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MANAGING TURNAROUND

"A turnaround is to produce a noticeable and endurable improvement in performance, to turnaround the trend of results from down to up, from not good enough to clearly better, from underachieving to acceptable, from losing to winning."

Stanley J. Goodman.[1]

Introduction

Turnarounds, according to the above definition, can apply to almost anything - a life, a company, a country, even a continent. Have you ever studied the turnaround of Singapore? At independence, in 1965, the income per capita of that island state was less than US$1 000. Today this figure is US$30 000, and the country has the world's number one airline, best airport, busiest port of trade and is a world leader in oil refining and publishing.[2]

The Treasury Department and the South African Revenue Service are recent examples of tremendously successful turnarounds in South Africa. Finanzauto SA, the Caterpillar distributorship in Spain and Portugal, which was acquired by Barlows in 1992, and NF Die Casting in Alrode were turnarounds in the 1990's that I regard as classics. NEPAD is a recovery programme aimed at an entire continent. Examples of turnarounds with global impact include IBM, Harley Davidson, Selfridges and, recently, Puma.

You must have heard people imply that turnarounds, or perhaps a particular turnaround, are easy. The assumption is that something was in such bad shape that it could only get better. Such statements are complete nonsense. Physics teaches us that the momentum of a troubled business is down not up. There are no easy turnarounds. Some are just less difficult than others.

I will now attempt to cover some of the fundamentals of turnarounds in brief sections: How turnarounds differ; Causes of business decline; Stages of a turnaround; Viability assessment; Turnaround tools and techniques; and the South African situation. Each of these sections could be an article in itself. I will, therefore, do an outline analysis and add in comments or highlights which I believe will be of interest to readers. What follows is based primarily on business turnarounds. Some of the practices, however, and I repeat *some*, can be applied to many fields of endeavour.

How turnarounds differ

A turnaround may not be that different from the management of a 'normal' business in terms of ultimate objectives, i.e. providing value to shareholders, customers, employees and other stakeholders, but it is the getting there that is different.

The major differences between a turnaround and a normal business include the following:

• A different type of leadership is usually required. "Turnarounds require a different breed of cat from a management standpoint than do more prosaic, stable business situations. That doesn't mean turnarounds require Clark Kent's better half. Rest assured that most turnarounds are accomplished by mortals, even rather ordinary mortals, who have certain strengths and, as in most mortals, weaknesses. No matter how awesome the task may seem, the turnaround job will yield to an organised approach. But that organised approach must be directed by a strong leader. Turnaround executives insist that distressed businesses require, perhaps, two or three times as much hands-on management as more stable companies."[3]

• The CEO and management will be under more pressure because the turnaround has to be done in addition to 'normal' ongoing management. (They really have three jobs - the ongoing task of 'normal' business plus the intensive management required by turnarounds and the intensive attention required for stakeholders - including, sometimes irate, shareholders and creditors and frightened employees.)

• Required actions are usually more severe because of actions not taken in the past.

• Faster decisions and actions are generally required because of the critical situations prevailing.

• There is generally less margin for error but also higher consequences of error.

• A different set of legal circumstances and risk.

• The situation will usually be worse than thought. It is often difficult to accept the enormity of approaching calamities, especially by those who were incumbent while the bad situation was developing. Sales forecasts of companies in trouble are notoriously off the mark.

Causes of business decline

Table 1 below lists internal and external factors which can cause corporate decline. In practice many of these are interrelated. One factor that is not explicitly listed is a product, or service, that is not competitive. Poor management is universally regarded as the leading cause of business decline.

When one considers the environmental factors - economic, socio-cultural, global, technological, political/legal and demographic - there are myriad variables that can change, either favourably or unfavourably, for a company. The situation is even more complex when Porter's Five Forces: threat of new entrants, power of suppliers, power of buyers, product substitutes and intensity of rivalry, are considered.

