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A Guide to Corporate Restructuring

How to Do a Turnaround

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I once stepped in to help a financial services company with $7.5 billion in obligations outstanding that was the largest, most prominent employer in a small southern town, and the only local company listed on the NYSE. Its stock price had been soaring (until accounting issues were reconsidered) and the CEO was the son-in-law of the founder, who was justifiably proud of having contributed to the wealth of his community, his employees, and, not least, his family. He turned down an offer for $7/share, only to watch the stock price fall to pennies a few months later. As you might imagine, he was devastated when his company started falling apart and was in no condition to preside over the dismantling of the company and the return to a more humble scale. Few top executives are equipped for that—it's not what they were trained to do. That's where turnaround management companies like mine typically enter the picture. We provide financial and operating advisory services, and step into management positions should the need arise.

Successful turnarounds aren't easy. They require vision, capital, pragmatism, and a very special quality of leadership that may be different from that needed to launch an enterprise from scratch or guide it to prosperity. I plan to explain in this article the critical steps involved in turning around a company in crisis. But I have to admit that pinpointing that mysterious leadership quality is almost as tricky as the turnaround process itself. It's like pornography—I know it when I see it but I get into trouble trying to describe it.

However, not being faint of heart, I will take a stab at it. My definition: turnaround leadership is the ability to take charge quickly, whether de facto or de jure, and capture hearts and minds in such a way that the energy of the weakened enterprise can be renewed and amplified far beyond its normal level. Mobilizing this "enterprise energy" enables ordinary people throughout the organization to face Herculean challenges. Such people are often flabbergasted to learn that they had it in them, and will ultimately feel proud rather than ashamed of the part they played in this difficult chapter of the company's history. Helping people and, therefore, companies to make the best of themselves, and along the way to compress ten years' worth of work into one, is one of the most gratifying parts of being a professional turnaround manager.

TELLTALE SIGNS OF TROUBLE

Despite Tolstoy's famous opening line in *Anna Karenina*, that "All happy families are alike but an unhappy family is unhappy after its own fashion," I find that the unhappy, troubled companies I have worked with have much in common. All too often I see a paralyzed management team and poor financial systems. Such management teams are often crippled by recurring bad news, wracked with self-doubt, and desperately praying that they can move

the company forward by doing what they did yesterday, hoping that the vision they get through looking in the rearview mirror will carry them into a future of remembered prosperity and growth. They think they can solve a problem that has built up over years with a single swift sale—and yet they often delay such decisive action ("How can we take such a ridiculously low price?!") until even that option vanishes.

As company fortunes wane further and consternation mounts among all constituencies—employees, customers, lenders, investors, vendors—it becomes increasingly unlikely that the embattled management can set and stick to a clear course of action. Circumstances seem so overwhelming that the executive team ceases to communicate, either among themselves or with their constituents, and a bunker mentality sets in. This retreat only creates further doubt, tension, and paralysis. Credibility, the most precious asset any management team has, erodes and often evaporates altogether.

To make matters worse, the already-besieged managers often have scant financial information to guide them toward stability. Financial systems of many companies are not designed to capture information in an appropriate manner to support the decisions required. Most systems were put in place, not surprisingly, during growth and good times. They were not set up to handle tough downsizing decisions based on detailed "what if" analyses.

That leaves the company's financial personnel scrambling—they find themselves up the creek without a calculator. In big companies, roles are structured: the treasurer traditionally worries about bank relations; the CFO about capital markets; the controller makes sure the numbers foot. They are not accustomed to the vagaries of living in a cash-poor environment. In smaller companies, financial personnel are running about putting their fingers in the dike, trying to keep customers buying and vendors shipping. Regardless of all their good intentions and determined effort, cash resources are dwindling. Company processes are rarely organized around the principle of conserving cash.

In almost all situations I have seen, cash management is treated as a lower-level function and managed on a fairly passive basis, sometimes with disastrous results. In one case involving a large manufacturing company, no forecasting of cash needs had been done, and the company complied with the request of its bank group for a cash forecast (a standard bank request of a troubled company) by having a payables clerk prepare an Excel spread sheet based on one month's cash inflows and outflows and replicate it out six months. Management, feeling the time pressure, sent the spread sheet to 22 banks without reviewing it, and therefore did not notice that it showed a recurring $35 million monthly payment which could not be explained. As a result, a significant percentage of holders of $850 million of unsecured bank debt sold their positions at deep discounts.

