "What gets measured gets managed." Yet debate on what should be measured and managed continues. Different groups have been grabbing for the steering wheel on this subject for decades. Regulators, accounting authorities, boards of directors, and management all have influence, and each has a different stake in the methods used. Investors have been left to pick through the disclosure documents, looking for the important facts. Legal and regulatory pressures have imposed GAAP as the communicating framework of choice. Unfortunately, investors find GAAP poorly suited for describing the real economics of a business. For estimating intrinsic value, GAAP only provides a starting point, and a distorted one at that.

Some more enlightened corporate leaders and most private equity investors go beyond GAAP, using non-GAAP measures and forecasts of future cash flow to provide a better link to value. While public companies are dissuaded from giving forecasts, private equity-owned portfolio companies routinely provide cash budgets and forecasts to their owners.

At the bottom line, private equity investors and better business managers dig deeply into the drivers of future cash flows and value. They allocate limited capital based on DCF, tying their goals and actions to corporate value. Having a scorecard based on value helps. Most private equity players closely track the value of their portfolio companies. Those public companies that report with value-based scorecards demonstrate to investors that they also track value. Beware of those with no value-based scorecard.

IMPROVE DISCLOSURES: TELL OWNERS ABOUT THE BUSINESS

Top private equity investors require frequent communication on cash flow and value from their portfolio companies. While public companies do have some limitations and restrictions on disclosure, they are protected by safe harbor rules. Think about the broad differences in how public companies disclose financial performance. A review of the annual report of a public company can begin to shed light on how top management and the people on the factory floor view the importance of corporate value.

Investors in public companies may find important insights on management's commitment to value building in SEC filings, as well as through the tone and facts disclosed in analyst presentations. A determining issue is transparency. Investors want to see the underlying "truth" about the outlook for companies they invest in. That truth

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is frequently obscured by masses of detailed data. Investors want to know management's goals. They want to know what's working and what's not working relative to those goals. Private equity investors are not limited by GAAP or restrictions on communication with management. They want to understand cash flow and value drivers.

Private equity is in a better position to develop a transparent view into the workings of its portfolio companies, but public company managers can bridge the gap and provide similarly useful information to their investors.

