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Turnaround *or* Restructuring?

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For companies suffering financial distress, assistance arrives in two principal, somewhat distinctive personalities: restructuring advisors and turnaround managers.

Restructuring and Turnaround: Where and When

Restructuring advisory work is well-known around the world, due in no small part to the missionary work of restructuring groups within multi-national accounting firms. The legal and business climate in support of rehabilitative turnaround effort has historically been unreceptive outside the debtor-friendly United States, though that is slowly changing.

Further, distress in the "larger market" (typically firms with annual revenue in excess of $500-700 million) is nearly always approached as a restructuring, rather than turnaround, exercise—irrespective of venue. Turnaround management solutions in multi-billion dollar enterprises require a window of time beyond the usual patience level of creditors and other constituencies. Restructuring is simply quicker.

Restructuring and Turnaround: A Definition

Viewed simplistically, restructuring is an exercise focused on (1) the balance sheet, (2) the current cash-generating capability of the enterprise and/or its constituent parts, (3) valuation of the enterprise and/or its constituent parts and (4) its debt-carrying capacity, with an eye toward (a) selling/liquidating the enterprise and/or its constituent parts and/or (b) effecting a forced reduction or conversion of debt levels to match cash-generating capabilities.

Using this same simplistic view, a turnaround management solution first focuses on (1) the cash flow (and profit & loss) statement, (2) operational effectiveness of the enterprise's management, systems, procedures, pricing, purchasing, production and market strategy, (3) segmented profit contribution by element (division/facility/product line/product), (4) redundant or underutilized assets, (5) the "depth-of-distress," (6) the window of time remaining before funds are exhausted and (7) pressure, patience and support among the constituencies, with an eye toward (a) effecting a significant increase in cash flow through cost reduction, improved working capital management, redundant asset liquidation, and rationalization of investment; (b) providing leadership and talent to support such change; (c) gaining/regaining credibility and support within the constituencies for necessary (often drastic) change; (d) all within a time frame delimited by cash flow and the forbearance of constituents and (e) moving to restructuring strategies (above) only if and when the company has previously maximized its self-help opportunities.

Restructuring and Turnaround: Practitioner Backgrounds

The points of view of restructuring and turnaround professionals, particularly given their differing origin and backgrounds, are distinctive.

Restructuring is a complex financial exercise in projection and valuation, preparatory to a delicate, often painful, negotiated balancing of creditor needs and attitudes toward accepting less-than-full repayment. Its practitioners' origins are most often in accountancy or, for very large distressed enterprises, investment banking or consultancy; most do not have prior backgrounds as industrial managers.

Most advisory work outside the United States is restructuring-oriented and principally conducted by accounting professionals. The largest accounting firms dominate this landscape, supplemented in the United States by a number of accounting-derived practices.

On the other hand, turnaround consulting is a complex operational exercise in providing experienced leadership to quickly and drastically reshape the business for improved performance, persuading highly reluctant managers, owners and investors to execute painful changes they have assiduously avoided—and impatient creditors to vouchsafe a window of time for change to occur.

Turnaround professionals must additionally develop restructuring skills because they are often engaged so late that inadequate time remains to execute a turnaround, and/or lender fatigue has set in so heavily that patience has been exhausted. Furthermore, a turnaround effort can be an incomplete solution and must be followed by some restructuring.

Turnaround consultants provide leadership under trying conditions and therefore are nearly always proven, experienced business leaders, generally not consultants or advisors by background. Their leadership-by-example must win the respect and acceptance of the distressed company's owners and managers. The most difficult part of turnaround consulting is frequently not the formulation of the turnaround strategy, but gaining acceptance for it.

Such leaders often come to turnaround consulting later in their careers, having served as CEOs (often on multiple occasions) with on-the-job experience working within distressed situations. Such leaders are often senior in age. Within my firm, for example, only 5 percent of our professionals are under 40 years of age. This is very different from the "pyramid" structure typical of major accountancy and investment banking groups.