In another situation, a transportation services company with a complex capital structure had only a five-year forecasting model to project earnings growth which took three days to run each time a query was posed. In yet another, a home improvement retailer avoided administrative insolvency only through the arrival of an unexpected tax refund and an out-of-the-blue payment from a long-ago, and long-forgotten, investment in a tax-sheltered windmill farm. A literal windfall. (Yes, all three of these companies were publicly traded, listed on the NYSE.)

The challenge facing the turnaround manager is thus easy to describe, and tough to carry out. First, restore management credibility, measure and manage the cash, assess the business(es) and its/their prospects, and develop a plan for going forward. Next, achieve buy-in from all constituents, and implement the plan. Immediately. As cash dwindles and customers, vendors, and employees walk out the door, time is the enemy.

SELECTING THE TURNAROUND TEAM

One of the toughest decisions is selecting the "turnaround team." Those in charge often have trouble accepting that things are not going to get better if they just wait a little longer. And as I said, time is often the enemy. I believe in looking for the members of this critical action team at every level of the organization chart. Tremendous knowledge is available within the organization; the challenge is to access it and put it into the framework of an actionable plan.

Thus the turnaround manager must immediately assess management's strengths and weaknesses. Often, battlefield promotions must be made quickly, which sends a signal to everyone in the company that things have changed and real deficiencies will be corrected, even if part of executive management must be changed. In all cases, it is imperative to demonstrate leadership through structured, consistent, clear communications to all parties, taking decisive actions on open issues, and providing structure to carry out the daily operations of the company.

Troubled companies have often developed what I call a "headquarters mentality," and have divorced themselves from interaction with operating units. Managers may believe that they can think more strategically if they are not pulled into daily operating issues, and they try therefore to create distance, often of hundreds of miles, from operating activities. Suspicious of this, I have been amazed at how many times I have uncovered a figure-eight situation, in which only one or two people, even in very large organizations, cross the line and communicate with both operating and headquarters units. Such people can be good candidates for battlefield promotions and are often remarkably effective very quickly, as they know, and have known for a long time, exactly what needs to be fixed and who in the company has the resources to get it done. They need to participate in the turnaround team process.

To stem the chaos I usually encounter with a company in crisis, I set up early morning, daily meetings of the turnaround team. Demonstrating and maintaining integrity of behavior, decision-making processes, and communications is critical to holding the company together and turning the company's attention toward tomorrow rather than focusing on past failures. These meetings must focus on cash resources—discussions of shipments, collections, inventory, backlog, orders, and cost reduction plans and progress—and actions that require immediate attention. Done well, the meeting can effectively flatten the organization chart and reduce routine and unnecessary, and therefore time- and money-wasting, paperwork, and create the urgency implied by Nike's famous tag line: Just Do It. Now.

FOLLOW THE CASH

At the same time the turnaround manager is completing the analysis of management, she must also be locating the cash and beginning the process of measuring its sources and uses and the company's actual daily requirements in order to create a tested 16-week rolling cash forecast, as fast as possible. This requires looking at the number of places in which cash is collected and from which cash is disbursed. And it also frequently requires turning upside down the employees' perceptions of what it means to do a good job. I have seen countless examples of employee taking pride in paying invoices *before* they come due. Careful, respectful behavior modification must take place rapidly to allow the company to conserve its resources.

I have turned up some amazing gems in the hunt for the cash: long-forgotten bank accounts, a nonexistent collection process on past due receivables. Once I found a whole department of 20 people that had no real function in the company but just kept getting paid. That was too weird for words: the company had reorganized several times and simply forgotten a whole department. In another situation, a simple review of real estate tax payments being made uncovered a significant piece of real estate that was nowhere reflected on the company's balance sheet.

Frequently, steady, focused attention on these areas will show marked results quickly, and can give the company some breathing room. The $35 million payment referenced in the Excel spreadsheet debacle mentioned above was made by a clerk on a routine basis despite the fact that most payables were less than $1 million, and it took two weeks for anyone in management to know that the payment had been made.