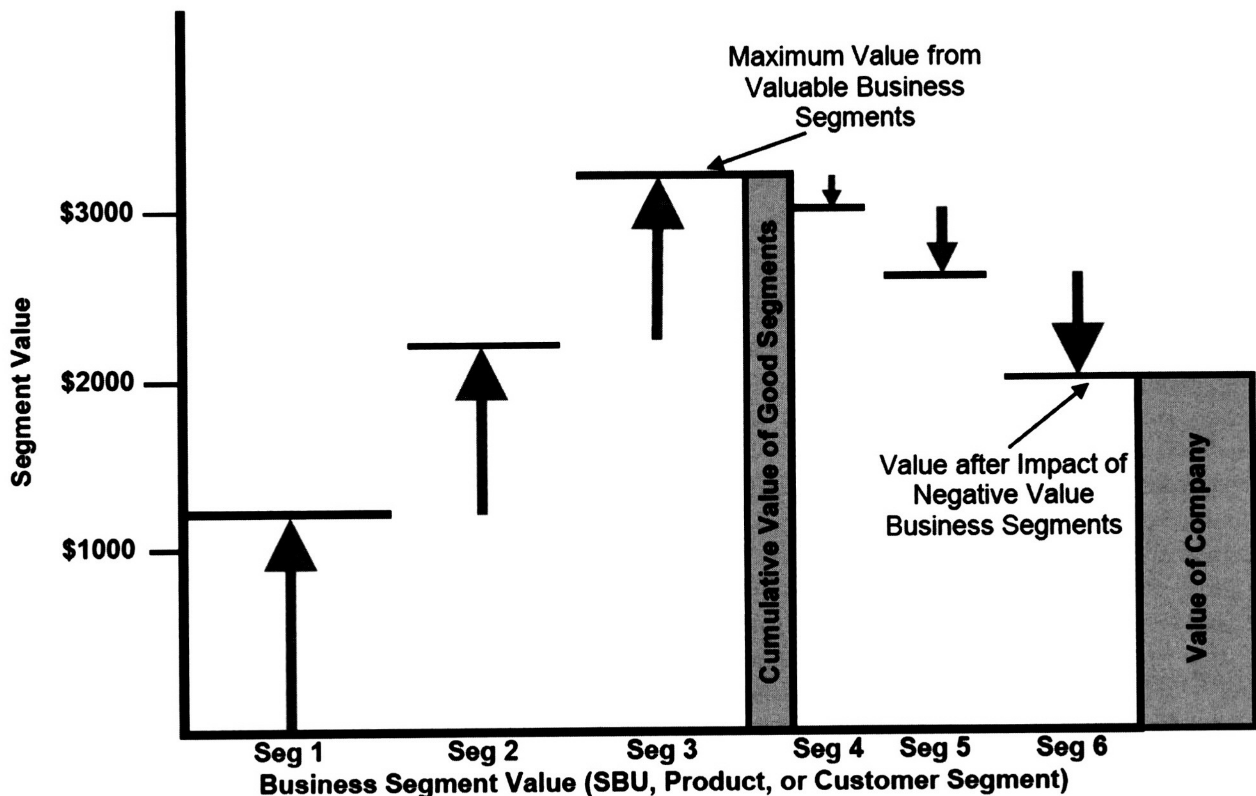
SET GOALS FOR SBUs, WHERE THE PERFORMANCE ACTUALLY HAPPENS

Frameworks like the value waterfall[3] in Exhibit 2 help management and investors understand which business units, products, or customers are contributing to value and which are destroying value. The value waterfall can be applied to any company or within strategic business units to understand which product lines and which customers allow the company to earn its cost of capital. Companies want to provide value for the customers, but customers need to be willing to pay enough for the company to make a reasonable return.

John Deere and Best Buy distinguish themselves through their value-based disclosures and management's commitment to extend the reach of value-based thinking to front-line employees.

Deere shows us that a public company can disclose value metrics and goals by key business line. For years, John Deere has published operating return on assets and shareholder value-added (SVA) metrics for each of its

EXHIBIT 2
The Value Waterfall Demonstrates a Commitment to Value Building



Notes: Segments 1–3 add to corporate value, but 4–6 decrease overall value. Valuation accuracy is consistent with the company's ability to perform analysis. Sale or restructure of Segments 4, 5, and 6 should be considered.

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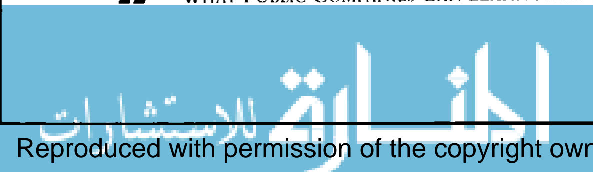

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key lines of business. Because these are "non-GAAP" measures, additional steps are required in the public reporting. Going the extra mile and disclosing these value-based metrics in good years and bad says a great deal about Deere's commitment to a value-creating culture. Management adds the finishing touch by linking incentive compensation to some of the same key metrics.

Best Buy has consistently included in its annual report a return on invested capital (ROIC) calculation. Management also educates front-line store employees as to how they can improve ROIC for their store and department. Simply disclosing ROIC trends and helping all employees understand the importance of creating a return above the cost of capital is one of many reasons Best Buy has outperformed its peers. Hedge fund legend Ed Lampert, chairman of Sears Holding, has struggled for years to get Sears to focus on value. In his February 26, 2009, letter to shareholders, he outlined his value-rebuilding strategy in the face of a global financial crisis.[4] Lampert has divided the company into strategic business units and disclosed his goal to close stores and businesses that are not likely to earn their cost of capital. He has challenged senior management to change the culture of the company to build better brands, improve merchandising, and create relationships with customers, in an effort to create value for the owners. Sears, like many public companies, is in the first stage of the value journey.