TABLE 1: CAUSES OF CORPORATE DECLINE

Internal Factors	External Factors
1. Management	Competition
2. Board of Directors	Changes in market demand
3. Inadequate financial control	Technological change
4. High cost structure	Commodity prices
5. Outdated technology	Government policy
6. Lack of marketing capability	Strikes
7. Excessive diversification	Bad luck
8. Loose information systems	Social change
9. Poor acquisitions	Environmental factors
10. Inappropriate financial policies	Industry factors
11. Overtrading	
12. "Big" prospect or deal	

SOURCE: Donald B. Bibeault (1999) *Corporate Turnaround*. Washington DC. Beard Books; G.C. De Bruyn (1990) *Corporate Decline and Recovery*. Lausanne, Switzerland. Business School Lausanne; and Stuart Slatter and David Lovett (1999) *Corporate Turnaround*. London, UK. Penguin Books.

Stages of a turnaround

It is possible to segment the turnaround process into different stages. These stages may overlap and work may be done on more than one stage at a time.

1. Recognition of the need for a turnaround.

2. Rapid appraisal of the situation.

3. Crisis management and emergency actions.

4. Stabilisation phase.

5. Detailed analysis and recovery plan development.

6. Rehabilitation or 'return to normal'.

Two other categories encompass all six of the above:

7. Management of stakeholder relations.

8. Implementation, delivery or 'getting it done'.

These stages are partly illustrated in the following two figures from Morris, Anderson and Associates, a leading US turnaround consultancy.

Early recognition of the need for a turnaround is one of the key factors for successful turnarounds.

FIGURE 1:

TURNAROUND FLOW CHART

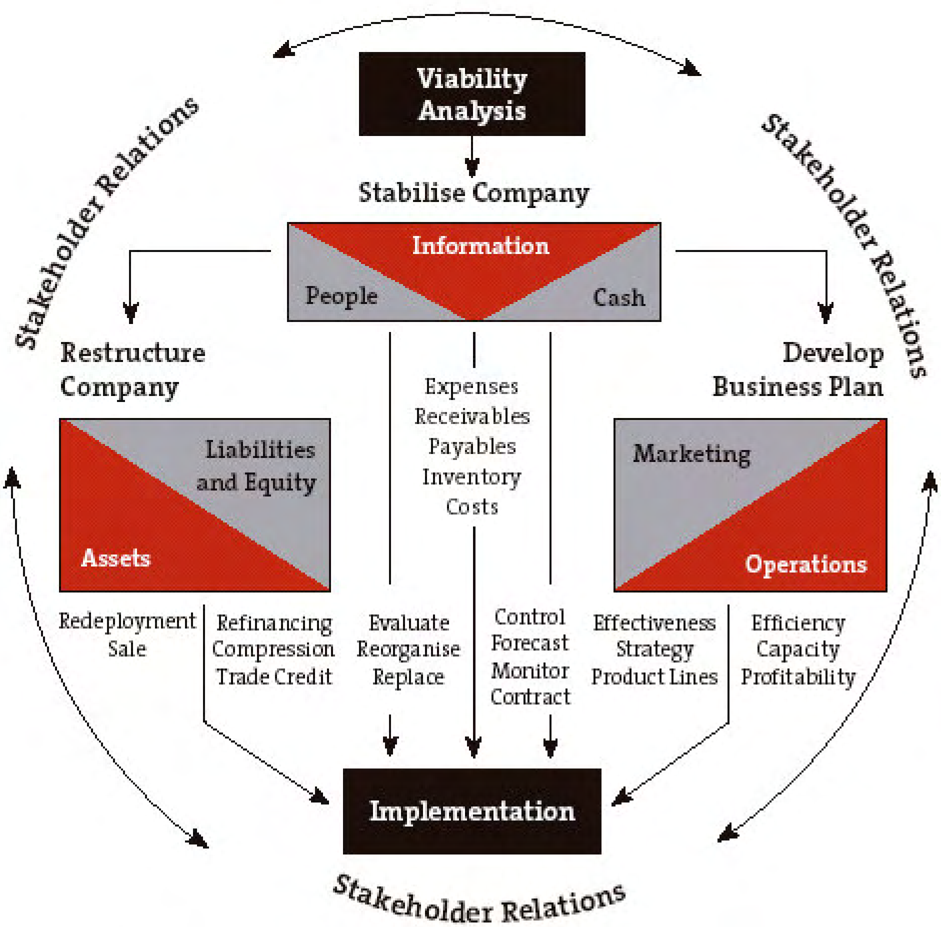
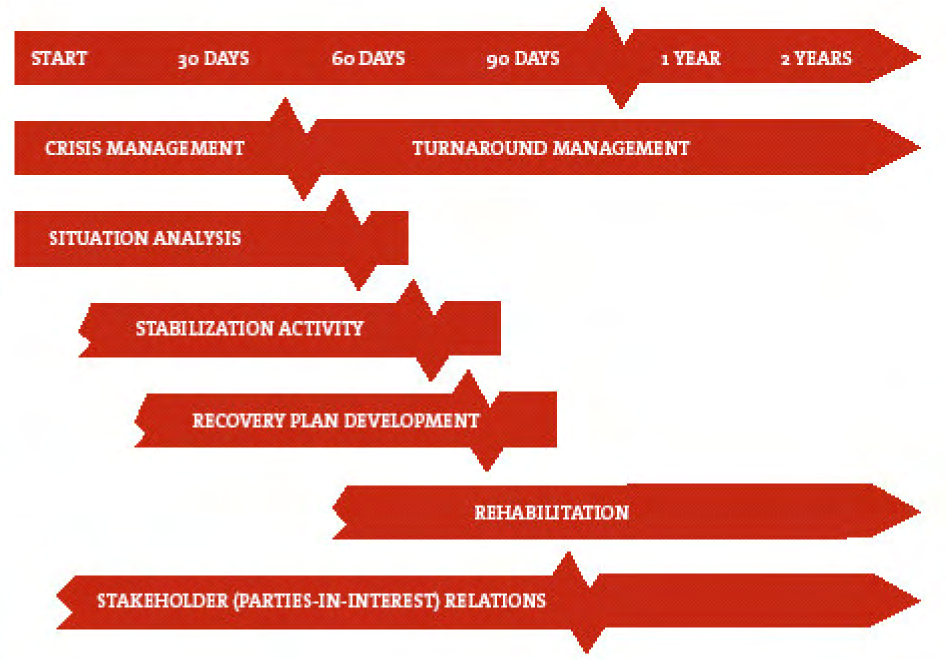