NOW TO THE HEART OF THE MATTER...

With a start on addressing the turnaround team and getting a sense of the cash, the turnaround manager must now get to the heart of the matter: can this company be saved? To answer that, I try very quickly to develop a hypothesis about the nature of the real problem behind the current crisis: is it a strategic issue, an execution problem, an operating matter, or an industry-wide situation? Of course most often it is a combination, and analyzing cause and effect can be a delicate maneuver. As part of this process, I conduct liquidation analyses, comparing forced and orderly liquidation values realizable to possible going concern values in order to determine whether the company is worth more to its stakeholders dead than alive, to put it brutally.

I also try to assess how critical the patient's condition is. A first-cut assessment establishes whether the company's very survival is under immediate threat (crisis, less than one month's availability of cash), whether large or recurring losses have threatened the company and its relationships but its survival is not immediately at risk (troubled, less than four months' cash availability, if left unaddressed), or whether the company is a chronic underperformer versus its peers (underperforming, less than one-two years' cash availability, if unaddressed). Each of these assessments implies a different planning horizon for taking corrective action, and very different courses of action as well.

- If the company is probably viable, a detailed analysis and action plan and timetable must be developed to put the company back on course.
- If the company is not viable, the turnaround manager must develop a plan to maximize value and minimize further downside risk to all parties.
- If the company is at the brink of the abyss, intense effort must go into preserving/raising liquidity resources so that there is time for the company to make the best of a bad situation, which may include a sale of the company or its assets, or radical and immediate surgery to cut the burn rate, or possibly a recovery based on infusion of new capital from some source, typically from a party already involved in the situation.
- In all cases, the turnaround manager has to maintain a positive outlook and calm demeanor while determining the best plan for an orderly winding down of business-as-usual and a determination as to whether a bankruptcy procedure would conserve value.

In companies that are not viable as stand-alone enterprises, the turnaround team must be both positioning for the best and planning for the worst. Positioning for the best requires development of a plan that can entice further infusions of capital or portray why the company and/or its assets may be valuable to someone else. Planning for the worst means preparing a detailed plan to wind down company operations, including analyzing the pros and cons of a bankruptcy filing. Both scenarios require that a lot of information be amassed, indexed, and centrally available.

In such situations, the company is likely insolvent, meaning liabilities exceed assets and equity value is gone, likely forever. The company's board, accustomed to considering shareholder value preservation first, must recognize that it owes a fiduciary duty to creditors, and must work to maximize the value of the company and its assets and therefore recoveries to all parties. This can be a hard shift to make for boards of companies. And the job of the turnaround manager is to make sure that the board and top management have been properly advised as to their responsibilities. Though some debate may exist as to the proper time frame to use in determining how to maximize asset values, with no liquidity the emphasis must be placed on a planned, orderly process, combined with clear, structured communications to all parties as to what is contemplated and why. Typically, orderliness translates into the highest possible net proceeds, a lessening of waste, and the development of the largest possible pie to divide among the parties.

Practically, it is often most effective to divide resources into two teams, with one working on "go forward" possibilities, and another dedicated solely to preparing for liquidation, sale, and/or bankruptcy filing.

In situations where survival is not immediately threatened, and the company has positive cash flow or at least liquidity resources available, there is more time to develop a detailed diagnosis and action plan. The turnaround manager performs a structured assessment to determine the company's current position, operationally, financially, and strategically. Armed with this assessment, the turnaround manager forms an opinion as to the company's viability and can start to build a plan to restore it to health.

CAN THIS COMPANY BE SAVED?

The strategic questions which must be answered early and often include the following:

- What business(es) are we in, and what are the main determinants of our success?
- What value do we provide, and to whom? Who holds the customer relationship, and how?
- What resources do we have or can we tap, and how can we best use them to improve the company's position?

The assessment study, conducted at the outset of the turnaround manager's engagement, has a dual purpose. First, it is critical to the determination of the company's current and likely near-term performance, on both a financial and an operating basis, and to an understanding of the company's strategy, its position within its industry, and the condition of the industry itself. Second, it is valuable as a benchmark for all parties involved to use to understand the nature and extent of the challenges facing the company, the time available, the actions required to address them, and the possible benefits to stakeholders in supporting the company's efforts to recover.

