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**How to Pick the Right
Turnaround Manager**

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With headlines bombarding us daily about large companies facing unexpectedly difficult circumstances, private equity investors are beset by more than routine worries about their portfolio companies. Given the small staffs of most such firms and the clear need to attend to their healthy investments, equity investors may find it desirable to call on specialized assistance when such worries develop. But it can be difficult to know when to call for help, whom to call, and what to expect when help arrives.

In my experience the biggest threat to a successful turnaround is that companies and their owners call us in too late—when nearly all other options have been exhausted. Precious time and money have been spent and there are often few resources left to marshal a true turnaround effort.

So how can you tell when it's time to get help? Trust your gut reaction. Private equity investors are smart guys—they know when they have more than routine problems. And when those worries first crop up, it's time to make the call.

Sometimes, the fear of spending money when a company seems least able to afford it keeps people from taking that first step in getting advice. But the cost of having someone come in to do an objective assessment of the situation can be very cheap insurance. If a concerned investor or investor group spends \$150,000 to have a third party analyze the

company, two broad outcomes are likely. Either the independent firm sees no life-threatening problem, or they do. In the first case, such an objective assessment can help you fine-tune the company and improve the quality of your information about your portfolio investment. In the second case, where there *is* something significantly wrong, the company can often be saved from disaster through early intervention—for a bargain price. Either way you win.

When we get the call early, turnaround is possible. When the company waits until it tries everything else, the turnaround manager is often reduced to two unpleasant options: sell at a distressed price or liquidate. Neither is good for the private equity firm.

WARNING SIGNS OF A COMPANY IN TROUBLE

If you're alert to the warning signs of a company in trouble, you'll know when to make the call. Here are some tangible warning signs I look for:

- Cash flow problems that put the company at risk of technical default with its lenders
- Sales are flat or declining
- Customers and/or employees are defecting at higher than usual rates
- Discrepancies between what the private equity company thinks the company should be doing and what the company actually is doing

Those are clear signs that an objective assessment of the situation would be valuable. You need to know if the problem is a hiccup or some systemic issue that needs to be addressed.

But the real problems, in my experience, are the intangibles. The biggest issues we face in troubled companies are not a result of nasty lenders or radical shifts in market dynamics. The root problems are usually internal—a management that is paralyzed because it's used to dealing with growth and now there is none. This paralysis often comes hand in hand with inadequate financial systems just when the precision of the information being collected and reported is most critical. That's trouble.

Just plain "wishful thinking" also keeps otherwise smart company managers and investors from making that call and getting outside advice in time. They hope they're merely dealing with a brief period of trouble. If they wait it out, they think, conditions will return to normal.

Another obstacle is the difficulty that smart, capable people have in admitting that the company they picked as a winner might be anything less than glorious, and that fixing the problems themselves may not be the highest and best use of their skills.

To be blunt, ego can sometimes get in the way. Major company executives didn't get to the top without a certain amount of confidence and ego strength. While that's important, it can also keep them from seeing that there might be certain things someone more removed from the company might handle more effectively.

WHICH FIRM IS RIGHT FOR YOU?

Once you're ready to zero in on a turnaround firm, you'll find that the restructuring industry is a relatively small group of highly experienced players. However, the picture is cloudy at the moment because so many people without real experience and expertise are hanging up a shingle and declaring themselves to be "turnaround experts."

Look for a firm with depth of experience in working with troubled companies. You need someone who is known and trusted in the restructuring community.

The restructuring industry has three groups of players: the big accounting firms, boutique investment banks, and independent turnaround management firms. For the most part, accounting firms do financial analyses. Boutique investment banks or Wall Street investment banks if they have nothing better to do, focus on capital structure and mergers and acquisitions advisory work. Both

those groups typically work in a fairly passive analytical process from outside the company.

Independent turnaround management firms have an advantage over the other two. Not only do they have experienced professionals who can provide the same analysis and transaction assistance, but even more important, they have people with experience running companies. So their team can not only analyze the situation, they are then willing and able to dive in and implement solutions inside the company, stepping into management roles, if necessary, which accounting and banking firms typically are not equipped to do.