Exhibit 3

Public Disclosures Signal Commitment to Value

Company	GOOD Value Disclosure	BETTER Value Disclosure
Berkshire Hathaway	Net Asset Value, described as a weak surrogate for intrinsic value	Buffet comments on the value drivers of Berkshire's four business segments
Best Buy	ROIC and its computation in an easy to understand full page	
Briggs & Stratton		Economic Return on Capital
Corn Products	ROCE, Market Capitalization, Debt to Capitalization	
Chevron	Cash Dividends, ROCE, and Debt to Enterprise Value	
Clorox	Free Cash Flow	Economic Profit, Total Shareholder Return
Hewitt Packard	Cash Flow From Operations and Free Cash Flow	
General Electric	Model one-page scorecard with multiple trends	Total Shareholder Return
Manitowoc		EVA and market value tracked over several years
Temple Inland	ROI by sector	Commitment to better ROI first and growth second
Whole Foods		EVA as a tool for major decisions and incentives for 750 managers

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A growing number of public companies are showing more value metrics and talking intrinsic value in their published reports. Exhibit 3 contains a listing of companies that go far beyond the confines of GAAP to disclose better measures of value. These companies show a commitment to value, and their disclosures are more than one-liners.

Unfortunately, the full list of public companies dedicated to value-building is far exceeded by those that stop with the required GAAP disclosures. Note that companies that reduce their annual report to a cover sheet over a 10-K report can still add valuable content on the few added pages. Doing so speaks volumes about a company's track record and commitment to value creation.

A final example is that of American Capital, a public company that operates with a private equity model. In its 2007 annual report, the company includes trend charts of such value-based metrics as:

- Net asset value per share.
- Internal rate of return on investment pools.
- Cash dividend levels and increases relative to LIBOR.

In contrast with reports like those of Deere and Best Buy, most public company reports display only GAAP or "EPS-speak" metrics. Examples of this are found in the annual reports of Hospira, a 2004 spinoff of Abbott Labs, and Kodak.

Hospira's 2007 annual report contains an imprecise statement about its commitment to giving stockholders a "fair return" and to safeguarding their investment. While it points to its two key strategies, "investing for growth and improving margins and cash flow," these goals are not quantified, leaving investors in the dark. The SEC-mandated, five-year corporate performance graph shows Hospira outperforming the S&P500 Index and S&P Health Care Index for the period 2004 to 2007, but the company does not state any goal to achieve that degree of relative performance going forward.

Kodak, once the leader in its industry, provided little more than a 10-K form for its annual report in 2007. For a company that dominated the image industry, Kodak's value-based disclosures are woefully lacking. Any disclosure techniques or commitment to value by Kodak's management is left unstated in its major annual communication to stockholders.

MANAGE THE PORTFOLIO: SET GOALS TO GROW, FIX, OR SELL

Formerly successful business units and public companies can lose their way. Served markets change. Value builders find it more difficult to create value in depressed or highly competitive markets. Private equity and public companies react differently to the need to respond to external changes. While private equity normally plans to hold the companies in their portfolio for three to eight years and then realize their gains, public companies can be loath to sell business units, considering it a sign of failure. This can be a big handicap for public companies with underperforming business units.

General Motors was once the gold standard of the modern corporation. Alfred P. Sloan, president and chairman of GM from 1923 to 1956, challenged each operating division to earn a return above its cost of capital. However, this crucial goal and the managerial discipline that it fostered got lost in the scramble to cut costs. Underperforming divisions lived on, long after they should have been axed. The business had changed due to competition, but leadership was not able to make the changes necessary to maintain an adequate return.