In a crisis situation, getting quickly to a view as to viability is critical, and the assessment focuses on the company's business definition and management, its financial and operating performance for the recent past, present, and projected near-term future, and on its capital adequacy and structure, its liquidation values, cash resources, and forecasting and management of cash flow.

In merely troubled and underperforming situations, more time can be spent on a formal process of defining the company's business or businesses, understanding the competitive environment, evaluating company performance, understanding the company's capital situation in terms of current structure, its capital adequacy, and its ability to service it, and possible alternative sources of capital. Such an analysis leads to a clear understanding of the company's strengths and weaknesses on which to build an action plan for recovery.

For a company to be saved, it must have at least one business which can be identified as a "core" business and which already is, or can be made, viable. To determine whether a company is or can be made viable requires a careful judgment call, based on answers to the following questions as they apply to the company as a whole and its component parts.

- Can the operating performance of the company be realistically and sufficiently turned around to become self-sustaining within the time available?
- Is the company's current capital situation sufficient to fund the cash flow required to achieve the turnaround, and, if not, are there reasonable alternatives available to address the capital gap?
- Does the company possess or can it add the organizational resources and skills needed to carry out the turnaround?

If the answer to all questions is clearly yes, the company is likely viable; then the next step is to develop a detailed improvement plan. If the answer to any of these questions is more a maybe than a yes, all constituents must be led to understand the assessment and be prepared to support the improvement plan knowing that the outcome is not clear-cut. In such a case, the improvement plan must include very specific, short-term benchmarks to enable progress, or lack of same, to be evaluated at *regular intervals* and understood by all parties easily.

The key guideline for any improvement plan is that it must underpromise and overdeliver. I have watched too many companies make the big mistake of a grand forecast only to find themselves forced to reforecast all too soon. By then, credibility is gone. To sustain the confidence and support of everyone in the company, reasonable performance goals must be established. In addition, though an assessment of the situation may have turned up a great deal of new information and an altered leadership style may have significantly improved company effectiveness in implementation, companies in distress are inherently unstable, and implementation of improvements requires the coordination of many moving parts. The turnaround manager must remain humble while projecting confidence, often paying as much attention to the small tasks that need to be done to enable others to do their job as to the big picture and long-term goals.

The turnaround manager's job is like being a fitness trainer to the stars—in order to help the client succeed, you can't be impressed with his or her reputation. You have to take a hard, cold look at the strengths and weaknesses and see which parts need work. Here's the checklist I use, no matter how big or small, famous or obscure, the company may be, to gauge its condition:

- ***Competitive position:*** Customer analysis; competitor and substitute analysis; supplier analysis; terms of rivalry in/structure of industry; macroenvironmental issues and influence.
- ***Human resource management:*** Top, middle, and line management assessment; operating personnel and work force analysis; recruitment, selection, training, and promotion systems analysis.
- ***Organizational issues:*** Organizational structure and legal entities; IT environment and responsiveness; accounting and control systems; performance measurement and compensation system.
- ***Financial systems:*** Cash flow measurement and forecasting; actual burn rate and break-even analysis; accuracy, timeliness, and focus of management reports; profitability analysis including the identification of key variables that affect profitability; understanding of both sides of the balance sheet.
- ***Marketing:*** Product or service line/number of products/services; distribution analysis; pricing disciplines; sales and marketing strategies, systems, measurements, costs; degree of coordination with manufacturing and R&D.
- ***Manufacturing/operations:*** Facilities and equipment analysis; systems and procedures; supplier analysis.
- ***Engineering/R&D:*** New product development process; product improvement procedures; process and productivity improvement.

AT LAST: THE PLAN

Armed with the above information, the turnaround manager can identify short- (emergency), medium- (business restructuring), and long-term objectives (achieve-

ment of strategic position and desired profitability). Such an improvement plan typically includes most of the following elements:

- Cost reductions
- Revenue enhancements
- Elimination of non-core assets and businesses
- Competitive repositioning
- Debt restructuring

The improvement plan should be as specific as possible, setting forth actions required, parties responsible, the timetable for achieving them, the method of measurement, and early-warning signs to watch for which may require adjustments.

