

Managing a Successful Turnaround ...

Even in Tight Capital Markets

By Carlos Rojas

The team navigating a turnaround must go way beyond reducing headcount alone and focus on seven steps to change the company's direction and improve its cash flow and profitability.

Today's businesses are operating in a tighter capital environment, one in which investors no longer have the appetite - nor ability - to fund several years worth of operating losses. Some companies have invested in organizations and infrastructure anticipating market demands that have not yet materialized; others have experienced explosive growth beyond their ability to manage profitably; while still others are operating with inadequate financial and operational controls.

With this as backdrop, many companies are finding it necessary to radically change direction and strategy to improve profitability - often resorting to layoffs alone, when much more is needed. What follows are seven key actions for successfully changing a company's direction and improving its cash flows.

1. Control Cash

A management team attempting a turnaround must get a firm grip on cash disbursements and receipts. To begin, the CFO or controller must identify all disbursement mechanisms and ensure that no payment occurs without their knowledge and consent. Understanding the cash outflows enables the turnaround team to identify potential areas for cost reductions. It also sends the message to the organization: It is not business as usual, and the old spending patterns and capital projects must be re-evaluated.

Often, expenditures that remain "in the pipeline" - from earlier times, when capital was more plentiful and growth projections more liberal - present an outstanding

opportunity to save cash. And while such attention to disbursements may slow the accounts payable process, gaining a quick understanding of the business and its cash flows is vital and worth a temporarily lengthier A/P cycle.

In one turnaround engagement, a daily expenditures meeting was held with the department vice presidents, where expenses and capital outlays were approved. The first 30 days were quite intense - with requests coming in for additional expenditures on cancelled projects. Well-intentioned managers believed the spending was necessary to wind up the projects, and the meetings provided a forum for discussing necessities, given the company's new realities.

Some expenditures were approved - those that were consistent with the company's long- and short-term needs. Over time, the need for meetings decreased as managers "took up the cause" and actively sought opportunities to save cash. Through the executives' efforts, the company reduced monthly operating expenses 46 percent over a one-year period.

2. Evaluate Accounting and Financial Reporting Systems

Every business needs accounting and operational data disseminated to its management team in daily, weekly, monthly and quarterly reports. Failure to produce or distribute management and financial reports is a significant internal control weakness. Yet, it's not unusual for outside turnaround consultants to find million-dollar ERP systems and reams of operational data - along with the absence of a cogent daily and weekly reporting package that tells management how the business is running.

The turnaround team needs to determine whether the accounting and reporting system produces the necessary data to produce management reports needed to run the business, and if it accurately captures all the transactions entered into by the company and lists all of its assets and liabilities. Often, the existing software is adequate but the system is not configured to provide the needed data. In those cases,

configuring the software can be quickly accomplished.

In one turnaround engagement, future purchase commitments were not being tracked. A commitment and contingency report was prepared and circulated among the company's top 10 managers to ensure that all such commitments were reported. Senior management then used the completed report as a checklist to re-negotiate the terms of the agreements that gave rise to those contingencies.

3. Focus on Strategic Solutions

Turnaround situations present many tactical challenges, and often the most pressing issues facing a turnaround team are matters pertaining to basic customer service needs. In such an environment, it is easy to become focused on operating issues and omit strategic planning. To be successful, however, the team has to concurrently address the daily tactical issues and conduct a strategic review.

The purpose of such a review is to articulate a new strategy whereby the company will grow revenues and be cash-flow positive. Two key review ingredients include: 1) participation from the organization's chief sales, marketing, technical, human resources and finance managers; and 2) the new or revised strategy has to be actionable using existing headcounts and capital resources. The team has to resist strategies that require significant new inflows of capital - in the midst of a turnaround, new debt or equity inflows may not be available to the company.

Management may conclude that the best way to make the company cash-flow positive is to merge it with a complimentary business. Once that decision is reached and approved by the board of directors, it must be pursued immediately.

In a turnaround engagement, a strategic review was completed within 60 days, and new products were launched and new markets opened within 120 days. Such actions resulted from the strategic review findings, showing that a portion of the company's revenue-producing assets were

underutilized and there were not associated product offerings in the pipeline. The revenue growth generated by the new products and markets later became important evidence to potential investors that the company was growing in an environment where competitors were experiencing decreasing revenues.

4. Know the Size of the Market In the current environment, many companies undergoing turnarounds are doing so because marketing plans were based on outdated or conjectural market data. In many cases, marketing plans were directly based on institutional reports, without attempting to "regionalize" national statistics or perform additional work to corroborate the issuing institution's conclusions. Accordingly, the technology that was put into place functions as designed but there is a shortfall in customer demand or product pricing.