Private equity is far less patient. Because their primary motivation is corporate value, they rarely bog down in deciding whether to close down a losing portfolio company that is bleeding cash. Unburdened by considerations about public reporting, they typically say "no" to funding a losing portfolio company that has dim prospects. Equipped with a clear vision of the returns they expected when they bought the company, private equity players are in a position to detect failure earlier. Successful ones go so far as to build in contingency plans to liquidate or divest early enough to protect the original investment. Occasionally a private equity fund will be hit by a disaster that arises with such speed it overwhelms the early warning systems and built-in protections. However, private equity has notably quicker survival reflexes compared with typical public companies.

Public companies can become preoccupied with the noise of quarterly reporting, expending much more of their intellectual capital on reporting, to the detriment of analyzing and repairing the problems that constantly challenge them. Private equity investors are generally better at raising the "signal to noise" ratio, because they are able to devote proportionally more time digging into the value equation. This puts them in a better position to respond to external threats and changes in the competitive environment.

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TOP VALUE BUILDERS HAVE A VALUE-BASED SCORECARD

Value building requires going beyond the GAAP metrics found in multiple databases. It requires digging into the CEO's brain through the tone of the annual report and compensation plans. Consider the following questions for any outside analyst or corporate director to ask when refining assumptions about a company and its future performance:

1. Does management have a disciplined value-building strategy and scorecard?
2. Is the scorecard prominently displayed with trends?
3. Is the scorecard oriented toward value-building or GAAP?
4. Does the executive compensation program support the scorecard and value?
5. Is the need to earn more than the cost of capital accepted by all employees?
6. Is the scorecard linked to a robust market based valuation framework?

In our analysis, private equity investors pursue value as an overarching goal. As a result, value metrics are more consistently and concisely incorporated into compensation and governance practices.

USE VALUE-BASED INCENTIVES TO ACHIEVE GREATER VALUE

A well-drafted annual report can help to underscore management's commitment to value and also to communicate a consistent message of value to employees and stockholders. The disclosures that are the most meaningful to investors in this area are those that management volunteers. When the disclosures are limited to those mandated by the SEC, they may lose value as they become matters of form.

Since early 2007, proxy statements from public companies have been required to provide more complete disclosures of total executive compensation than ever before. This is an area of reporting where there have been few volunteers. In this case, the SEC is forcing companies to quantify components of executive compensation that have been hidden from view in the past. Investors should now be able to determine whether top management is being "paid for failure." Investors should also be able to compare the compensation of top executives in comparable companies. These new disclosures now run from five to eight pages or more.

Because private equity firms buy businesses with the goal of creating value within a short time period of three to eight years, they focus management incentives on the same goals. In contrast, public companies see their various business units as permanent parts of the overall enterprise. This creates an important distinction, as public companies find it difficult to develop the same visibility as private equity concerning management's actual ability to create value. Nothing clears the slate like the sale of a business unit. With cash in hand and the sale of a business, management's success or failure is abundantly clear. Unfortunately, there are still significant business units within public companies that have no income statements and balance sheets. Without these basic tools of measurement, the value created or destroyed by the performance of a business unit is nearly impossible to determine.

Regardless of the managerial capability of the company, it still must make its executive compensation decisions. All boards find compensation discussions difficult. The goal is to establish a disciplined value-building culture, supported by consistent compensation incentives. Unfortunately, the cultures of many companies are heavily focused on product lines or customers, to the detriment of shareholder value. For example, the U.S. auto executives fell in love with their products and got caught up in political disputes with labor. Compensation at all levels, throughout the industry, drifted away from creating shareholder value. Management forgot about convincing the employees that the company had to produce a rate of return above the cost of capital for their shareholders.

When a private equity firm buys a sleepy and undervalued company or division, it installs management incentives to build value. These incentives promote change to a culture that makes everyone accept that the business exists to produce a return on capital for its shareholders. Original management teams that do not understand the new value-creating culture are quickly exposed and asked to leave.