FIGURE 2:

TIME (WORK) FLOW CHART

- TYPICAL CRISIS MANAGEMENT AND TURNAROUND ASSIGNMENTS



Periods depicted extend significantly for heavily regulated or public companies. Similar if not greater extensions are applicable to municipal corporations and companies in chapter proceedings. Other factors that influence time periods include the degree of control (direct or indirect) granted, size, complexity and the quality of information available.

Among the first things that I have looked at in the rapid appraisal stage are projected cash flow (to see how much time is available to rescue the business), legal advice if the situation is serious and a rapid examination of the product, or service, price and terms versus competition. If you cannot look at the whole product line look at some of the best sellers. Some humorists have suggested that it is also a priority to find out where the restrooms are...

When undertaking a detailed analysis the areas I usually consider the most important are:

1. Products, price, distribution and terms versus competition.

2. Industry, or sector, economics, value chains and key factors for success.

3. Industry, or sector, norms, standards and nuances.

4. Financial and market performance versus competition.

5. Sales, capital employed, marginal contribution, profit, return on capital employed and cash flow by market segment, division, customer, product line, product, facilities, function and geographical area. While it might sometimes be difficult to obtain, this information, one cannot manage averages or aggregates and it is crucial to have this sort of information.

A new CEO is appointed in the overwhelming majority of turnarounds, at least in the UK and USA. This is said to lend credibility to the turnaround underway. It is very rare that a person who has presided over the decline of an organisation is asked, or even allowed, to lead the renewal or turnaround.

Viability assessment

Not all crisis situations can be turned around. Slatter and Lovett (1999)[4] point out that the chances of recovery vary according to the combined effect of six major factors: causes of decline; severity of the crisis; attitude of stakeholders; firm's historical strategy and internal environment; external environment and industry characteristics; and the cost price structure.

A key question is *whether the company or entity is worth turning around*? Will the return on the resources and investment required be sufficient? How does the alternative of turnaround or 'fix-it' compare with the options of sale, merger or closure? Many situations can be turned around if enough investment and resources are applied - the original company may be transformed into something unrecognisable - but will it be worth it?

