

# White Paper of Interest

## Managing Turnarounds:

### Phases and Actions in the Turnaround Process

By John M. Collard

There is plenty of trouble in today's economy. We are experiencing the worst downturn since the great depression. Few industries have been spared the agony of hardship. 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 made more difficult and 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. While 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.

Lets address the turnaround process as if all constituents are in favor of proceeding through to the end, when a restructured entity emerges. Clearly there are other scenarios that you can envision.

There are many causes that contribute to business failure. According to a study conducted by the Association of Insolvency and Restructuring Advisors only 9% of failures are due to influences beyond management's control and to sheer bad luck. The remaining 91% of failures are related to influences that management could control, and 52 % 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, 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 Roger 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. This is opportunity for distressed investors with the "dry powder" to invest at bargain rates, the stable of turnaround leaders to affect a turnaround, and the knowledge and chutzpa to take on these challenges.

To be successful in this arena you need clear-thinking to quickly assess opportunities to determine what is wrong, develop strategies that no one has tried before, and implement plans to restructure the company. The problems are rarely what management indicates they are, but instead are two or three underlying systemic ills that can often 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 down to its depressed state, therefore they are not equipped to manage the turnaround.

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) [[www.turnaround.org](http://www.turnaround.org)] 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) [[www.actp.org](http://www.actp.org)] 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; see Turnaround Process Phases and Actions Chart. 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 the 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 the cash management function to ensure control. If you stop the 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 the level the 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 too 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 caliber of your human capital.

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

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.

## 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]
<b>Objectives</b>	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 TA? Develop preliminary action plan and nature of turnaround	Survival Get Control Breakeven 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
<b>Sales &amp; Marketing</b>	Jump-Start 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 S&M costs within industry avg. Sell, sell, sell more	Reassess competitive & product line pricing Exploit exist products Develop new products Improve customer & distribution mix Improve S&M effectiveness	Explore new markets & customer segment Examine industry restructuring opportunities Pursue value-added chain restructuring Consider synergistic diversification
<b>Financial</b>	Track cash Develop trusted reporting & analysis	Analyze: Cash Flow Break-even Profitability Cost reduction Balance Sheet Reporting G/Mgn by Product	Restructure debt Improve work/capital Sell non-producing assets Reduce cost/Increase Revenue Eliminate creative accounting practices	Improve liquidity Cleanup 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
<b>Manufacturing &amp; Production Operations</b>	Produce to meet sales levels only Balance peaks and valleys Volume Out = Throughput	Analyze: Facilities Equipment Systems and Procedures Suppliers	Shut down operations Reduce work force Reduce inventories Control purchases Increase productivity	Develop productivity improvement programs Re-evaluate overhead Establish on-going profit improvement programs	Restructure operations for competitive advantage Consider strategic alliances with world class firms
<b>Engineering, Research &amp; Development</b>	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
<b>Organization</b>	Organize for change Right-size company	Analyze systems: Does Org Structure make sense? Actg/Control Incentive/performance measurement & compensation	Structure TA 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 w/action the seriousness of the situation	Restructure to reflect changing strategies Organize to succeed, then fill the positions with talented people - don't compromise
<b>Personnel &amp; Human Resources</b>	Hold employees accountable Nurture critical human capital resources Slow turnover rate Incentive-Based Mgt	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

*End of Article Text*

*About the Author*

John M. Collard is Chairman of Annapolis, Maryland-based Strategic Management Partners, Inc. (410-263-9100, [www.StrategicMgtPartners.com](http://www.StrategicMgtPartners.com)), a turnaround management firm specializing in interim executive CEO leadership, asset recovery, corporate renewal governance, and investing in underperforming distressed troubled companies. He is a Certified Turnaround Professional, Past Chairman of the Turnaround Management Association, serves on public and private boards of directors, is a frequent author, speaker, and advisor to companies, institutional and private equity investors, and governments. He was inducted into the Turnaround Management, Restructuring, Distressed Investing Industry Hall of Fame.

SMP was named Maryland's Small Business of the Year, and received the Governor's Citation, Governor Martin J. O'Malley, The State of Maryland. Turnarounds & Workouts Magazine has twice named SMP among the Top Outstanding Turnaround Management Firms. American Business Journals named SMP among the Most Active Turnaround Management and Consulting Firms in Baltimore/Washington, and the Mid-Atlantic Region. Global M&A Network, presented their Turnaround Atlas Award for the Turnaround Consulting Firm of the Year - Boutique to Strategic Management Partners, Inc.