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A Hands On Approach To Get An Under-Performing Company Up To Speed

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A Hands On Approach To Get An Under-Performing Company Up To Speed

By John M. Collard

Executing a turnaround is no easy task.
John M. Collard, of Strategic Management Partners, Inc.,
Spells out the guidelines to get an under-performing company up to speed.

Mergers & Acquisitions, The Dealmaker's Journal, SourceMedia, Inc.

Investing in under-performers has become a more acceptable practice, as it can be very profitable if investors know what to look for and how to execute, as many buyout firms and hedge funds are finding out. Success, however, depends largely on the ability to determine if a troubled company is in fact turnable and if so, how to fix the problems. The key, investors are finding out, is to not spend money on past sins and to obtain at the right price, which on top of implementing a turnaround, can result in a rewarding process.

This niche market allows investors to capitalize on initial positive results, which have become stalled investments. It's important to seek out enterprises with a critical capital shortage, but still show future potential. Investors should look for companies that can provide quality products at competitive prices that are severely undervalued due to ineffective management, and/or lack of market direction and unacceptable penetration. There are opportunities that require capital, yet may lack competitive market experience and essential managerial skills. But the infusion of capital put into the hands of a leader with a sound strategy and a return-on-equity goal in mind can be a powerful motivator.

The key to returns from investing in under-performers is to build properties that future buyers want to invest in. Investors need to build an enterprise with the sole purpose of selling it at maximum value, which means concentrating on exit strategies from the start. To do this, it's important to keep in mind what future buyers will look for: namely consistency; a high probability of future cash flows; a marketing-oriented management team; and a realistic potential for a buyer's return from their entry valuation.

There is great value in rebuilding an entity and setting it on a path toward long-term growth - at which point it becomes time to find an exit. There are many buyers who accept lower return rates for stable growth and shy away from under-performers until they have been fixed, so it's important to leave some future enticement for the new buyers.

Recovery Cycle

Whether the investment is in a new entity or a portfolio property gone bad, the recovery cycle is much the same. Most troubled entities reach that state through a progression of mismanagement - from officers to board members to investors. When the entity is at a precipice there is opportunity. The present owners, lenders, and other stakeholders will have little choice but to bargain, and deals can be made. Be cautious however, because many wait too long and while doing so, allow the value to deteriorate completely. Avoid the pitfall of investing in an insolvent company with no fix available; as surprising as this sounds, many do.

Determine viability by understanding what is wrong within the company (usually two or three things) that has caused their breakdown. Don't be fooled by symptoms, and never listen to current management; if they knew what was wrong they should have had a prior fix.

A crucial element is to provide solutions to fix the real problems that no one else has used, whether it's new non-cash resources or applications to influence the revitalization. Investors should take advantage of mispriced material inputs, labor, assets or capacity, and intellectual property. The answer is never, “just add cash,” and always requires new leadership to implement change.

Negotiate acceptable terms that allow for substantial upside when the work is done. If there are no solutions, creditors won't cooperate, or if the price is unrealistic, go on to the next deal. Finding good turnable deals is fundamental to success.

Take Control

There must be a successful turn before the entity can be sold. Never leave this to chance and always take active control of the entity. Passive investing if managed by prior management is like a placebo, and often leads to a lost investment. Passive positions are only acceptable if they contribute to an investor pool that has an active lead participation.

Many equity investors approach an under-performer scenario in their own portfolio by applying strictly financial considerations. These same [financial] investors compound their problems when they take control of their company to determine whether or not it can be salvaged or lobby for sale or liquidation. When sold, which is often the case, they write-off their investment. Inherent in this scenario is a fundamental problem; purely financial consideration is not enough when an operational or revenue-driven turnaround is required. While many investors have run financial or investing institutions, few have run companies as well, and are ill equipped to do so. This, however, leads to opportunity for those who can run companies.

There is substantial value derived from investors who also have senior operating leadership experience in their background. They can determine whether one strategy or another can affect the revitalization, and why others didn't work in the past. Many private equity firms and hedge funds are adding operating executive talent to compliment their managing partners.

Some may recognize the often used axiom: “Lead, follow, or get out of the way.” When there is an underperforming entity, it is time for existing management to 'get out of the way.' They guided the company during this mismanagement slide, so why allow them to complicate the situation any further?

Process of Recovery

There is a process to guide an entity through corporate renewal. It involves utilizing a transferable set of skills to revitalize the property and restore it to a sale-worthy state.

To do that, investors want to focus on value creation and guide the company to a new plateau. Their advantage is that of an objective focus, untarnished by the situation at hand. They can bring a perspective that does not reside within the company because the players lack experience with their new situation. These investors should be the teacher, while the stakeholders are the pupils, and together the company should be rebuilt to move in new direction. Successful investors effectively manage "change control."

To move in this direction, investors should install a CEO with transition experience in value-building situations. This leader will demonstrate expertise in: managing crisis, transition, and rebuilding processes; shaping business strategy and financial structure; developing management talent and utilizing and growing existing resources; growing sales and market share; maximizing return on capital; and developing incentive-based compensation programs.

