A Survival Guide for a Successful Turnaround

Almost all companies will experience significant operating difficulties at some point. These problems can be caused by external factors or may be self-inflicted. Managers must provide strong leadership while implementing a turnaround. Managers who recognize problems at their earliest stages, utilize aggressive, root-cause problem-solving and follow fundamental "turnaround principles" are far more likely to navigate a quick and successful turnaround. In nearly every case, the difference between leading a successful turnaround and suffering through a protracted downward spiral is the management team and the turnaround methodology they employ.

See the Forest Through the Trees

Before management begins to develop a turnaround plan and before they begin to rally a workforce, someone needs to take a step back and ask: "Does this company have a reason for being?"

Answering this question honestly may be very difficult for some managers because of the emotional capital they have invested in the business. Nonetheless, brutal honesty is needed. With a sound turnaround methodology, you may be able to work miracles, but no turnaround manager can bring the dead back to life.

If the company has lost its market niche, alienated its customers, no longer is protected from competitors by high switching costs or has lost its competitive advantage, it may be too late for a turnaround. Without substantial new working capital, which may not be available, or a new equity investment, which may not make economic sense, there may not be a viable company to turn around. The right team must be assembled quickly. If the company does not have the right team in-house, management should engage a crisis manager. The decision tree below outlines the thought process necessary before the turnaround can begin.

Early Recognition of Problems

Early recognition of developing problems is a key element in minimizing damage resulting from operating and financial problems. If you let a problem or poor business practice continue unaddressed, it will soon become accepted by the workforce as standard operating procedure and could spread throughout the company. When this happens, management now must not only solve the problem, but also lead a cultural transformation to modify the behavior and expectations of the workforce. Cultural transformation will require a substantial amount of time, and in a turnaround, time is of the essence.

Leaders can identify problems at their inception through frequent review of sharply focused management tracking and measurement systems. Management reporting and tracking systems
should be focused on those critical areas of the operations that will determine if the company can successfully implement its strategy. Some of these areas can include:

- factory throughput
- returns and reworks
- overtime
- contribution margin by sku
- revenue per employee
- bids quoted vs. bids won
- on-time delivery
- backlog.

When the appropriate activities are identified and tracked on a regular basis, managers will be in a position to identify problems or their symptoms at their earliest stages. Very often managers will rationalize identified weaknesses rather than aggressively search for the root-cause problems. This results in problems being masked rather than solved. Early recognition loses its benefits when a wait-and-see attitude is adopted.

**Root-cause Problem Solving**

What you initially believe to be the root-cause problem may be only a symptom of a larger, hidden problem. In order to get to the true problem, you may have to ask numerous questions of many people, both inside and outside of your organization. One question leads to another and then another. Persistence and follow-up will help get to the root-cause problem. As you peel back the onion, you should get into the habit of always asking one more question.

Successful managers master the early recognition of root-cause problems and are comfortable with taking immediate aggressive actions. In some cases, a manager may have very strong early recognition skills but does not have the skill set to lead a turnaround. In these situations, the manager must quickly bring in a turnaround professional who can take quick, decisive actions.

**Turnaround Principles**

To effectively lead a turnaround, management must instill a common operating philosophy throughout all levels of the organization. There are four basic turnaround principles that embody this operating philosophy. A great deal of a leader’s time will be dedicated to imparting these principles because they involve cultural change and behavior modification. These turnaround principles are:

- aggressive hands-on management
- non-reliance on sales growth to solve the problems
- continuous improvement philosophy
- sense of urgency mentality.

The leader and senior managers must be on-site and actively involved in the daily efforts to identify root-cause problems and implement the root-cause corrective actions. Absentee or part-week leadership will kill any turnaround plan. CEOs and senior managers cannot expect to turn around a business over the phone or by e-mail or by flying in Monday afternoon and flying out Thursday afternoon.