It's also critical to look for a track record. Look for both a firm and individuals within the firm with whom you'll be working who have experience helping companies move through difficult chapters in their histories and come out the other side successfully.

In my experience, industry expertise can be valuable, but there is typically a great deal of industry expertise within the troubled company. The skills that are in short supply are the skills that relate to mobilizing that expertise, clarifying the direction of the company, and leading all the people in the company, at every level, through difficult times. In a nutshell, the essential ingredient is leadership. Leadership and the ability to build or rebuild trust in strained circumstances.

This may sound obvious, but you need to check the reputation of each company. Consult law firms and lenders and others who've guided portfolio companies through trouble. Listen to the answers—and sometimes that you have is not said as well. When you are comfortable that you have built a list of good possibilities, arrange interviews.

HOW TO GET THE MOST OUT OF THAT INITIAL INTERVIEW

In order for the troubled company to get the most out of the interview and choose the right firm, the company and/or its owners should be ready to give the turnaround firm a description of the proximate cause of the phone call—that is, what they sense is wrong that caused them to make the call in the first place. Often it's not what is really wrong with the company, but it's a starting place.

The private equity investors should have some sense of what they would consider to be a successful outcome, seasoned with recognition that should the portfolio company make the actual engagement, the turnaround firm will need to behave as a fiduciary for the enterprise. As

the turnaround manager gets into the situation, actual definitions of success may change, but it is useful for all concerned to have some concrete vision of what outcome is desirable.

And here's what the company should expect from the turnaround firm:

- The turnaround firm should bring to the interview the people who would actually lead the engagement—complete with their bios and references.
- The firm should be able to satisfy you that they have the technical expertise and range of resources (from accounting to operating management to transactions advisory services and other specialized services) that are required to solve your specific problems.
- They should show you a sample outline of how their firm has structured similar engagements in the past and what range of fees have been incurred. (My firm typically prepares a detailed project plan, once engaged. We think it's important in managing costs, expectations, and accountability.)
- Most important, you should take a careful look at how you feel about the individual from the firm who will lead your company through its challenges. You need to feel comfortable that he/she can collaborate with you and your existing management, employees, vendors, lenders, and, we can't forget, the customers.

Good chemistry is critical. You have to feel confident that this person can lead effectively in either a behind-the-scenes consulting role or from the front lines as a designated officer, if that need arises.

In a lot of our engagements we are supporting existing managers in executing our proposals—achieved with their input—on redirecting their company. But in some of our engagements, it is necessary to replace a portion of top management. We need to be prepared to do that—and bring all the stakeholders together—to turn things around.

WHAT THE TURNAROUND FIRM SHOULD DO FOR YOU

The first thing you should expect the turnaround firm to do when they walk in the door is the same thing Bob Woodward and Carl Bernstein did to get to the bottom of the Watergate investigation: "Follow the money." In my firm, first we look at the cash situation. We track

down who in the company is controlling the cash flow—and we explore how fast it's coming in, and going out, to see the severity of the crisis and determine how much time we have to fix it.

Cash flow analysis is almost always a fundamental need of our clients. It's amazing how many companies haven't got a clue as to what's happening with their cash or how critical it is to manage cash flow intelligently. Most managements have typically delegated cash management to a fairly low level within the company.

We develop short-term cash plans—typically a rolling 16-week cash flow forecast—and we implement comprehensive cash and financial controls. We also do a quick analysis of the company's profit centers, products, and how well it uses its assets.

At the same time, we meet with company management, operating personnel, and salespeople to get a qualitative picture as well. We want to find out what's going on in the competitive environment, in the production process, in sales, in customer and employee retention.

Then we prepare a detailed work plan and a time-and-responsibility schedule. We get very specific here: we list all the immediate tasks needed to be done, who's supposed to do them, and the deadlines for completion.

Using all this information, we then prepare a comprehensive analysis of the company's situation and its future prospects. We call this the "Glass Assessment." Often, we see what those closest to the situation have missed. We present what we see as the current and likely near-term performance of the company, an analysis of its strengths and weaknesses, its position within its industry, the condition of the industry itself, and a range of alternative strategies.