The turnaround team needs to carefully gauge the existing demand for the products and services being offered. Two questions that must be answered by senior management include: "What is the size of the market?" and "What share of the market does the company service?" A follow-on question is, "What additional market share will be gained and how?" Correct decisions for allocating capital and personnel resources can only be made knowing the size of the market, the share of the market the company currently services and how much of the market it can capture.

The turnaround team needs to quickly quantify the company's market size and identify its market share to determine what products will drive revenue growth. Even though a company may divest unprofitable products, subsidiaries or divisions, it needs to show growth and the potential for further sales growth in its core products. Such growth will send a message to vendors, creditors, investors and employees that the company has a future if they tough it out. In such cases, commissioning a market study by an industry-wise consulting firm may be warranted.

5. Clean Up the Balance Sheet

Focusing on the balance sheet allows the turnaround team to realize hidden value in the business, as well as identify and mitigate financial risks. The team should take steps that are consistent with the turnaround strategy, to generate as much liquidity as possible from receivables, inventories, intangibles and fixed assets. The quicker it can evaluate collection policies and inventory levels and rationalize fixed assets to the new strategy, the quicker that liquidity-enhancing transactions can be completed.

Customers will bristle at more aggressive collection policies, but as long as the company's collection policies are within industry practices and communicated clearly and honestly, these policies should not impair relationships. In many cases, cash flows can be improved without impacting collection policies.

Evaluating accounting controls and procedures pertaining to the revenue cycle are especially productive in terms of identifying "lost" revenue opportunities. (In one engagement, \$70,000 dollars per month of revenues was identified as never being billed to customers, and adjustments to the billing system eliminated that revenue leakage.)

To identify and mitigate these risks, the turnaround team should first evaluate the adequacy of all valuation accounts. Next, fixed assets and intangibles should be evaluated for impairments. While impairment charges will not affect cash, they may impact debt covenants. Another area is the adequacy of tax liabilities, including property and sales taxes. Should tax contingencies be identified, many taxing jurisdictions have voluntary amnesty programs that forgive penalties and/or interest on outstanding taxes.

Once the team begins the due diligence process to either sell the company or obtain additional funding, the importance of a clean balance sheet becomes clear - because prospective investors will focus on the balance sheet to evaluate the company's strengths and weaknesses.

6. Change Processes to Increase Productivity

New visions and strategies that are implemented as part of a turnaround generally entail "having to do more with less." While an organization can produce short-term productivity improvements through the "adrenalin rush" of a leadership change, only by changing processes can productivity gains be maintained.

Changing policies and procedures is laborious and requires detailed knowledge of products, delivery systems, personnel qualifications and operating assets. Knowledgeable middle managers are key in a turnaround because, given the limited time window available, shareholders do not have the time necessary to hire a consulting firm and bring in dozens of consultants to learn the business and make recommendations.

Middle managers need to understand the importance of the process they are undertaking. Conveying the urgency for the turnaround is always a fine art; the turnaround team wants to convey a need for change without sending a doomsday message. Besides realizing what needs to be accomplished, middle management also needs to be convinced that the restructuring is necessary. This obligation to "convince" them falls on the CEO and his or her direct reports.

7. Communicate Clearly

One risk facing the turnaround team is that employees, customers, vendors and creditors may retain the company's legacy message. Often, the new message will be transmitted clearly to the first line of executives, but as the message percolates to the middle-manager level - those with relationships with vendors - the message may get diluted.

Mixed messaging is detrimental to the turnaround because it increases the risk that unnecessary expenditures may occur causing confusion both internally and externally. With all of the operating changes implicit in a turnaround, it is important to provide crisp messaging and eliminate excess "static." The turnaround team has to provide the leadership, press releases and

scripts to ensure that a consistent message is delivered to employees, customer, vendors and bankers.

During the process, the company cannot afford deterioration of its customer base. Thus, communicating with customers and taking steps to retain their business is key for the turnaround's success. It's up to the CEO to communicate the effects of the turnaround on service delivery to customers, and for key accounts, a personal visit is often required.

Effectively forecasting the effect of turnaround plans on customers, and honestly communicating such effects, is vital for retaining customer trust during this difficult phase of a company's evolution. Thus, it is advised to vet both internal and external communications with a public relations professional who is familiar with the company and its history - one who can assist in articulating the new scope of the company's operations for both press releases and internal employee communications.

Depending on the company, one or another of the seven points described above may play a larger role in favorably influencing the turnaround. Two denominators that apply to all seven are authority and speed. Those executives leading the turnaround must have the full backing and authority of the board of directors, and swift action is necessary to stop cash losses and begin the process of restoring confidence with employees, customers, vendors and investors.