Most private equity buyouts install a higher level of financial discipline than that found in the average public company. Exceptions are public companies that were leveraged buyouts. For example, Borg Warner's CEO, Tim Manganello, commented in his 2005 annual letter to shareholders: "Ours is a culture of: entrepreneurial innovation ...,

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global presence . . ., a fierce commitment to financial discipline born out of a leveraged buyout background."[5]

Bob Lane at Deere has proven to us that public companies can be effective at setting incentives consistent with shareholder value. Before Lane became CEO of Deere in 2001, most employees at Deere had little idea of the importance of earning a reasonable return. The movement of Deere's stock price with the business cycle had been a constant source of pain, with compensation periodically whipsawed by external events. At that time, Deere was considered by many investors to be a "good" company, but it remained victimized by the strong economic cycle of farm and construction equipment and a unionized work force. Lane explained to employees that they had great products, but not a great business. He initiated a culture change program to make every employee aware that there was work to do to make Deere's business as great as its products.

Educating employees on value and economics was a top priority for Lane. The consistent theme of the annual report over the next six years was easy for employees and investors to understand: "Growing a business as great as our products." Compensation goals were based on increasing shareholder value. This meant earning a realistic minimum target return on capital, taking into account the reality of the business cycle. During the upward phase of the cycle, the return goal was set at 28%, at mid-cycle 20%, and in decline 12%. Every product team at Deere must have a plan in place to achieve these goals as part of its short-term incentive program. The use of the different goals for different stages of the macroeconomic environment has allowed Deere to achieve higher levels of return at each stage of the cycle because it reflects the reality of the business.

Lane charged each business unit and division with an imperfect but meaningful 1% per month for capital employed in the business. Simple in concept, the 12%-per-year charge was not simplistic. It taught the entire organization that achieving an economic profit required covering the cost of capital. According to Bob Lane in a discussion with the authors on December 18, 2007, "the concept of economic profit and how it is applied is understood by thousands of managers, not by a few financial people at the top."

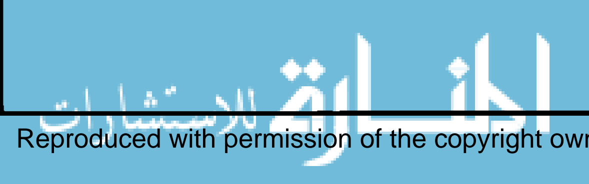
In its annual reports, Deere educates investors and employees about the operating return on assets (OROA) of its key product lines. Management communicates with Wall Street analysts with value-based concepts like shareholder value added (SVA).[6] At Deere, absolute gains in economic profit serve as the basis for medium-term incentive bonuses. To avoid bonus boom and bust, the bonus payouts are based on a four-year moving average. Deere's long-term incentive program ties the fortunes of management to Deere's success by requiring that the top 1,000 employees own equity.

Bob Lane considers value-based metrics like SVA to be more effective for its scoreboard. The SVA scoreboard has helped change the focus of Deere's corporate culture from GAAP and products to value creation. Without value-based metrics it is hard to get people to think about the importance of cash flow and the effective use of capital. Compensation experts agree. Mark Ubelhart of Hewitt Associates believes that the value-based movement, which was so visible in the 1980s and 1990s, has had a significant and lasting impact on the design of compensation plans.[7] Research shows that more companies are using disciplined value based metrics like cash flow and ROIC in their plans.