This leader must get directly involved in making decisions to achieve the ultimate goal - a sale at increased valuation. He or she must be held accountable for performance and timely results. Most importantly, they must get things moving. On the “volume in” (revenue/sales) side, look at where and how revenue is generated, and keep it coming in. On the “volume out” (throughput/production) side, ensure that the product or service gets 'out the door'.

The final step to complete the turn is to hire a 'marquis' manager to lead the enduring team. This permanent team adds to value equation.

Set Strategy

The investing goal is a shorter-term high-multiple return (for the risk) while allowing the ongoing longer-term returns for the buyers who provide an exit. It is crucial to implement long-term strategies that will survive your exit.

While situations differ, one essential strategy is to drive revenues; growth cannot occur without more sales. The strategy must address the problems plaguing the company, and provide a roadmap to revitalization. If the only solution is to pursue strategies tried before, then don't invest.

An effective strategy is key to implementing change. Investors must establish a new vision, distill this direction into concrete goals and objectives, and create a guide for everyone to follow. Rebuilding momentum is critical to success.

Also, the value of a company increases sharply with a strong permanent and credible team, who can demonstrate their ability to produce consistent sales, profit and cash flow results. Establish continuity in the organization to allow everyone to expect orderly change and opportunity.

Capitalize on available under-utilized human capital - essentially the middle managers that remain. Chances are that they are dedicated to the company and its success. Guide them to their next level, and they will take the company the next big step.

Of course, another consideration, and of key importance, is to acquire new business and improve sales. There are only two ways to increase sales: Either sell new products to existing customers, or sell existing products to new customers. Most under-performers have forgotten, or never had, the basics of marketing and promotion. Clearly promote what your products and services can do for your customer to satisfy their needs and differentiate why the company's product stands apart from the competition.

Become market driven, adapt to changing conditions, and improve your competitive position. Deliver only what customers are willing to pay for and no excess (more cost).

Meanwhile, a major component to success is to create reasons for investors to invest. A sound strategy with a viable marketplace, efficient delivery and production vehicles coupled with a cohesive management team will entice the investment community. Securing new capital becomes much easier when investors see high probability of return and a viable exit strategy.

As important to infusing cash for working capital needs is to make certain that cash won't be diverted to past commitments. Establish relationships with creditors so they will work with the new management team - give them upside when the turn is complete. Consider a 'Creditor's Committee' approach (out of bankruptcy) to keep them plugged in and participating. Pre-packaged bankruptcies are also available to ensure cooperation. Investors can always purchase assets out of bankruptcy to ensure a clean structure, a strategy being utilized more often as buyout funds get more comfortable with the process. In many ways this approach can be considered alternative and complimentary financing.

Investors taking a turnaround approach should implement systems and processes to drive the business and control the day-to-day environment, which allows management to run the critical elements of the company. Many managers waste time on tasks in which the results would be essentially the same whether they managed them or not. Focus on the important things - controlling cash and costs, increasing sales, enhancing value creation, and manage these.

Processes define guidelines and expectations. Watch for the benefits derived from communicating what is expected. This will re-establish delegation of authority and expectation to those who can turn the events of the company, and more importantly, demonstrates the value of this recurring phenomenon. When results are recurring this stimulates value.

Lastly investors should leverage all resources (People/Facilities/Advisors) to complete the turn. Often the key resource is the employee. Set up an incentive structure that pays only when they accomplish the goals set in your long-term strategy. A robust incentive structure shares the risk and if successful then everyone will gain. If not, though, then it isn't profitable to subsidize poor performance. The incentive for investing is the return when the sale occurs. The employees' incentive should be based upon performance that will take the company beyond its sale. After all, they are a key asset that a potential buyer is looking for.

To maximize the return, it is essential that investors know when to 'cash-out'. The greatest ROI comes when the turn is complete and the company is ready for the next tranche to fund growth. At this point there are many new investors who will want to participate.

In summary, investors need to leverage opportunities to take advantage of distressed level asset pricing in distressed situations, when the risk-to-reward ratio is high. They need to take operating control in all entities to make certain that those decisions that few understand are made to influence the outcome and install leadership with extensive experience and past success revitalizing and restructuring entities.

Buy, invest, manage and renew with one thing in mind: Maximize value for Resale.

When the process is completed, only one result can occur - value creation and profitable returns.

M&A

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About Collard
John M. Collard, is Chairman of Annapolis, Maryland-based Strategic Management Partners, Inc. (410-263-9100, www.StrategicMgtPartners.com), a nationally recognized turnaround management firm specializing in interim executive leadership, asset recovery, corporate renewal governance, and investing in underperforming distressed troubled companies. He is Past Chairman of the Turnaround Management Association, a Certified Turnaround Professional, and brings 35 years senior operating leadership, $85M asset recovery, 40+ transactions worth $780M+, and $80M fund management expertise to run troubled companies, and advise company boards, litigators, institutional and private equity investors.

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