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Reviving troubled companies: Phases and actions in the turnaround process

By John M. Collard

Turnaround opportunities abound for those who have the knowledge and fortitude to go through the process. The rewards can be plentiful, and the failures catastrophic.

The process of turning around a troubled entity is complex. This is compounded by the multiple constituencies involved, all of whom have different agendas. Lenders want a return of their invested capital, preferably with interest. Creditors want their money in exchange for goods and services. Original investors want and hope for recovery of their capital. Distressed investors want to buy in at 20 cents on the dollar, then turn a profit; some by trading the credit, others by turning the business positive, then selling. Owners want to avoid guarantees and recoup some of their equity. Employees want their jobs and benefits. Directors want to avoid risk and litigation. Other stakeholders want their interests protected. These desires can often be at odds with other parties and hamper the effort.

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 is denial, sometimes negligence, but it always results in loss. Mismanagement is most often seen in more than one of multiple areas:

- Autocratic management, over-extension
- Ineffective, non-existent communications
- High turnover due to neglect of human resources
- Inefficient compensation and incentive programs
- Company goals not achieved or understood
- Deteriorating business, no new customers
- Inadequate analysis of markets and strategies
- Lack of timely, accurate financial information
- History of failed expansion plans
- Uncontrolled or mismanaged growth

Look for the root causes first

Will Rogers once said, "If you find yourself in a hole, stop digging." Good advice for directors and managers with the responsibility to lead a company. Very good advice for lenders and investors contemplating investing more capital into a troubled property.

To be successful in this arena, you need clear thinking to quickly determine what is wrong, develop strategies that no one has tried before, and implement plans to restructure the company. The problems are rarely obvious. Instead, there are often two or three underlying systemic ills that can be fixed. You can't focus on the symptoms, but must find the real causes. Management has allowed these problems to exist and bring the company to its depressed state. Therefore, they may not be equipped to manage a turnaround.

Turnaround specialists are often an excellent choice. 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 CEO or chief restructuring officer. Turnaround consultants, on the other hand, advise management — perhaps the same management that failed before.

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. Look at these individually to understand what should transpire at each stage, and what role each function in the company should play. The chart below should give you a good idea of this.

Keep in mind that timing is important to coordinate what is happening between functions. Stages can overlap, and some tasks may impact more than one stage. smartCEO

About the Author

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Chart →

Turnaround process: Phases and actions

Stage/Focus	Management Change Stage [Leadership]	Situation Analysis Stage [Viability]	Emergency Action Stage [Crisis Control]	Business Restructuring Stage [Change]	Return to Normal Stage [Going Concern]
Objectives	Put top management team in place Select turnaround specialist Replace some/all top management Eliminate impediments	Can it survive? Should it be saved? Is the business viable? Are cash resources available to fuel turnaround? Develop preliminary action plan and nature of turnaround	Survival Get Control Break even Positive cash flow Raise cash to support turnaround Protect resources Protect asset value	Create profitability through operations Restructure business for increased return on assets and investments	Seek profitable growth Emphasize profits and returns Build competitive strengths
Sales & Marketing	Jumpstart sales Drive revenue Volume In = revenue	Analyze: Products & services Distribution Sales & marketing strategies &systems	Correct underpricing Prune product lines Weed out weak customers & distributors Bring sales & marketing costs within industry avg. Sell, sell, sell more	Reassess competitive & product line pricing Exploit existing products Develop new products Improve customer & distribution mix Improve sales & marketing effectiveness	Explore new markets & customer segments Examine industry restructuring opportunities Pursue value-added chain restructuring Consider synergistic diversification
Financial	Track cash Develop trusted reporting & analysis	Analyze: Cash flow Break even Profitability Cost reduction Balance Sheet Reporting Gross margin by product	Restructure debt Improve work/capital Sell non-producing assets Reduce cost/increase Revenue Eliminate creative accounting practices	Improve liquidity Clean up balance sheet Fix capital structure Develop control systems Create managerial accounting system	Develop strategic accounting Restructure long-term financing Develop stock valuation and buy-back system
Manufacturing & Production Operations	Produce to meet sales levels only Balance peaks and valleys Volume out = throughput	Analyze: Facilities Equipment Systems & Procedures Suppliers	Shut down operations Reduce workforce Reduce inventories Control purchases Increase productivity	Develop productivity improvement programs Re-evaluate overhead Establish ongoing profit improvement programs	Restructure operations for competitive advantage Consider strategic alliances with world-class firms
Engineering, Research & Development	Develop new product and services to support sales	Analyze: New product development Improvements in: Product Process Productivity	Accelerate high-potential projects Shut down tangential projects Unbundle product offerings	Make new product development market & customer oriented Build an economic value-added orientation into process engineering	Establish advanced technology monitoring systems Seek competitive advantage, strategic leverage in all R&D activities
Organization	Organize for change Right-size company	Analyze systems: Does organizational structure make sense? Accounting/control Incentive/ performance measurement & compensation	Structure turnaround team Review individual accountability & teamwork Reward those that change the situation Release those that don't	Restructure for competitive effectiveness Develop rewards that reinforce turnaround Demonstrate with action the seriousness of the situation	Restructure to reflect changing strategies Organize to succeed, then fill the positions with talented people; don't compromise
Personnel & Human Resources	Hold employees accountable Nurture critical human capital resources Slow turnover rate Incentive-based management	Analyze: Management teams Sales, finance & ops personnel Recruiting, selection, training, starting & promotional systems	Get peoples' attention Establish who's in charge Create a professional, business-like atmosphere Sanction nonperformers	Improve people mix Incentive-Based Mgt Bolster people to believe in consistent reward system Get people to think 'profit,' 'ROI,' 'cash flow'	Institutionalize continuous management and employee training and development programs Grow human assets