Don Delves, president of The Delves Group, has recently seen public company board compensation committees developing incentives for incoming CEOs with the goal of doubling the value of the company over a certain time period. He also notes that the depressed public company stock prices of 2008 and 2009 are putting most stock options out of the money. While CEOs of private equity portfolio companies look to exit value, those rewards are also pushed further into the future. More companies are putting more incentives on operating cash flow and market share gains as stock prices are highly uncertain during the current economic crisis. In the uncertain economic environment of 2009, some public companies are setting lower incentive goals and lower payouts intended to cover a wider range of outcomes.[8]

BETTER GOVERNANCE TAKES TIME, MANAGEABLE SIZE, AND SKIN IN THE GAME

Directors of the portfolio companies of more successful private equity funds spend more time to get better insights. According to one study, non-executive directors of private equity-backed companies "spend on average, nearly three times as many days on their roles as do those at public companies (54 versus 19)."[9] They focus on the performance of key people, cash flow, and the value-drivers of the business units more so than their public



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peers. Due to time demands, public directors find it difficult to get more involved. One alternative is for public company directors to engage a dedicated board analyst or value consultant to help them understand performance of the company down to the business unit level.

According to Ray Svider, a managing partner of private equity investor BC Partners,[10] boards of public companies must overcome agency problems to improve the value-creation practices of public companies. While they may rely on compensation consultants to help design compensation plans, the directors of public companies don't have time to devote to really understanding the industry issues in depth. Thus they have difficulty assessing management and value performance. Svider related his experience as a director on one board, where he continued to serve for 10 years after his private equity fund took the business public in an IPO. Even 10 years after the IPO, he was still looked to as "the board expert" on company issues. This was the result of the three-month due diligence process he led when his private equity fund made the initial investment in the company, and his close monitoring of the company while it was owned by his private equity fund.

According to Svider, the other directors never took the time to understand the issues facing the company because of their other "full-time" duties as seated CEOs of their own companies. Public company directors are more likely to accept the recommendations of management rather than challenge them or replace managers for underperformance. Replacing a public company CEO takes a great deal of time for even a subcommittee of the board. Public company boards are therefore more likely to tolerate sub-potential value-building performance, relative to their private equity peers, who have skin in the game.

SMALLER, FOCUSED BOARDS PRODUCE BETTER GOVERNANCE

Boards of private equity portfolio companies are focused on guiding management toward long-term value creation. The number of directors is kept small (four to six), focusing the activity of the board on strategic, value-building issues. Private equity directors usually have a substantial investment, which encourages their focus on the business. In contrast, public company directors feel pressure to focus on the most recent quarter's GAAP financials, reducing the time they spend on long-term strategic issues. Because of time and experience constraints it's difficult for public directors to develop a detailed understanding of a larger multi-business corporation without outside help.

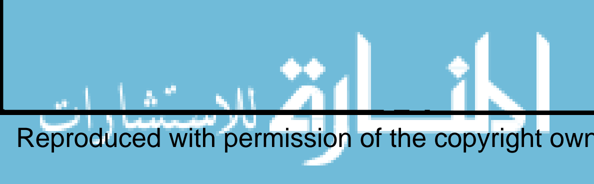
Effective boards use value-based metrics. GAAP-imposed measures do not adequately track value, in part because they aggregate business units. Research shows that companies that shift from performance measurement based on accounting to measurement based on value may find that a third of their prior decisions on capital allocation and value of business units were just plain wrong.[11]

A wise board and management team seek to develop an economic view of their company. They take into account the return on capital, time value of money, alternative uses of capital, future risk, and uncertainty. They hone the message about corporate value and teach it to employees and investors. To be effective the message must be meaningful to all stakeholders. Simply placing a metric like ROIC or SVA in an annual report without organizational follow-through will not work. When the value-based incentives affect executive pay in the right way, and are clearly understood by the board, senior management, and employees, value-building performance is much more likely. Without this alignment, creating value may be an elusive goal.

SUMMARY: VALUE BUILDERS PURSUE THE FOUR STEPS OF THE VALUE JOURNEY WITH DISCIPLINE

To successfully pursue the value journey to top-value-builder status, public directors and private equity investors must monitor progress along four major steps. Outside investors and analysts can evaluate public-company management on their progress toward top-value-builder status. Private equity-owned companies can generally move faster than their public peers. There are many small steps within each of the four basic steps described below:

1. Talk and think value. Engage in constant communication to the work force and full disclosure to the shareholders.
    a. Set the right value based goals.
    b. Communicate verbally and in annual and periodic reports to change the culture and ensure all employees understand how to build value.
2. Implement metrics to drive cash flow. These include return on invested capital, customer retention, customer value, and growth. Analyze served market size, growth and market share trends.



