

Distress is painful: delay, deadly

The current economic crisis will put additional pressures on already struggling companies. But how do the stakeholders, be they Management, Directors, Debt Holders or Equity Participants, determine whether to bring in external help?

And, if so, when?

Ask any seasoned Interim or Turnaround Manager why distress is painful: simply put, there's a huge amount to do, inadequate and/or insufficient resources and time available, and frequently people are focused on doing things that are not top priority. Making an accurate assessment of the challenges, getting to know what needs to be done, and forging stakeholder agreement are all critical.

Probe deeper and ask why things don't always go smoothly once the agenda is set. Even when you agree what could help resolve the complex issues burdening the company, denial, prevarication or obstruction by or between the stakeholders can easily constrain the speed with which the turnaround can be started, let alone executed.

Early challenges include: getting a clear understanding of the situation; understanding how long things have been deteriorating; discovering what has prompted action now; and finding out whether the person giving the brief was in possession of all of the relevant facts. Generally, the bigger the organisation, the more likely it is that perceptions will differ as to the correct interpretation of the same body of fact.

Even once the stakeholders commit to an agreed turnaround plan, there may still be further factors which delay recognition of the extent of the issues confronting the business; and an Interim or Turnaround Team may find themselves restricted from taking even modest risks because of an urgent need to operate within tight banking covenants and closely-monitored headroom.

The Turnaround Team may also have to fight hard to win the confidence of stakeholders, including employees, and to manage customer and supplier expectations through a period of considerable change.

This results in more pain

Given a situation with many of these factors, the number of issues compounds and, unless they have had prior experience of a distressed situation, few stakeholders understand how much the pace of deterioration can accelerate and how rapidly the decline curve can become steeper with the passage of time.

As the company's fortunes begin to decline, so do performance drivers: typically morale worsens, staff and management turnover increases, customer service levels decrease, operational issues emerge, levels of profitability become unacceptable, cash becomes scarce and working capital requirements increase. In severe cases, products may become uncompetitive or obsolete due to lack of investment, key customers and contracts may be lost, and key suppliers may withhold supplies, or move swiftly from standard payment terms to cash-with-order. Cash flow starts to run the business, confidence levels are shaken and relationships with creditors and backers alike can become adversarial.

Unless assertive, operational action is taken very quickly, reinforced by solid financial backing, then it follows that control of the business may well be wrested away from the directors and the value of returns to the stakeholders will decline rapidly.

. . . and here's an example:

A private-equity-backed national wholesaler had failed to deliver the expected synergies from a recent merger. A new CEO, the 5th in 3 years, was appointed to stabilise and regenerate the business and an Interim CFO was recruited, initially for a 3-6 month period.

- During this period the accounts for the previous year - - which were more than 6 months behind schedule - - were to be closed, cash forecasting and management disciplines were to be introduced and the business was to be subjected to two independent accountant's reports: one for its senior lenders, and one for the private equity house.
- During the first 3 months, however, the CFO uncovered a £2.7m black hole in net current assets on the balance sheet, an undisclosed long-term liability of about £20m and significant record integrity issues between physical and financial entries in the IT systems. Furthermore, an assessment of the break-up value of the business showed that the positions of both the PE investors and the senior lenders were under water.
- A new business plan was prepared, primarily by the CEO and CFO, which focused on the growth of internet fulfilment in order to compensate for volume reductions in sales to traditional high street retailers. This won a prompt injection of fresh equity, as well as the backing of the senior lenders who agreed to continue their support, provided that improved cash forecasting was implemented and facility headroom limits were adhered to strictly.
- Negotiations were successfully undertaken to reduce the burden of an inherited, onerous lease and a debt-to-equity swap was arranged, both of which factors strengthened the balance sheet. However, this was insufficient to prevent credit insurers from withdrawing cover from the group. With the backing of the board, the CFO began negotiations of self-insured trade terms

with leading suppliers in order to ensure orderly trading continued throughout the seasonal peak period.

- Before his term was completed, the Interim CFO assisted a further new CEO to settle into the business. He also recruited a well-qualified successor, who stepped in to a more structured and manageable CFO role. The Finance team was strengthened by the creation of an analytical, business support resource and by the recruitment of a strong Financial Controller.

The final outcome was highly successful, but the Interim CFO's assignment, along with a return to profitable trading, had taken 25 months.

A less painful approach to distress

If you think you're doing everything right, but the numbers don't reflect that, it's time to go back to basics. Double-check that operational and financial statistics start from common ground and that both reflect the actions being taken to achieve operational excellence.

If the numbers are still not right, or if things are starting to go badly wrong, it may be preferable to bring in a Turnaround Manager or an Interim until the situation is stabilised, rather than take the risk of hanging on in there.

As with any walk of life, there are times when it pays to seek out specialist help from someone who's training and experience equips them to work well in a specific field: they will almost always outperform those for whom this is uncharted territory.

. . . which is helped by . . .

Interims and Turnaround Managers have the added advantage of not being wed to any of the historical mental frames that inhabit most businesses. Their focus is on a successful outcome for the company or the stakeholders, so they are not necessarily bound to existing strategies or emotional ties. They are often able to ask pertinent questions based on their experience which may help to identify disconnects between the activity and the reported data.

By bringing a fresh pair of eyes to bear on what are often recurrent challenges, they can develop synthesised, strategic solutions, empower stakeholders and build significant long-term value.

. . . and here's an example:

The MD of an online retailer saw a significant reduction in sales volumes during the 2008-9 economic downturn. He identified the threats to profitability, and of potentially being subject to severe cash

constraint. Had the trend continued the business would have been at risk, so he approached a Turnaround Practitioner to work alongside him and develop a restructuring plan.

Analysis of the business situation showed clearly that the product range had been extended too far, which contributed to cash flow difficulties and depressed profit margins.

Product lines were therefore rationalised in order to remove unprofitable or slow-moving items. More realistic assessments of future business were made and headcount was adjusted. This approach meant that only one round of redundancies was necessary, which helped the company get into recovery mode more quickly and resulted in less uncertainty amongst employees. The automated web platform was replaced in order to make it more responsive and cost-effective and advertising agreements were improved. Improved planning also led to a reduction in inventory and eased the cash situation, whilst further strategic and tactical improvements were also implemented.

This allowed the business to trade profitably and positioned it well to capture market share when the economy rebounds.

Spot the difference!

We know that each turnaround case is unique, but there are some common themes that foster success. Top amongst these are vigorous implementation, and the use of a large number of wide-ranging turnaround strategies.



In both cases above, difficulties were successfully overcome. However in the second example, where management took proactive steps to deal with a situation before it started losing control, the turnaround in performance was more structured and far-reaching than it might have been had the situation deteriorated further. Additionally, the business was proactive in its attitude so all the effort was spent on improvement, rather than on overcoming inertia or denial.

Lessons to remember

What you see in the numbers may not always reflect reality. There is merit in having an experienced eye look over the financial reporting process, and in particular marrying short-term cash forecasts with medium-term sales and margin ambitions.

Turnaround specialists tend to have well-honed antennae which help them identify the true root-causes of a firm's difficulties, bring broad experience, objectivity, lateral thinking, common sense, the courage to speak their mind and a willingness to act on their own initiative. Their skill is in knowing what is going to make the most impact . . . and then getting on with it.

It takes courage for an executive board to call for help from an external source - - and sometimes they need to be prompted to do so by other stakeholders - - but the earlier that operational and financial difficulties are recognised and an Interim or Turnaround Manager is engaged, the better are the chances of survival.

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