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Managing Turnarounds in Times of Crisis

Phases and Actions To Accelerate the Recovery Process

By John M. Collard | January 15, 2010

The process of turning around a troubled entity is complex. This is made more difficult and compounded by the multiple constituencies involved, all of whom have different agendas. Directors want to avoid risk and litigation. Lenders want return of invested capital, preferably with interest. Creditors want their money in exchange for goods and services. Original investors want and hope for recovery of capital. Owners want to avoid guarantees and recoup some equity. Employees want jobs and benefits. Other stakeholders want their interests protected. These desires can often be at odds with other parties and hamper the effort.

Address the turnaround process as if all constituents are in favor of proceeding to the end, when a restructured entity emerges.

There are many causes that contribute to business failure. According to a study conducted by the Association of Insolvency and Restructuring Advisors only 9 percent of failures are due to influences beyond management's control and to sheer bad luck. The remaining 91 percent of failures are related to influences that management could control, and 52 percent are internally generated problems that management didn't control.

Businesses fail because of mismanagement. Sometimes it's denial, sometimes negligence, but it always results in loss. Mismanagement is most often seen in more than one of multiple areas:

- Autocratic Management, Overextension
- Ineffective, Non-existent Communications
- High Turnover Neglect of Human Resources
- Inefficient Compensation & Incentive Programs
- Company Goals Not Achieved or Understood
- Deteriorating Business, No New Customers
- Inadequate Analysis of Markets & Strategies
- Lack of Timely, Accurate Financial Information
- History of Failed Expansion Plans
- Uncontrolled or Mismanaged Growth

Will Rogers said, "If you find yourself in a hole, stop digging." Good advice for directors with responsibility to lead a company.

Turnaround specialists are often an excellent choice when these circumstances are present. They bring a new set of eyes, trained in managing and advising in troubled situations. These experts are either practitioners or consultants. Turnaround practitioners take management and decision-making control as the chief executive officer or chief restructuring officer. Turnaround consultants on the other hand advise management, perhaps the same management that failed before.

The Turnaround Management Association (TMA) was formed in 1988 and has grown to 8,600 members around the world who represent multiple constituencies working in the industry. TMA sponsors a Certified Turnaround Professional (CTP) program with strict reference checking requirements and testing of a Body of Knowledge to become certified. Approximately 500 CTP professionals are registered today.

The key is to build enterprises that future buyers want to invest in. Investors/buyers look for:

- Businesses that create value. Consistency period to period.
- High probability of future cash flows. History of performance and improvement, or the promise of cash.
- Market-oriented management team. Focus on producing revenue.
- Ability to sell and compete; develop, produce, and distribute products; thrive and grow. Track record or demonstrated changes in the right direction.
- Fair entry valuation. Realistic return potential.
- Exit options. Realize high ROI at the time of their resale.

There is a process of recovery and investment. It is based upon the fundamental premise that there is a lack of management when companies are in trouble. You must conduct fact-finding to assess the situation, then prepare a plan to fix the problems. You must implement the planned courses of action by funding the process and building a team to carry it out. Then monitor the progress and make changes where necessary.

Stages in the Turnaround Process

There are five stages in the turnaround process: Management Change, Situation Analysis, Emergency Action, Business Restructuring, and Return to Normality. We will look at these individually to understand what should transpire at each stage by each function within the company. The timing is important to coordinate what is happening between functions. Stages can overlap, and some tasks may impact more than one stage.

The process is designed to first stabilize the situation, which is done by addressing management issues, assessing the situation, and implementing emergency actions. The restructuring process begins with preparations during the emergency action phase. The positioning for growth starts with restructuring and grows when normalcy stage is reached.

Management Change Stage

It is very important to select a CEO who can successfully lead the turnaround. This individual must have a proven track record and the ability to assemble a management team that can implement the strategies to turn the company around. This individual most often comes from outside the company and brings a special set of skills to deal with crisis and change. Their job will be to stabilize the situation, implement plans to transform the company, then hire their replacement.

It is essential to eliminate obstructionists who may hamper the process. This could require replacing some or all of top management depending on the deal. This will undoubtedly mean also replacing some of the board members who did not keep a watchful eye.

Management must address issues related to major stakeholder groups (executives, function managers, employees, lenders, vendors, customers, others). There must be change in the focus of how the company will operate to accomplish a turnaround. Most companies have a lack-of-sales problem, which necessitates a change to jump-start sales and drive revenue. There must be information that all can rely on for decision making. Production management must support and make what the market wants to purchase, at competitive price. You must nurture critical human capital resources that are left within the company, while at the same time holding them accountable for results.

