There is still time to act - turnaround

The objective of turnaround management is to guide the company out of an economically unviable situation, which, in most cases, threatens its existence, into a situation of stability for the future

Ricarda Huch

"I consider as futureless those who do not further their personal and professional development but still don't want to die - who want to stand still."

Stage of crisis

Relieving a company of its current distress by restructuring and redirecting it into a stable and competitive market is one of the most demanding challenges any management can face.

The objective of turnaround management is to guide the company out of an economically unviable situation, which in most cases threatens its existence, into a situation of stability for the future. This happens when the company can generate adequate revenue and when it has enough financial backing, especially equity capital.

The reasons a company gets into distress may be diverse. To some extent these are **exogenous reasons** that have taken place in the business environment and that are out of the company's control, including high interest rates, labor shortages, lack of raw materials, strikes, disasters (fire, flood, etc.), excessive labor costs, politically or globally induced price increases for raw materials, seasonal fluctuations, market saturation, or substitute goods.

But the causes may also lie within the company itself, **endogenous reasons** attributable to corporate leadership, including miscalculations, incorrect financial forecast, sustained marketing weakness, obsolete portfolio, high development expense, or uncoordinated product engineering, excessive labor costs, outflow of liquidity because of inadequately high profit distribution in the previous years, insufficient investment, deficient quality control (purchase, production, sales), or weakness in management control and indecisive leadership.

This trouble spot, which impacts the company internally and externally, may be the source of a corporate crisis.

management

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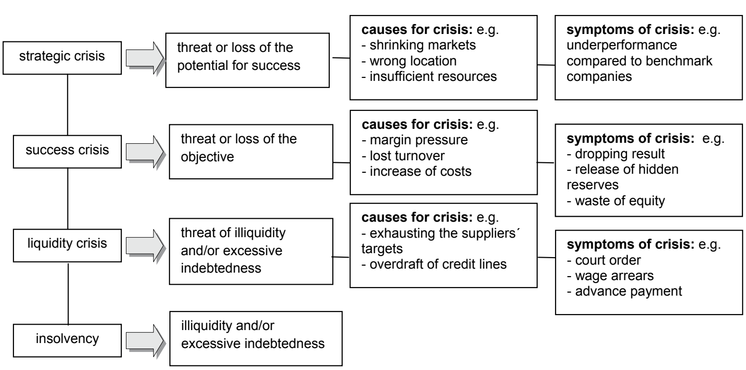
By Jürgen Kohler

In general, a corporate crisis occurs when the substantial objectives and values of the company are directly threatened. Crises can be due to strategic, success-related, or liquidity reasons.

Types of crises can affect each other. A strategic crisis, due to incorrect market positioning or adherence to obsolete technologies, may provoke a success crisis, which may indirectly lead to an unfavorable financial structure and a liquidity crisis. But a liquidity crisis does not necessarily have to be preceded by a strategic crisis. The success crisis (or just the liquidity crisis) may also necessitate a rescue package without having its origin in a strategic crisis. Reorganization may resolve a strategic crisis. The turnaround may take place in the course of the earnings crisis. The extrajudicial reorganization is helpful in the case of a liquidity crisis, whereas the judicial reorganization is handled during insolvency.

Types/causes/symptoms of a crisis according to the threatened corporate objectives:



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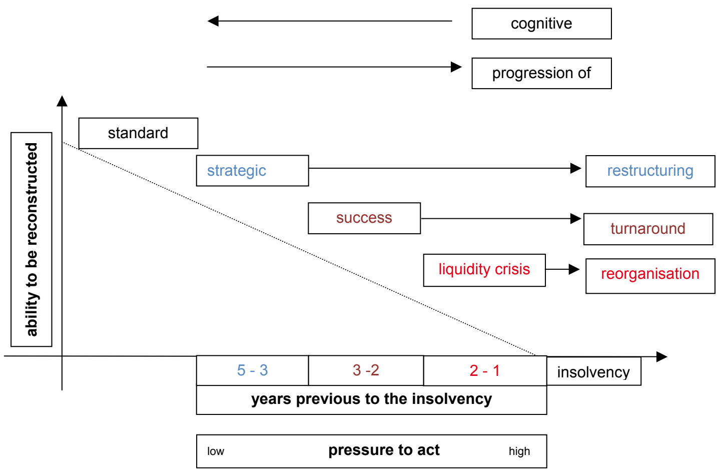
The sooner management realizes there is a crisis - and addresses it together with its partners, banks, associated companies, employees, customers, and suppliers – the possibility of an effective reorganization or turnaround increases considerably. The maxim "silence is golden" does not apply; "let's talk about it" does.
The further the crisis has progressed, the more the persons in charge have to keep channels of communication open. Nothing is more damaging to a crisis-ridden company than employees and self-appointed "insiders" who spread unfounded rumors about the company.
"I focus on unmitigated transparency. Thus I pledge to regularly communicate with you during the following weeks and months," Jürgen Dormann, CEO and turnaround manager of the once crisis-ridden and today very successful Swiss technology company ABB, said in September 2002, in one of his Friday letters, 112 e-mails to more than 140,000 employees throughout the world in 15 languages. By using a tool installed in the Intranet by ABB, every employee was able to track 1,400 individual measures for the company's rescue and, via conference calls with those responsible for the project, to resolve problems and talk about progress. Dormann focussed on 100 percent transparency, honesty, and quick, precise, and consistent action.
This way it quickly becomes apparent whether the top management consists of experienced managers with sociopolitical responsibility and irrepressible desire for change, or simply functionaries who can be likened to fair-weather pilots and do nothing but wait and see; they want to please everyone and don't want to rankle anyone, and they abide by the motto: "Just as the disaster appeared, it will also disappear!"
In his 11th letter Dormann wrote: "For us there is no way to cut costs without cutting jobs… Is this dramatic? Yes… But it is crucial for ABB's survival." A few days later Dormann confronted his management with the reality. He planned and pushed personnel reductions by 10,000 employees.
Current studies show that management takes at least a year to make critical decisions in times of crisis 66% of the time. This is too long and can threaten a company's existence.
According to Dr. Martin Prager, of Pluta Rechtsanwalts GmbH (an association of attorneys) and a former liquidator at BenQ, arrogance, lack of experience, and inability to make decisions on the part of management in times of crisis are responsible for nine out of 10 bankruptcies.
In 2007, about 28,500 companies filed for bankruptcy in Germany. Euler Hermes Kreditversicherungs-AG (a credit insurer), in collaboration with the University of Mannheim, predicted a dramatic increase in bankruptcies for 2009. Creditreform predicted there would be 33,000 to 35,000 bankruptcies in 2009.
Management's inability to make quick decisions almost always means the company's situation won't improve. Shareholders lose patience with poor sales, as do creditors, bankers, employees, and management. In almost all cases, the investors put more pressure on management and

