The protocol of a turnaround manager

This peek into a turnaround pro's playbook reveals the initiatives directors themselves can take to preempt the call for help. **BY DEBORAH HICKS MIDANEK**

CHANGE IS A CONSTANT, surprises happen all the time, and directors need to be sure they are well positioned to protect the health of the company for which they are responsible. Fine, you say, but how can we predict the future?

As a veteran turnaround manager, one who has spent her life in the returns department, I believe there are several actions boards can take routinely to reduce the likelihood of needing to call me. In most cases, by the time I arrive, options are few, much value has been lost, and the board feels helpless.

This article focuses on lessons from turnaround management practices that directors can adopt to reduce the likelihood of unwelcome surprises coming from inside the company, and to increase their preparedness to handle discontinuous events arising from any quarter. In other words, to avoid having to face the need for a turnaround manager, be your own — and, most important, do this regardless of whether there is an apparent problem or not. When things look too good they often are, and early recognition of possible trouble is the most important component involved in fixing it.

1. Understand the cash

In almost 30 years of working with troubled companies, I have never yet seen a company that has a good understanding of its cash. Executive time is typically spent on important bank and capital market relationships, and on financial reporting. Cash management is typically a clerical function, not part of regular management scrutiny. The board, not burdened with daily running the business, can assist on this, and through this *continuing* process help both management and board better understand the company's business dynamics. Greater understanding of the critical drivers of cash through the business leads to greater confidence when the unexpected inevitably occurs.

How to do this? The first thing a turnaround manager does on arrival in a new situation is to figure out as fast as possible how much cash there is, where it is, and who has what claims on it, typically working from the general ledger and actual receipts and disbursements. A rolling cash flow forecast is typically created, covering, for example, 16 weeks forward, and including receipts, disbursements, use of working capital, and taking into account major debt and capital expenditure payments.

Understanding the flow of cash allows the turnaround team to estimate how much time there is to identify and address sources of difficulty, and how broad the range of possible options might be. In one recent subprime mortgage originator situation, I arrived at a company that had $600 million in cash on its books and a board comfortable they had the resources to withstand the storm. On a quick look, all but $15 million of that cash was encumbered, payroll was in jeopardy, and an immediate filing was inevitable. A company can appear to have more than adequate resources when looked at on a financial reporting basis, but GAAP interpretation can often disguise the availability of cold hard cash. It is a very good discipline for that cash flow forecast, and related "flash reports" on key variables the board wants to track, to become part of every board package.

Deborah Hicks Midanek is president of Solon Group Inc. (www.solongroup.com), a firm she started in 1989 to work with boards, management, lenders, investors, and employees of companies facing serious difficulties. She has led a variety of businesses through strategic, operating, and financial challenges. She is a frequent speaker and author on corporate governance and turnaround management issues.

The next thing the turnaround manager does is work on creating an integrated financial model, tying the cash flow to profit and loss and to the balance sheet. Typically, financial and management reports are periodic snapshots and do not focus on constant improvement of understanding key drivers and their integration. The key is to continue actively to work on constantly improving the model against the actual numbers that the company generates. This can lead to tremendous insight and a very good early warning system that will allow both board and management attention to focus on key measures quickly, with confidence. By comparing the model to budget and actual results each month, the model not only improves in accuracy each month, but the variance analysis provides critical insight into the underlying drivers of the business and allows early identification of trends. In some instances, it may not be the model that needs to change but the process of creating the budget in the first place. These models are not difficult to build; a treasury staff member or even an outside consultant can be charged with building, maintaining, improving, and presenting them for the benefit of the board.

Sticking relentlessly at the board level to scrutinizing the iterative improvements each month to the integrated model helps deepen understanding of the business drivers that determine earnings quality and profitability. On the downside, it keeps visible such critical issues as compliance with key ratios and covenants and the dynamics of working capital usage. If a two-year rolling projection is employed, for example, it will help to identify possible crunch periods — tight covenant compliance or possible cash shortfalls — so they can be planned for well in advance. A final benefit of doing this work at the board level allows shared ownership of the information itself and active knowledge in the boardroom.