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a. Provide incentives based on value-based metrics.
b. Go beyond simplistic EPS-speak metrics to a value-based scorecard.
c. Understand the portfolio and waterfall of values: SBU, product, and customer.

3. Report and act on value insights and value-driver trends. Disclose performance of key parts of the portfolio on a regular basis, not just if the trend is positive.

a. Report on value-based trends monthly at the operational level and at least quarterly to the board. Monitor changes in the value waterfall.
b. Develop plans and scenarios that explain potential results and risks, as well as how better results will be achieved and risks mitigated.
c. Execute plans to improve portfolio value, reduce risk and cut losses.

4. Push toward the goal of achieving top-value-builder status with total shareholder returns of 20% or more.

a. Recognize that most public companies will not earn 20% returns if they serve the wrong markets with the wrong products, particularly if they are guided by leaders who are not good communicators and value builders.
b. Once 20% returns are achieved, ask how long they are possible in the face of competition.
c. Understand market values relative to intrinsic value, and when to buy and when to sell.

ENDNOTES

We owe a debt of gratitude to several people who assisted in the adaptation of this article by reviewing and providing insights, including Edwin Marks, Sean Falmer, Rawley Thomas, Robert Agnew, Duncon Bourne, and others.

[1]This article is adapted from three sources:

- "Driving Long-Term Value: What are the Next Steps?" Shepherd G. Pryor IV, William J. Hass, and Dennis N. Aust, *Directors Monthly*, Vol. 30, No. 12 (December 2006), p. 1.
- *The Private Equity Edge: How Private Equity and the World's Top Companies Build Value and Wealth*. Arthur B. Laffer, William J. Hass, and Shepherd G. Pryor IV. New York: McGraw-Hill, 2009. This book provides a broader perspective on the macroeconomic and political impacts on valuation and value building.
- "The Value Edge," Chapter 2 of *Valuation Handbook: Valuation Techniques from Today's Top Practitioners*, Benton Gup and Rawley Thomas, eds. New York: John Wiley & Sons, 2009 (forthcoming).

Go to www.topvaluebuilders.com for links to related topics.

[2]"Is Private Equity Giving Hertz a Boost?" (with appended correction dated November 11, 2007). Andrew Ross Sorkin, *The New York Times*. Available at: http://www.nytimes.com/2007/09/23/business/23hertz.html?n=Top/Reference/Times%20

[3]Refer to *The Private Equity Edge; How Private Equity Players and the World's Top Companies Create Value and Wealth*. Arthur B. Laffer, William J. Hass, and Shepherd G. Pryor IV. New York: McGraw-Hill, 2009.

[4]"Chairman's Letter." *Sears Holdings*, February 26, 2009 at: http://www.searsholdings.com/invest/

[5]"To Our Stockholders." *Borg Warner 2005 Annual Report*, p. 2: http://www.borgwarner.com/invest/files/2005-annual-report.pdf

[6]See the investor relations presentations at www.JohnDeere.com as examples of what is needed to demonstrate a commitment to value in public companies: "Growing a Business As Great As Our Products." Deere & Company, March 2009: http://www.deere.com/en_US/ir/media/pdf/presentationswebcasts/2009/febmarch09_presentation.pdf

[7]Co-author interview with Mark Ubelhart, architect of human capital foresight and practice leader, value-based management, Hewitt Associates, December 21, 2007.

[8]Co-author interviews with Don Delves, president, The Delves Group, March 4 and 10, 2009.

[9]"The Voice of Experience: Public versus Private Equity." Viral Achara, Conor Kehoe, and Michael Reyner, *The McKinsey Quarterly*, December, 2008.