Turnaround Solutions: Long Term vs. Short Term

Distressed companies frequently require both improved efficiency of operations as

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well as a contraction of the business by withdrawal from diseconomic activity. For owners and managers, who frequently believe they have already pared costs to the maximum, further "improved efficiency" is distressing. Withdrawal from diseconomic activity, particularly activities nurtured to provide important future growth, is even more painful. Turnaround managers, as advocates of necessary change, are often the much-unloved deliverers of pain. There is thick emotional content in disassembling what others have carefully built, diseconomic or not.

For these reasons, skilled turnaround consultants first take a careful assessment of the "*degree of distress*," analogous to an emergency room physician taking the temperature of an incoming patient. Subsequent actions depend greatly on whether that temperature is 100ºF, 103ºF or 106ºF—dictating whether one wields a scalpel, knife or hatchet—and whether there is time for analysis, contemplation and buy-in versus a requirement for immediate, often draconian, action.

The "art" of turnaround is a carefully measured balancing of the necessities dictated by the painful present counter-balanced against future growth prospects. An analogy for clients is the pruning of a tree. If the root system is unable to sustain the whole tree, one must identify (often difficult to do) and prune dead or dying branches, which in turn helps provide adequate nourishment to the remaining tree. Even more emotionally charged and debilitating is the pruning of new shoots and branches that require a disproportionate share of nutrient.

Turnaround Solutions: First Steps

The first steps are to take an initial pass through the financials, control systems and management team to develop detailed, 13-week cash flows. For companies experiencing a high degree of distress, the turnaround professional may have seized control of the checkbook and immediately begun the pruning process. In most situations, he or she has determined the company has weeks or a few months of cash, rather than days, and commences with Phase 1: getting their "hands around the business" and mapping out the turnaround strategy. Dependent upon size and complexity, this will require one to six professionals for three to four weeks.

At the conclusion of Phase 1, the turnaround professional provides the Board and management with his or her unwashed, independent view of the company as well as a broad strategy of turnaround and/or restructuring steps and/or alternatives. This is often an uncomfortable process. More "personal" agenda items are, of course, the most difficult to face: incompetent owner/manager/blood relative, inadequate senior managers, asphyxiating future avenues of growth, identifying management blunders, axing treasured owner/management fringe benefits, trimming health plans, scheduling sizable layoffs, shuttering long-standing facilities, facing liquidation, etc.

The turnaround professional's view is sometimes challenged, and a differing point of view is advanced by management. If he or she can be convinced, the view and next steps are modified. If unconvinced, he or she will present both competing points of view in a presentation, usually made shortly thereafter, to secured lenders.

Turnaround Solutions: Next Steps

The alarm has sounded, but who is listening? The crucial next step is to win acceptance for a plan beset with woeful human consequences and its blows to ego and self esteem. Acceptance faces a simmering stew of economic necessity, survival, lender pressure, aspiring rationality, board support, backbone, conflicting loyalties and denial.

When reflecting on more successful vs. less successful outcomes over the past 20 years, the key difference was not the quality of the proposed turnaround strategy, but whether at this stage, a steadfast commitment to execute the plan emerged. Less successful outcomes arise from a tentative, wavering acceptance that ultimately bogs down in the harsh realities of implementation.

Given the consensus, turnaround consultants either move forward during the next several months on plan execution (typical of smaller, lower-middle-market companies) or on more tactical planning based on the strategic outline. For upper-middle-market companies, the turnaround professional may proceed two to four months into the engagement before implementing the turnaround plan. In conducting "profit improvement" work for underperforming-but-not-distressed companies (often the under-achieving portfolio companies of equity and mezzanine investors), the implementation process is slowed somewhat as working groups are formed, in conjunction with middle management, to provide buy-in to ensure the ultimate sustainability of the turnaround goals.

Turnaround Solutions: Final Thoughts

The turnaround professional is typically on site anywhere from three to 12 months; this is a not an insignificant commitment of talented professional support. The return on investment on such an undertaking is usually an annual savings five to 10 times the cost of the turnaround team, plus the liberation of substantial capital, on a one-time basis, due to more effective working capital management and rationalization of redundant assets.

In many cases, the resulting change is sufficient to stabilize the company, giving it renewed life. In other cases, particularly when begun late in the degenerative spiral, these changes must be followed by refinancing, reinvestment, or whole or partial sale of assets. In nearly all events, there is more-than-sufficient value generated in the process to have justified the turnaround solution. ■

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