

Overview

Ten years ago, turnaround specialists were a relatively unknown breed in the business world. However, as once-stable companies struggled to maintain profitability, the expertise of corporate renewal professionals became more recognized and valued by businesses in various stages of underperformance. During an economic downturn or in an improved economy, changes in competition, cyclical financial markets and international volatility have created a climate where no business can take financial stability for granted.

Many companies have turned to downsizing and consolidation to improve their economic health. However, this has taken its toll on corporations as the ranks of managers groomed to assume top positions have been thinned. A turnaround specialist, operating as either an interim manager or consultant, may replace a company's CEO and temporarily take over the decision-making process of a company to lead it back toward stability. Or, the turnaround professional may become an active advisor to the troubled company's board of directors.

Advantages of a turnaround professional

The turnaround specialist enters a company with a fresh eye and complete objectivity. This professional is able to spot problems and create new solutions that may not be visible to company insiders.

The turnaround manager has no political agenda or other obligation to bias the decision-making process, allowing him or her to take the sometimes unpopular, yet necessary, steps for survival.

Experience within a particular industry is not as important as experience in crisis situations when a company is facing bankruptcy or the loss of millions of dollars in revenue. Like an emergency room doctor, the talent lies in making critical decisions quickly to staunch the bleeding to give the patient the best chance for recovery.

Operating in the eye of the storm, the turnaround specialist must deal equitably with angry creditors, frightened employees, wary customers and a nervous board of directors. With the highest stakes on the table, clearly this is no assignment for the faint-hearted.

Signs of a troubled business

Executives who run into corporate troubles often go through the same processes that dying people do: denial, anger, bargaining, depression and then finally acceptance. Unfortunately, most companies wait until the final stage to hire turnaround professionals, unless they are forced to do so earlier by a lender, equity sponsor, or bankruptcy court. Corporate managers who recognize and acknowledge the signs of trouble and get help in the earlier stages have a much better chance of a successful recovery for their corporation.

Most businesses in distress will display more than one of these common signs of trouble:

Ineffective management style

The president and founder of a company is unable to delegate authority. No decision, big or small, can be made without his or her blessing. As a result, the rest of the management staff is without solid experience or any feeling of ownership. Dishonesty or fraud may exist. The board of directors is nonparticipative and ineffective. If the president suddenly becomes incapacitated or dies, the entire company is in danger of collapse.

Overdiversification

The business has yielded to pressure to diversify to reduce risk. However, too much diversification causes it to spread too thin. As a result, the business becomes vulnerable to the competition.

Weak financial function

The company with its excessive debt and inadequate capital is operating with little or no margin for error. Its credit is overextended and fixed assets and inventories are excessive.

Poor lender relationships

Its weak financial position has led to the company developing an adversarial relationship with its lending institution. Fearing that its loan may be in jeopardy, the company tries to hide financial information from the bank. Phone calls are not returned. Reports stop being filed. Since money is the lifeblood of most any business, this kind of lender relationship only leads to more trouble.

Lack of operating controls

The company is operating without adequate reporting mechanisms. This is like flying an airplane without an instrument control panel. Management decisions based on old or inaccurate information can head the company in the wrong direction.

Market lag

Changes in the marketplace have bypassed the company, leaving it with sagging sales and lost market share. For some, the deficiency is technology; their equipment or products and services have become obsolete. For others, the problem lies in sales and marketing; the company hasn't kept pace with the needs of the marketplace.

Explosive growth

The business is growing rapidly. A business that is a success at \$5 million in sales a year can become a dismal failure at \$10 million. Companies achieving fast growth from concentrating on boosting sales overlook the effects of growth on the balance sheet. Growth often carries a very high price tag from significant investments in R&D. Leveraging a company to such a degree means that management must operate with little or no margin for error.

In addition, growth has led to overrunning the people capacity. Staff is not able to work successfully at the new level. For example, managing engineering operations for a company with 12 plants is much different than managing one with two plants. The same challenge applies to others in key positions in marketing, sales, operations and manufacturing. A company can grow beyond its ability to manage.