Our aim is to get everyone to agree on what the problem is and how to fix it. Unless everyone understands the nature and the extent of the challenges they face, and agree upon the time available and the actions required to address them, revitalizing the company will remain an elusive goal.

Once we get everyone on board as to how to fix the problems, we work with company owners and management to decide who can best implement the plan—who can take the ball and run with it. The choice generally depends on whether management has the stomach, time, and experience to do it, or whether they need to have their skills supplemented by someone else who steers ships in storms for a living.

What many CEOs or company owners don't take into account is that despite the extraordinary skills that led them to the top spot, leading a company in crisis can be

a very different proposition. A good turnaround firm has executives with "war-zone" experience (to mix my metaphors) who can step in as CEO or CFO and can help facilitate a successful outcome, fast.

Just as it takes an outsider, at crisis points, to come in and develop a truly objective assessment of the company's problems and come up with a plan of action, it may take an outsider to execute the plan. After my firm does our assessment of the company, we then come up with a plan for stabilization—we want to get to a positive cash flow as quickly as possible.

THE BENEFITS YOUR COMPANY REAPS

Many companies ask us how they can justify hiring us when they are already strapped for cash and having trouble paying creditors. To me, that's like asking how somebody who has lost his job because of illness can afford to go to the emergency room when he has a heart attack. The company may have no other choice if it wants to survive. We like to think of ourselves as intensive care specialists.

But even if it turns out that the patient wasn't on the critical list, the truth is all of us could probably be a lot healthier than we are. And sometimes it takes the advice of an objective professional to make us take those necessary steps. Fortunately, making a company healthier translates directly into enhanced profitability and value.

Let me tell you the real reason we earn our fees: we do the nasty stuff that most CEOs can't do or don't want to do, so they can keep on doing what they do best. In one private company I worked with recently, two co-CEOs who had built the company up over 40 years knew they needed to change, but they wanted someone else to play "the heavy"; to identify and implement the needed changes. We were the bad cop and they got to continue playing the good cop. Best of all from their perspective, once the turnaround was complete and the company redirected, we went away, leaving them to their revived futures.

Frequently we can relieve an already-strained management team from the distractions involved in the restructuring process. A tremendous amount of time gets soaked up dealing with vendors, lenders, customers, creditors, and investors. You can imagine that sometimes these exchanges get quite heated. This allows management to focus on the core operation of the business.

HOW TO AVOID EVER NEEDING A TURNAROUND FIRM

If companies paid more attention to a few simple business practices, they might never need the services of a turnaround firm. Here are the most common mistakes I see companies making that sooner or later get them into trouble.

Failure to envision the possibility of failure. Most managers don't want to bring up any thoughts of failure, or zero growth or anything negative. They're too busy hoping tomorrow will be just like yesterday. Just look at the headlines of the *Wall Street Journal* and you'll see the consequences of this kind of wishful thinking. You have to game-plan for worst-case scenarios. At least one highly successful investment bank regularly does a business plan assuming every kind of catastrophe in its markets.

Misguided measurement systems. This is so common a problem that even healthy companies suffer from it. Often companies don't really know what the variables are that drive their business—and their profits—so they have set up systems that measure the wrong things. They are not accurately assessing how their company is really doing financially. How can they possibly communicate the full picture to stakeholders in the company when they haven't made the proper analysis in the first place?

Fear of discussing anything but good news publicly. It takes courage to report bad news and admit change is needed. I see this problem at all levels. From the bottom to the top, people are afraid to point out the problems, the weaknesses. Who wants to be the one to say the emperor has no clothes? When my team meets with the employees of troubled companies, you'd be amazed at how often they tell us we're the first people who have ever asked to hear what is wrong with the company. And believe me, they know.

But it often takes an outsider to ask the tough question—and be able to listen to the answers. The best turnaround firms are the ultimate outsiders who ask, listen, and then do something constructive with that information. And then leave, looking for another new challenge.

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