Changing management is synonymous with changing the philosophy of how we will run the place to achieve results. Communication with all stakeholders is paramount through all stages of the process. Set goals that achieve stakeholder objectives, then apply incentive-based management to motivate the proper results. Tie everyone to the same broad set of goals and accent how functions can compliment the performance of related departments.

Situation Analysis Stage

Your objective is to determine the severity of the situation and if it can be turned around. Answer questions like is the business viable? Can it survive? Should it be saved? Are there sufficient cash resources to fuel the turnaround? This analysis should culminate in formulating a preliminary action plan stating what is wrong, how to fix them, key strategies to turn the entity in a positive direction, and a cash flow forecast (at least 13 weeks) to understand cash usage.

Identify effective turnaround strategies. Operational strategies include increasing revenue, reducing costs, selling and redeploying assets, and competitive repositioning. Strategic initiatives include adopting sound corporate and business strategies and tactics, setting specific goals and objectives that align with the ultimate goals of the stakeholders. Too often, goals are misaligned with the ultimate direction and cause confusion, wasted time, false-starts, and send employees in the wrong direction. Understand that many of the good employees have already left the company, you will have to work with the second string in the essence of time and build as you go.

You must understand the life cycle of the business and how it relates to the chosen turnaround strategy. Document key issues so that all will understand what you are trying to accomplish, and all will pull in the same direction. Identify what product and business segments are most profitable, particularly at the gross margin level, and eliminate weak and nonperformers. Make certain that all functional areas (sales, production) are working to support the goals of their counterparts. Selling work with flexible delivery times can fill valleys in production cycles, which reduce costs per unit. Producing only what sales can sell to meet customer demand will increase sales and gross margin.

Turnaround strategies are often impacted by local government policy considerations and regulations. In the United States the WARN Act requires 60-day notice of massive lay-offs, which certainly impacts cash flow. In many countries in Europe and Far East there are stringent rules (local country driven) governing the payment of wages after lay-offs, dealing with the local authorities regarding the process, and even prioritizing which workers can be laid off when in fact others may be more qualified. When government policy favors labor and employment is not “at will” there will be complications to the process.

Emergency Action Stage

Your objective is to gain control of the situation, particularly the cash, and establish breakeven. Centralize cash management function to ensure control. If you stop cash bleed, you enable the entity to survive. Time is your enemy. Protect asset value by demonstrating that the business is viable and in transition.

You must raise cash immediately. Review the balance sheet for internal sources of cash such as collecting accounts receivable, and renegotiating payments against accounts payable. Sell unprofitable business units, real estate, unutilized assets. Secure asset-based loans if needed. Restructure debt to balance the amount of interest payments with a level a company can afford.

Lay off employees quickly and fairly. It is much better to cut deep all at once, than to make small cuts repeatedly. Remaining employees are more prone to focus if they believe in job security, rather than look for the next action.

Rightsizing the company is much more than employee layoffs. Correct underpricing of products, prune product lines to only those profitable and that meet demand, and weed out weak and problem customers. Sometimes there is to much overhead applied to support a customer who isn’t paying their fair share of that service. Emphasize selling more product at profitable rates. Reward those that change the situation, sanction or release those that don’t.

Business Restructuring Stage

Your objective is to create profitability through remaining operations. Stress product line pricing and profitability. Restructure the business for increased profitability and return on assets and investments. At this stage your focus should change from cash flow crisis to profitability. Fix the capital structure and renegotiate the long and short term debt.

Ensure that reporting systems put in place are operationalized to show profitability at each revenue center, cost center, profit center, cash center, incentive center. Unless employees can see it they can’t manage it.

Incentive-based management will drive employees to get involved smartly, and manage to the goals all ascribe to. Create teams of employees to identify and rework inefficiencies and promote profitability.

There are only two ways to increase sales. Sell existing product to new customers. Sell new products to existing customers. Do both if you want growth.

Return to Normal Stage

Your objective is to institutionalize the changes in corporate culture to emphasize profitability, ROI, and return on assets employed. Seek opportunities for profitable growth. Build on competitive strengths. Improve customer service and relationships. Build continuous management and employee training and development programs to raise the caliper of your human capital.

This could be time to restructure long term financing that more reasonable rates now that company is stable on a growth path.

The odds of a successful turnaround are increased dramatically if a Turnaround Process Phases and Actions Plan is implemented and followed. This plan can certainly be adapted to unique situations when required. Turn one around.

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Boardroom Intelligence

*John M. Collard is chairman of Annapolis, Maryland-based Strategic Management Partners Inc., a turnaround management firm specializing in interim executive CEO leadership, asset recovery, corporate renewal governance, private equity advisory, and investing in underperforming distressed troubled companie*s. 410-263-9100
www.StrategicMgtPartners.com