2. Go beyond the numbers to qualitative analysis — your own

Often there is a great divide between management and board, in which management generates numbers and reports, board reviews and questions, and they meet again in a quarter. Going back to the turnaround management protocol, the next thing the turnaround manager does is work on a diagnosis:

— What is this company about and where is this problem really coming from?

— What business are we in and how do we fit?

— What are the company's key strengths and how are they being deployed?

— What customer need do we really fill?

The best companies are biological organisms, constantly sloughing off old skins and morphing into something new. But, in many, what was once a strong strategic focus and framework gets set in stone and a well-intentioned management team forces all data into the existing framework. Oddly, the more successful the management team has been in the past, the more likely it seems they are to be vulnerable to this.

Directors can help protect against this hardening of the arteries, the rigidity that rejects experimentation and punishes mistakes, by playing the role of the curious outsider, walking around and listening. Are customers leaving? New ones arriving? Why? Where does execution fall short of expectations, and where does it exceed? Collect your own impressions and find ways to cut across the silos through which information typically moves. Does the information you receive match the information you require to make an informed decision?

Continuing to probe and question can provide huge benefits to a management team blessed by a board who actively understands the business and shares responsibility for its success (and, in the

Boards: Take the initiative

Here are actions boards can take routinely to reduce the likelihood of needing to call for turnaround management help:

• **Understand the cash.** GAAP interpretation can often disguise the availability of cold hard cash. Greater understanding of the critical drivers of cash through the business leads to greater confidence when the unexpected inevitably occurs. Directors can sponsor the creation of a rolling cash flow forecast that covers the forward quarter and includes receipts, disbursements, use of working capital, and major debt and capital expenditure payments. This can provide a very good early warning system that will allow attention to focus on key measures quickly.

• **Bring your own qualitative analysis to bear.** Even in the most successful companies, beliefs can get set in stone, and a well-intentioned management team can try to force all data into the existing framework. Directors can help protect against this rigidity by playing the role of the curious outsider, walking around and listening. The outsider, whether turnaround manager or director, can challenge myths when employees cannot. Far from micromanagement, this practice defines board, management, and employees as a team working together to secure continuing success.

• **Appreciate the people.** One of the *greatest* pleasures of working as a turnaround manager is to find out how very much people are capable of doing. In turnaround situations, people feel they matter hugely. Passions to try harder come out as purpose is urgent, initiative rewarded, and regimentation reduced. Turnarounds allow people to be themselves, and when people are appreciated as their most authentic selves, they can and often do achieve unbelievable things.

— Deborah Hicks Midanek

alternative, its failure). Avoid the idea that this is micromanagement and focus instead on defining an environment that includes board, management, and employees in the same equation, all driving toward the robust success of the enterprise.

In a typical turnaround engagement, the initial assessment is done by the turnaround manager as an unbiased outsider collecting data and asking questions, holding interviews with the management team and with function heads and if possible with members of the rank and file. This simple device often yields untold riches as the detached outsider asks basic questions, the answers to which are often assumed to be obvious. Day-to-day behavior and habits build up assumptions about company activities that may be untrue, untested, or out of date. The outsider, whether turnaround manager or director, can challenge stories and myths in a way that employees cannot. How many times have I heard about the company being the low-cost provider as an end in itself? Or the most modern? Or the best located? Okay, now tell me why it matters to the future health of the corporation?

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Often, companies as they mature seem to divide into two very different worlds: the world of execution, and the world of management or policy. In many cases if not most, only a handful of people cross the line between one world and another. Often CFOs have not been in the stores in decades, or the head of HR has never set foot in the plant. These divisions create communications barriers that can be invisible when times are good but can be impenetrable when times are harder. Management retreats from talking as they feel they are supposed to know the answer, and the operators responsible for execution, often feeling blamed and impotent, throw up their hands in disgust and stop trying to be heard.