Phases of a crisis process/types of crises:



request outside consultants.

Management passes through three phases: the **analysis phase**, the conception phase, and the implementation phase. The whole process usually takes one to two years.

The analysis phase is the fact-gathering stage in which **the cause of the crisis** is analyzed.

The **conception phase** is when a recovery strategy for the company is worked out. Precise measures are identified for improving management, introducing guidelines for travel expenses and company cars, closing or relocating production facilities, reducing jobs, etc.
Dormann relied on the “symbolic management” and gave clear signals at the beginning of his tenure. Company cars and company jets were sold. Board members and employees flew economy class within Europe. Management ate together with employees and talked about the company's future. This empowered the employees and motivated them.
The **implementation phase** is when progress is evaluated and planning modifications are carried out, including financial planning, profit and loss statements, and liquidity planning. The liquidity plan is based on the planned income and loss statement, because the incoming payments and outpayments depend on the financial annual result.

A consulting firm presents its evaluation of the crisis to the relevant banks together with a restructuring report. The banks

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In almost all cases, the investors put more pressure on management and request outside consultants then decide whether to approve the issuing of bonds or extending loans. The consulting firm often negotiates better terms with the company's creditors to avoid bankruptcy.

Restructuring is preferable to bankruptcy. The company's dilemma can be illustrated like this:
When restructuring is unacceptable to the investors - often due to diverse political, economic and personal reasons - the only alternative to bankruptcy may be selling the company or a “turnaround share.”

Most turnarounds differ mainly in the method of financing (private equity, loans for restructuring, mezzanine), in the forms of investment (majority interest/minority interest, all kinds of general and silent partnership, asset-based financing), in the investment entry (strategic crisis, performance crisis, liquidity crisis, insolvency), in the investment volume, and in the focus on the branch.
According to the BVK (German Federal Association of private-equity companies), only 1% of portfolio investments in Germany are for distressed companies. This is due to concern over a tough business with serious issues.

The question of whether it is better to wait and buy the company at a lower price once it enters bankruptcy plays a decisive role. But the banks ask themselves: “Do we keep the company alive until it is sold and get a higher sale price than we would through bankruptcy, or do we throw good money after bad money, knowing that the turnaround fund will try to take advantage of the creditors?”
These questions are indicative of the complexity and conflict of interests for the turnaround management.
The pivotal and essential questions for the turnaround investors are always the same ones:

- How many shares will I receive for the purchase price?
- When will I retrieve the capital employed and at which interest rate?
- When will the company become profitable again?

If the company is unable to raise additional capital, it may have no choice but to file for bankruptcy protection. For incorporated companies, according to German law, the chief executive officer or the executive committee must file for bankruptcy within three weeks of failing to pay creditors and/or incurring excessive debt.
If the insolvent company has enough assets to cover the costs, bankruptcy court begins proceedings and a liquidator is appointed.

When the bankruptcy process begins, the liquidator has three choices:

- liquidation of the company
- asset deal
- insolvency plan

In the case of a **liquidation or asset deal**, the liquidator uses the company's assets to settle the creditors' claims, according to the Bankruptcy Act. This happens when no prospective buyer is to be found and/or the insolvent

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company is not in a position to restructure itself.

Instead of a liquidation plan, the creditors may agree to a restructuring plan. They will agree to this if they believe the loss of receivables will be less than the loss of receivables in the case of a liquidation. An asset deal is necessary when restructuring is not possible and if the know-how about the product and the fixed assets is of interest to a prospective buyer.

In the case of restructuring, the legal entity remains the same. A bankruptcy plan allows the waiver of unsecured receivables to eliminate the inability to pay or the excessive indebtedness. Accurate accounting and a loyal clientele is required.
Restructuring during the bankruptcy process is enhanced the earlier management files for bankruptcy. This is why the Bankruptcy act allows filing for bankruptcy, in the case of an imminent illiquidity.

Conclusion

The turnaround management is pressed for time during the restructuring process. Time is money and both are scarce. Pragmatism and promptness are required. In principle, a strategic course has to be determined, pursued, and maintained, regardless of other theories. Rigorous steps, like in a military emergency, have to be taken, but without loosing sight of attributes such as straightforwardness, dignity, and respect for other persons during this difficult process.

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