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2005/02/09 12:00:00 AM

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Better to analyse and reinvent than to rush into liquidation

Philip Reynolds

A SHIFT in thinking is taking place as banks and creditors realise you can get a much

better return from a well executed business turnaround than a hasty liquidation. It is a topical issue in SA, with legislation pending, an inquiry into the insolvency industry under way and major concerns about job losses always on the agenda.

Businesses today face unique challenges caused by rapidly changing financial and market conditions and the pace at which technology is developing. Participation in global markets and free trade brings with it both opportunities and threats, while the market forces of capitalism and the pace of change make even successful businesses vulnerable. Businesses need to be reinvented constantly to remain ahead.

Managers often blame business decline on external market changes, while the major causes of business failure often lie in the internal elements of a business — finance, operations and marketing. Managers have direct control over these functions and are the force that drives them, yet 80% of business failures are caused by management's inability to control them.

Through scenario planning managers can plan for changes in the external environment to safeguard their businesses. It is important to monitor changes such as economic growth; market dynamics; price-level changes; technological changes that allow rapid breakthroughs and changes in products; production and marketing/distribution; sociocultural changes that alter consumer preferences; purchasing patterns and the conditions under which a product can be sold; and legal and political changes that can adversely affect production, sale and distribution.

Coming to grips with the effects of the internal and external business environments is a necessary first step towards identifying the symptoms and causes of business decline. Turning the business around can then begin.

Often a turnaround is regarded as a cost-cutting rather than a revenue-expanding exercise. In some cases, costs can be cut, but the real focus needs to be on building brand awareness and developing product mix.

There are several aspects that are vital to the success of a business turnaround. The most important is that the business must have a sound core that can be saved: a saleable product or service, a proven market, operating assets and capable personnel. The turnaround also needs the leadership of competent management, capital for use throughout the process, and the trust and support of the company's stakeholders.

Long before a business starts to decline, warning signals start flashing, but managers often do not notice the red lights, or they ignore them. Often the call to save a business will come too late — a few days before salaries need to be paid, for example. The alarm needs to be sounded in good time to allow

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for expert restructuring. The earlier the necessity for change is realised, the less painful the turnaround will be.



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Credibility with banks is generally destroyed by the time a crisis is reached. Third-party specialists can go a long way to facilitating those relationships. The most important challenges for a business in distress are time and money. If ways can be found to buy time and manage the capital and cash-flow issues, the business will have an opportunity to recover.

Closure must be seen as a last resort as the liquidation process destroys value and jobs. Communication and working with the trade unions and labour are also essential to the restructuring of the workforce for a successful turnaround.

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Saving jobs is a priority for government and, through new legislation that forms part of the proposed business administration act, government is moving towards supporting businesses in distress by providing a mechanism that allows time to refinance. The proposed law will hopefully allow businesses to buy time with a legally enforced moratorium on claims, a process that is done informally at present through agreements with banks and creditors.

During the moratorium, trade will need to be funded, and the business will need to provide a well-considered plan to indicate to lenders exactly what the problem is, how much funding is needed and when they are likely to be repaid. Most banks will not be willing to commit additional funds unless the plan is valid and based on realistic projections of a business's ability to sustain itself after the turnaround.

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The impartial input of consultants and their ability to make tough decisions are a vital part of the process. But they are not doers, they are facilitators. They simply lead the thought process helping the people close to the business to arrive at the right conclusion. The success or failure of a turnaround rests on the shoulders of the company's most valuable assets not shown on any balance sheet: its leadership, owners, management and employees. It is on their effort, performance, credibility and commitment that the turnaround specialists, lenders, creditors and the marketplace ultimately rely.

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□ Reynolds is partner, reorganisation services, at Deloitte.

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