Turnaround tools and techniques

As every accountant knows there is a limited number of variables that affect profitability and cash flow. In the operating statement, or profit and loss account, these will be volume, mix, price, cost of goods sold, overheads, interest and tax. Of course the drivers and details behind these are extremely complex and varied - but there are seven major variables as shown. In the balance sheet the major variables will be the various assets and liabilities. Capital and debt structure and customer and supplier credit terms are other major determinants.

Table 2 lists various techniques and tools. Product or service is at the top of the list. If these are not competitive, then points (2) and (3) are very difficult, if not impossible, to achieve, while success in the other listed areas will only alleviate the situation for a limited period. Reducing costs is normally faster and more predictable than improving sales revenue, so this often gets focused on during turnarounds.

Accountants may enjoy testing (5) - many small but simultaneous changes. Take the annual report of a company and improve all of the major variables by one per cent, and then two per cent É *The Power of One?!*

I am a great advocate of customer and product line profitability analysis, which, ideally, should be routine and not done only in a crisis. The analyses are, however, only such until the findings are evaluated and implemented.

TABLE 2

TURNAROUND TECHNIQUES AND TOOLS
1. Product or service
2. Improving sales revenue
3. Pricing
4. Reducing costs
5. Many small, but simultaneous, changes
6. Customer profitability analysis
7. Product line profitability analysis
8. Working capital management
9. Restructuring
10. General

The South African situation[5]

The legal environment of turnarounds in South Africa has, for a long time, been determined by the Companies Act and Insolvency Act (liquidation, Section 311 - relating to compromise with creditors - and judicial management). South African insolvency laws are widely regarded as antiquated compared to countries like the USA, Germany and Britain.

In March 2003 the South African Cabinet approved the introduction of the *Draft*

Insolvency and Business Recovery Bill - the unified version of the new Insolvency Act. The state law advisors are currently reviewing this and the official Bill is expected to be published soon.

The departments of Justice and Trade and Industry are working on a new business rescue model to replace judicial management. It is expected to provide for bankruptcy protection legislation, Black Economic Empowerment and appointment of a turnaround expert, as business administrator, if a turnaround is deemed viable.

There are, as yet, no specialised private equity funds, or similar sources of loan funds, for turnarounds in South Africa. The government is currently considering establishing a turnaround fund.

The Labour Relations Act and government policy are supportive of job security and this can, at times, raise conflicting interests. It is my view that *no job is really secure unless the employer is successful or there is an employment contract which the employer has the wherewithal to honour*.

Conclusion

This article sketched out the fundamentals of managing a turnaround. CEOs and other managers under pressure are well advised to protect their jobs (and reputations) and the interests of shareholders and other stakeholders, by heeding early warning signals and taking action, or getting help, much sooner rather than later. Taking a corpse to a medical doctor is hardly a productive exercise. The 'patient' with early symptoms has a far greater chance of survival.

I cannot really comment on the Draft Insolvency and Business Recovery Bill before seeing the details. It certainly seems to be a significant step in the right direction. Turnaround management could 'come of age' in South Africa. I do admire the US Chapter 11 protective bankruptcy model where companies are protected from creditors while they restructure and reorganise under the jurisdiction of a court. Two of the most recent companies in Chapter 11 were United Airlines (the world's largest airline), and the notorious WorldCom.

It is a great pity about the lack of funds, or institutions, providing readily available equity and loan financing for turnarounds in South Africa. This may be partially due to historic reasons. When seven widely diversified companies dominated the private sector in SA they provided their own turnaround funding and resources. This situation has changed and, I believe, profit opportunities are being missed. Turnaround funds sometimes outperform venture capital funds in Europe and the United States.

With all the great Treasury and National Budget achievements, South Africa's economic growth rate is not yet what anyone wants. In fact it is near the bottom of the 25 emerging market countries monitored by *The Economist*. I am sure that a better application of turnaround management would make a meaningful contribution towards better growth rates and, hence, employment. A

Source:

1. Stanley J. Goodman (1982) How to Manage a Turnaround. New York, NY. Free Press.

2. Lee Kuan Yew (2000) From Third World to First, The Singapore Story. New York, NY Harper Collins.

3. Donald B. Bibault (1999) Corporate Turnaround. Washington DC. Beard Books.

4. Stuart Slatter and David Lovett (1999) Corporate Turnaround. London, UK. Penguin Books.

5. Turnaround Management SA. http://www.corprenewal.co.za/ **A**

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