[10]Ray Svider, managing partner, BC Partners, panelist, Private Equity Conference, sponsored by the University of Chicago Booth School of Business, Chicago, February 20, 2009.

[11]"How HOLT Methods Work: For Good Decisions, Determine Business Value More Accurately." Rawley, Thomas, and L. Edwards, *Corporate Cashflow*, Argus Business, Vol. 14, No. 9 (September 1993), pp. 37–40.

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ECONOMIC CONDITIONS FOR TURNAROUNDS SHOULD IMPROVE IN 2009 AND 2010 8

JAMES F. SMITH

The author of this article recommends reading the book *Manias, Panics, and Crashes: A History of Financial Crises* for reassurance that the likely future path of the U.S. and world economies is up. The book teaches that booms and busts have happened repeatedly, and that economies always come back stronger than before and sooner than most people expect. Monetary and fiscal stimuli cause an end to the panic, a stock market boom, and strong growth in the real economy. If the monetary stimulus is removed quickly after the boom, steady growth results. If not, then inflation and another recession ensue. The author expects the authorities to engineer a successful turnaround for the U.S. and world economies, which will be good for private turnaround managers.

YOU BRING THEM A CHEST OF GOLD, THEY TELL YOU IT'S TOO HEAVY 14

HUGH C. LARRATT-SMITH

Things were very smooth when the economy was expanding at a rapid clip. Companies and private equity groups added leverage at every opportunity. Liquidity was abundant. Now, politicians are saying that banks are hoarding capital—and banks are saying that they want to lend money, but qualified borrowers are not knocking on the door. One thing is clear: the deep freeze in the credit markets will not thaw quickly.

WHAT PUBLIC COMPANIES CAN LEARN FROM PRIVATE EQUITY: *Pursue the Value Journey* 20

WILLIAM J. HASS AND SHEPHERD G. PRYOR IV

This article provides important guidance based on the authors' study of top value builders from both public and private equity-owned corporations. They observe that a wide range of effective application of value-building fundamentals among public and private companies exist. A disciplined approach to value building is the prime factor of differentiation between success and failure. As a result, both public companies and private equity portfolio companies have significant room for improvement. Four major steps of the value journey provide guidance to top value builders in good times and bad.

LIBERATING A BUSINESS FROM ITS HISTORY: *The Turnaround of Dana Corporation* 29

CORINNE BALL, HENRY MILLER, AND TED STENGER

When auto-parts maker Dana Corp. was near collapse, restructuring professionals entered the scene and effected a comprehensive reorganization of Dana's global business. They facilitated negotiations between various stakeholder groups and utilized the Chapter 11 bankruptcy process strategically, resulting in a restructuring that included groundbreaking deals to limit Dana's liabilities for retiree welfare benefits and pension plans; the divestment of noncore businesses, both domestic and overseas; the institution of a pan-European receivables securitization facility; the out-of-court reorganization of its European operations, avoiding insolvency proceedings in multiple jurisdictions; the restructuring of a struggling finance subsidiary; and the renegotiation of unfavorable contracts with Dana's significant OEM customers. Dana emerged from the process with a competitive cost structure, rationalized manufacturing footprint, and streamlined corporate organization, in stark contrast to the well-publicized difficulties of other auto industry participants.

FINDING "INNER STEEL": *A Pennsylvania Company's Remarkable Rebirth* 38

JOHN J. BELLARDINI AND WALTER C. NEWCOMB

In 2002, Michelman-Cancelliere Iron Works of Bethlehem, Pennsylvania was a respected provider of structural steel for large infrastructure projects in the Northeast. Four years later, MC Iron faced extinction with significant financial losses. With its willingness to persevere and the strength of an exceptional turnaround team—JC Jones & Associates—MC Iron found the "inner steel" to make the deep, lasting changes needed to turn a losing operation around and ensure long-term success. The path was painful but in little more than a year, recovery was complete and MC

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