Precarious customer base

The business relies on a few big customers for most of its sales. If a manufacturer selling to large retail chains has two customers representing 60 percent of its business, the company is obviously vulnerable. The loss of just one customer could put hundreds out of work and send the business into bankruptcy.

Family vs. business matters

Family issues are causing decisions to be made based on emotions, rather than sound business judgment. Sibling rivalry has ruined many privately-held companies. Deciding which relative should run the business after the founder's retirement or death can be one of the most difficult challenges a business can face. Divorce can also shatter a business, leaving it in fragments. Nepotism can cause bright, skillful

managers who aren't part of the family circle to take their talents elsewhere.

Operating without a business plan

The growing company is operating without a business plan. Armed with 15 or 20 years in the business, management often operates by the seat of its pants. Its plan may change overnight because the plan is based on management's own "feel" for the market. In some cases the business plan exists in everyone's head rather than in writing. The result is that plans are carried out according to individual interpretation.

Stages of a turnaround

Stage One: Changing the management

Most CEOs or company presidents don't relinquish power easily. Often their egos make it hard for them to admit such a downturn is really happening or that they are unable to pull the company out of its nosedive. So, usually the first step is to put into place the top management team who will lead the turnaround effort. In many instances, the board of directors selects and hires the turnaround specialist, although others, such as bankers and corporate attorneys, may also be involved. As an outsider rather than a corporate insider, the turnaround specialist enters the company carrying no political baggage.

During this stage or after Stage Two—situation analysis—steps are taken to weed out or replace any top managers who might impede the effort, including the CEO, CFO or weak board members.

Stage Two: Analyzing the situation

Before a turnaround specialist makes any major changes, he or she must determine the chances of the business's survival, identify appropriate strategies and develop a preliminary action plan.

This means the first days are spent fact-finding and diagnosing the scope and severity of the company's ills. Is it in imminent danger of failure? Does it have substantial losses but its survival is not yet threatened? Or is it merely in a declining business position? The first three requirements for viability are analyzed: one or more viable core businesses, adequate bridge financing and adequate organizational resources. A more detailed assessment of strengths and weaknesses follows in the areas of competitive position, engineering and R&D, finances, marketing, operations, organizational structure and personnel.

In the meantime, the turnaround professional must deal with various groups. The first is angry creditors who may have been kept in the dark about the company's financial status. Employees are confused and frightened. Customers, vendors and suppliers are wary about the future of the firm. The turnaround specialist must be open and frank with all these audiences.

Once major problems are identified, the turnaround professional develops a strategic plan with specific goals and detailed functional actions. He or she must then sell it to all key parties in the company, including the board of directors, management team and employees. Presenting the plan to key parties outside the company—bankers, major creditors and vendors—should regain their confidence.

Stage Three: Implementing an emergency action plan

When the condition of the company is critical, the plan is simple but drastic. Emergency surgery is performed to stop the bleeding and enable the organization to survive. At this time emotions run high; employees are laid off or entire departments eliminated. After sizing up the situation objectively, the skilled turnaround leader makes these cuts swiftly.

Cash is the lifeblood of the business. A positive operating cash flow must be established as quickly as possible, and enough cash must be raised to implement the turnaround strategies. Often, unprofitable divisions or business units are unloaded. Frequently, the turnaround specialist will apply some quick, corrective surgery before placing them on the market. If the unit fails to attract a buyer in a given time frame, liquidation occurs.

The plan typically includes other financial, marketing and operations actions to restructure debts, improve working capital, reduce costs, improve budgeting practices, correct pricing, prune product lines and accelerate high-potential products.

The status quo is challenged; those who change as a result of the plans are rewarded, and those who don't are sanctioned. In a typical turnaround, the new company emerges from the operating table a smaller organization but one that is no longer losing cash.

Stage Four: Restructuring the business

Once the bleeding has stopped, the losing divisions sold off and the administrative costs cut, turnaround efforts are directed toward making current operations effective and efficient. The company must be

restructured to increase both the profits and return on assets and equity.

In many ways, this stage is the most difficult of all. Eliminating losses is one thing, but achieving an acceptable return on the firm's investment is another.