The financial and cash flow impact of the improvement plan should be carefully delineated, starting with the outlook if no action is taken, so that all constituents understand what is at risk—and what can be gained. The impact of each identified improvement initiative should be shown layered on top of the no-action scenario so that expected impact can be clearly measured. Some improvement initiatives may hurt cash flow in the short run, and this needs to be clearly understood by all parties as well.

IT AIN'T OVER TILL IT'S OVER

Here, at the final stages of the turnaround, is where I think many otherwise talented consultants make serious mistakes. Many players in the turnaround world I have met believe that a clear and compelling plan speaks for itself: once they've set that up, the company's problems are deemed solved, their job is done, and they go home. In my experience, however, the real challenges still lie ahead. You can have the best plan in the world, but you cannot implement it without achieving broad buy-in on the part of all parties involved: the company and its employees, bottom to top, and the external constituents, including lenders, investors, and to an extent vendors and customers.

Real leadership is required in order to sell the plan, especially to the many external players who are, not surprisingly, focused on their own institutional positions and not convinced that the company's plan may be the best route to maximizing their gain and minimizing their pain. Compromises may have to be made, but if general agreement can be achieved with all parties and a clear understanding of expectations on all sides can be reached, the odds of achieving the plan's goals in the time frame called for increase substantially.

Let me give you an example of how important achieving buy-in can be. My company was recently called in to help a family-owned waste management company because the company had tripped some technical covenants even though it had not missed any interest payments. It earned less than its public company peers, and earnings trends were continuing unfavorably. Our challenge was to assess the causes of the problem and fix them, while reducing financial leverage. On the face of it, not a terribly complicated analytical challenge. But as the company's lenders, to their credit, knew from having watched other non-family advisors come in over the years and fail to achieve results, getting the company to make adjustments would be very difficult.

In this case we did not do our traditional Glass assessment as the first step. Instead we enlisted company personnel to analyze, identify, and develop proposed solutions to each aspect of the turnaround required. With approximately 100 family members involved in the company, we figured we had to present ourselves as facilitators and coaches rather than distant analysts telling them what to do with the estimable company they had built. We not only got buy-in to a very complex turnaround plan, but we had the steps required clearly set forth by the company's own people, and a public accountability system already in place since the critical players had all stood up in front of their fathers, cousins, and brothers and first identified the issues, then proposed solutions, and finally taken ownership for implementation.

This, in turn, made my company's job of convincing the lenders to back the plan relatively simple in that not only was there a detailed plan and timetable, but company management and the turnaround managers all spoke with one voice, all believing that every aspect of the plan was achievable within the applicable time and resource constraints. And the actual implementation process became simply a matter of managing all the well-oiled parts: clarifying objectives, measuring specified milestones, keeping the course and vision clear.

PICKING THE TURNAROUND MANAGER

Now that you know how to accomplish a turnaround, you may still be wondering how you pick the right turnaround manager for the job. My advice is simple: as with most of the important decisions you'll make in your personal life, if your business is in trouble, talk to the prospective turnaround manager and trust your instincts. Sure, you want someone with analytical process

and financial and operating knowledge; but you also want someone who knows how to listen to those in the company who may know what is wrong—wherever those voices may come from in the organizational hierarchy. You want someone who knows how to lead, but who also knows how to pick others to lead, who can be sometimes coach, sometimes kingmaker, sometimes just the coffeemaker.

Basically, it's what we all learned in kindergarten: pick someone who plays well with others. Because no company got into trouble all alone, nor can it get out of it all alone. As a good friend and former CEO of a Fortune 25 company said to me, "Deb, if you see a turtle on a fence post there's one thing you know: he didn't get there by himself."

...A FINAL THOUGHT

One more thing: call early. The earlier we get involved, the better the odds of success. If anticipated problems don't arise, you have gotten an unbiased assessment of your company which cannot possibly hurt you. If they do, you have increased the range of possible solutions by giving the turnaround team the most precious resource of all: time.

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