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by Raymond Lackner

Crisis and Turnaround Management

The search for value in distressed companies is the first step on the road to recovery. The organization's survival depends on how well the company capitalizes on opportunities and protects itself against vulnerabilities that occur inside and outside the organization. The survival will also depend on how the company deals with its customers' changing needs. For a growing number of small and medium-sized companies, selling expenses have severely cut into profits and additional sales come at even higher incremental selling expense. The governing strategy for these companies cannot be "more of the same;" it must be "a better way." It must be an innovative way of satisfying the existing market and/or creating a new market.

An innovation may include an invention, but it is something different, it is a better way of doing something physically, economically, or socially. Two of the most famous innovators were "King" Gillette and Cyrus H. McCormick. (Peter Drucker, "Management," 1974.)

"King" Gillette did not invent the disposable razor blade; in fact he had lots of competition in that. In his time, most blades sold for one cent each, and the handle sold for about 8 dollars. But eight dollars could buy eighty shaves at the local barbershop. Gillette repositioned his company by practically giving away the handle and selling the blades for five cents - half the price of a store bought shave.

Cyrus H. McCormick is credited with inventing the mechanical harvester. However, his machine was one of several similar and expensive machines on the market, and the farmers could not afford them. McCormick's real innovation was the installment sale of farm machinery to groups of farmers, letting them pay over time. The farmers staggered planting times so that they could share the use of the machines, the cost of which they shared.

Key to any successful turnaround are decisions as to what the reconstituted innovative business "should be" (the new business model), and then the concentration of all the organization's resources to realize that model.

Repositioning and restructuring a distressed company may require the filling for protection from creditors under Chapter 11 of the U.S. Bankruptcy Code. Ideally such filing is made after the new business model has been postulated, a plan for its implementation created, and some implementation steps have been taken. In any event, under the U.S. Bankruptcy Code, for 120 days after filing the debtor company has exclusivity for proposing its reorganization plan. Such a legal step, (a petition for reorganization), provides the distressed company with a breathing space, namely time to think, plan, and act free of harassing calls, levies, and garnishments by creditors. A well-prepared and well-executed Chapter 11 organization will maximize chances for the company's survival. Costs, benefits, and risks of employing the Chapter 11 mechanism must be carefully weighed against those benefits.

Bankruptcy laws are vital to our free enterprise system. Without such protections few if any entrepreneurs would be willing to start a new business, for without bankruptcy mechanisms, insupportable debts accumulated as a result of past errors or misfortunes would hound the unfortunate debtor forever. The bankruptcy system is a normal and necessary part of our capitalist system. Still, bankruptcy should always be a last resort. Company managers, directors, and stockholders should always consider first other ways to restructure, reengineer and/or reposition their company.

If properly handled, banks, government bodies, unions, and trade creditors are generally open to alternatives to the debtor company's bankruptcy liquidation (Chapter 7). The reason for that is simple: Only a fully secured creditor can be indifferent to liquidation, which is usually at a fraction of book values of the debtor's assets, and in addition certain administrative expenses take precedence even before a bank's security. The situation gets more complicated where the owner has issued personal guarantees and has unencumbered assets that the beneficiary of the guarantee can seize. However, prior to insolvency, even such situations can be generally handled well. There is more to be said on this subject, but it would take us outside of the scope of the present article.

When a Company is in a crisis situation it is advisable to have an expert turnaround manager evaluate the Company's future prospects. The expert is able to make a competent and dispassionate review of the company's situation and available alternatives. While the alternatives may initially be obscure, the core of the diagnosis is simple and follows the same broad lines. The enterprise's efforts are not producing the desired results. A systematic and penetrating analysis of costs and revenues, including entire product lines, must be undertaken. Costs that are found not contributing to profits must be eliminated. Innovative ways of producing, marketing, and distributing products and services must be considered. In addition, the accumulated obligations may or not be supportable for the company. They may have to be restructured, postponed, reduced or converted into something that is supportable. It is well known, that many executives just like "simple" workers and middle managers, resist change. The press of the day-to-day business is their concern and the fear of the unknown is a problem for many at all levels. Yet, a real crisis manager looks undaunted at where the company needs to be, admits

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> ***"Distressed companies must find innovative ways to satisfy the existing market and/or create a new market."***
>
> ***- Raymond Lackner***

past misfortunes and errors, and focuses on how to get the company back on track.

The fact is, management is concerned about keeping the doors of the enterprise open but is rarely able to do so on their own and simultaneously turn their company around. They are too busy, too stressed, and the decisions required generally run contrary to their instincts honed in operating profitable companies. Accounting firms and other purely financially oriented advisors can help companies reduce expenses, improve cash flow, and sometimes to restructure finances. This is fine as far as it goes, but what is really needed by distressed industrial companies is a consultant that can do the foregoing as well as being able to restructure, reengineer, and reposition the operations of the company with innovative strategies geared towards methods concerning product focus and development, manufacturing, distribution, and promotion.

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