The financial state of the core business of the company is particularly important. If the core business is irreparably damaged, then the outlook is bleak. If the remaining corporation is capable of long-term survival, it must now concentrate on sustained profitability and the smooth operation of existing facilities.

During the turnaround, the product mix may have changed, requiring the company to do some repositioning. Core products neglected over time require immediate attention to remain competitive. In the new, leaner company, some facilities might be closed; the company may even withdraw from certain markets or target its products toward a different niche.

The "people mix" becomes more important as the company is restructured for competitive effectiveness. Reward and compensation systems that reinforce the turnaround effort get people to think "profits" and "return on investment." Survival, not tradition, determines the new shape of the business.

Stage Five: Returning to normal

In the final step of the turnaround, the company slowly returns to profitability. While earlier steps concentrated on correcting problems, this one focuses on institutionalizing an emphasis on profitability, return on equity and enhancing economic value-added. For example, the company may initiate new marketing programs to broaden the business base and increase market penetration. The company increases revenue by carefully adding new products and improving customer service. Strategic alliances with other world-class organizations are explored. Financially, the emphasis shifts from cash flow concerns to maintaining a strong balance sheet, long-term financing, and strategic accounting and control systems.

This final step cannot be successful without a psychological shift as well. Rebuilding momentum and morale is almost as important as rebuilding the ROI. It means a rebirth of the corporate culture and transforming the negative attitudes to positive, confident ones as the company maps out its future.

Judging the success or failure of a turnaround

Of course, not all turnarounds succeed in the manner outlined here. A company may put a quick end to its disastrous losses but never quite attain an acceptable return position. When this occurs, management may decide to sell the business to a company better able to produce an acceptable return on the funds invested. In a sense, this is not failure at all. The company may very well thrive and reach new heights under different ownership. Here, the turnaround manager can play a key role in identifying prospective purchasers and then negotiating a successful sale.

Ironically, some companies never reach Stage Five because of significant success in the earlier steps. The turnaround becomes so successful that the company becomes a target of a takeover bid. Again, this must not be viewed as a failure. The company was saved and continues to perform well with stronger sales than ever before.

Choosing a turnaround professional

For a troubled company, no decision may be more crucial than hiring a turnaround manager. Yet, with all the pressures and distractions taking place within the company, this decision comes at the worst possible time.

Questions to consider

- ▶ What length of time is expected for the services of a turnaround specialist?
- ▶ Can the company pay the turnaround specialist's fees?
- ▶ Will other specialists be brought in by the turnaround manager?
- ▶ Will the rest of the existing management team be able to work with the specialist?
- ▶ What exactly is expected of the turnaround specialist?
- ▶ Are the goals in writing?
- ▶ What are the chances of success in turning around the company?
- ▶ Is the company willing to let an outsider liquidate or sell key units of the business if necessary?

Key factors in making the right choice

Background

Experience is the most important credential. MBA degrees and CPA designations count for little if the turnaround manager does not have a proven track record. The candidate should be able to produce a portfolio of success stories and satisfied clients.

Ethics and professionalism

Membership in the Turnaround Management Association indicates the degree of professionalism and honesty of a candidate. TMA holds members to a strict Code of Ethics, and all members whose profiles are listed in this *Directory* have signed a statement acknowledging the TMA Code of Ethics.

TMA also encourages certification by the Association of Certified Turnaround Professionals as a further demonstration of expertise and commitment to the corporate renewal industry. The Certified Turnaround Professional (CTP) designation indicates that a turnaround specialist has met specific standards of education, experience and professional conduct and has successfully completed a rigorous written examination.

Reputation

No turnaround manager can expect to succeed without quickly gaining the confidence of creditors as well as accessing new sources of credit. Check the candidate's reputation with leading bankers, attorneys, accountants, financial advisors, factors and trade creditors.

Managerial skills

As the chief architect and implementer of new strategies, the turnaround specialist must be an organizational leader. Look for a person of action, with entrepreneurial instincts, "hands on" experience, and interviewing and negotiating skills.

Fee structure

Make sure the fee structure of the turnaround specialist is clear and fair. A company should make sure it can afford such a service or else it may be trading one set of problems for another. Find out if there is an incentive or performance arrangement in the contract.