In a home improvement products retailer I was involved with, I asked the store manager to tell me what his biggest problem was in 10 seconds or less. He immediately said that the distribution center had no tracking of orders so he routinely ordered carpet and got glue or spray paint. No matter how much money, therefore, the new owners poured into advertising, sales were not going to move if inventory in the stores could not be managed.

Stories like these are easy to find, and hard to believe. What is a director to do to address them? The first and easy response is to say that these issues are failures of management and that the CEO is not doing his job. Changing the CEO, however, may not have any impact on these absurdities, which are often completely invisible unless someone is actually walking around looking for them. Following the normal course standard operating procedure is typically what creates these glitches; the SOP has not changed to match new realities, but unless someone is empowered to look, ask, and see, communication about the problems they cause often goes unheard.

In an unusual response to the glitches in the home improvement retailer, the new owner of the company asked me — the incumbent and, at his invitation, continuing chairman of the board — if I would serve as an ombudsman, a blind drop box to whom employees or vendors or customers for that matter could address their concerns without regard for hierarchy or political ramifications. Once confidence in my good will and discretion was established, this actually worked pretty well as I learned how to field issues and where to go to get the causes identified and the fixes put in.

It became a badge of honor to have brought me something that could be and was fixed. The sourcing and fixing of silly problems became fun as all of us were focused not on blame but on improvement and forward motion, and as we collected them we got much better at seeing trends and fixing underlying issues as we focused the whole company on acknowledging problems, fixing them, and moving constantly toward continued improvement. And it was a wonderful example of trust-building between a nonexecutive chairman and a CEO.

3. Focus on growing the people

One of the greatest pleasures of working as a turnaround manager in often-desperate situations is to find out how very much people are capable of doing, and what remarkable achievements can occur when all are urgently pulling toward the dream of renewing the company's fortunes. If companies could access that energy and passion all the time, the value realization would be incredible.

Having seen people develop hugely when under the gun in dozens of situations, I realize it is because in turnaround situations people feel they matter hugely. Difficult circumstances cause people to look inside themselves and determine who they are and what they stand for. Blinders come off, and the perceived cost of a mistake seems low compared to the agony of inactivity. Passions to lead and risk and try harder come out in unexpected places as purpose is urgent, initiative often rewarded rather than stunted, and daily regimentation reduced.

Turnarounds allow people to be themselves, and often to be appreciated for being themselves in ways that they have never experienced before. When people feel they are being their best, most authentic selves and being appreciated and recognized for that, they can and often do achieve unbelievable things.

How to help management inspire and engage employees every day to feel valuable and appreciated for who they are? In what may seem an ironic twist, emulate the best aspects of the turnaround environment: foster growth by bringing company resources together around shared information and a shared context, a shared set of values and goals, and then encouraging them to try, to innovate, to fail, to grow, and to lead. Work actively to build an organization where people are rewarded for initiative, not punished because they're the ones who know the most about the work. Empower people to develop themselves.

The reality today is that the people doing the work know a lot more about their jobs than their bosses ever will. It is not up to the boss to tell them how to do it, and often they have options to work somewhere else. Play to their need for purpose and meaning in work, not to their pocketbooks alone. Help people to understand the significance of what they're doing and value the meaning for which they come to work every day. And help them understand that the board values what they do.

Successful companies and boards shift from a pure focus on money and numbers to understanding that the biological model drives growth. Their actions reflect the knowledge that sustained success requires tending to a living, constantly changing organism that is largely the creation of a collective imagination. They know that the company in their care is not a tangible fixed thing called ABC Corp. but an organism in which the board plays the role of farmer, dedicated to creating a rich medium for growth. A collaborative environment where director, manager, employee, work together to craft value through embracing change, welcoming problems as opportunities to learn and grow, opportunities for all to grow and realize dreams. ■

Does the information you receive match the information you require to make an informed decision?

The author can be contacted at dhmidanek@solongroup.com.