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Simply being on the premises is not enough. Leaders must be out of their offices and visible to the employees. Finally, the management team must clearly communicate to the workforce the problems facing the business along with the plan to address the situation. Leaders must keep the employees energized and confident that their efforts are having a positive impact on the turnaround. Periodic updates are essential.

Often, the turnaround plan is premised on growing our way out of the problem. This strategy will certainly hinder and probably prevent a successful turnaround. Periods of growth and strong performance can mask many problems. It’s when growth stops and cash flow is strained that the underlying problems become exposed. Sales growth is a function of demand. If there is flat or declining demand, which is generally the case in a turnaround situation, there is little ability to grow. Dedicating precious financial and management resources to marketing to support growth under these conditions wastes time and money.

Management must adjust the company’s cost structure to the current revenue level, and as part of the process of adjusting the cost structure, management must develop a continuous improvement philosophy. Leaders must communicate this principle to the entire workforce. Everyone throughout the entire organization needs to look for opportunities to lower costs, increase efficiencies, streamline processes, improve customer service and increase customer loyalty. This principle will require a significant amount of a leader’s time because it requires employee behavior modification during periods of uncertainty. The ultimate goal should be to make this a core competency that is pursued zealously by all employees.

Expense control should be viewed as a continuous improvement activity. Everyone in the organization must be motivated to look to cut costs and control expenditures with every decision that they make. Expense control should survive after the turnaround has been completed and become a core competency. Cutting costs will involve many difficult and unpopular decisions. Not surprisingly, many managers try to avoid these decisions until it is too late to cut costs fast enough to preserve dwindling cash balances.

Finally, leaders must communicate that time is of the essence in executing the turnaround. All employees must develop a sense-of-urgency mindset. The way to do that is by getting the workforce to buy into the turnaround plan. This can be accomplished by showing the personal gains to be realized. This, too, requires behavior modification and will be a challenge for managers. As is the case with these continuous improvement philosophies, the goal is to make this principle a core competency that survives the turnaround.

**Psychological Stages of a Turnaround**

Recognition and acknowledgement of a problem may require the manager to admit, at a minimum, that mistakes have been made, and at worst, that there has been a failure. This creates significant psychological barriers that need to be overcome. Four common psychological stages of a turnaround are:

- denial
- projection
- reluctant recognition
- aggressive action.

In the denial phase, the manager refuses to recognize that a problem exists. He or she is confident that this is a period of temporary challenges and that the company should not deviate from its current strategy. With this psychological mindset, a manager can remain in his or her management comfort zone.1 This phase can last anywhere from several days to several months, depending on the level of external pressure brought by independent third parties (bankers, accountants, vendors, etc.).

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In the projection phase, the manager grudgingly admits that there is a problem but refuses to search for the root cause. Instead, he or she projects accountability for the problem to sources external to the business (bankers, vendors, customers, new regulations, economic swings, etc.). This phase allows the manager to continue to avoid responsibility and to hang on to or remain in his or her management comfort zone. This phase can also last anywhere from several days to several months, again depending on how much external pressure is brought to bear.

Eventually, management must admit that there is a problem and recognize that they must act before the business reaches the point where it cannot be saved. This is the phase of reluctant recognition. In this phase the leader is willing to listen to advice from the management team and outside advisors.

The fourth psychological stage, aggressive action, is when leadership begins the turnaround process by either beginning the search for root-cause problem(s) and developing root-cause corrective action or engaging professional turnaround management to start this process. The amount of time that it takes to get to this point is directly related to the speed and success of the turnaround.

If the leader is unable to recognize that there is a problem with his or her business and is unwilling or unable to take aggressive action, the company will continue to deteriorate. This will make the turnaround process more difficult and could result in substantial damage to the value of the business that may ultimately result in liquidation.

Implementation Principles

In a turnaround situation, cash is king. A company in the midst of a turnaround is generally burdened by tight liquidity and inadequate cash balances. Control of this precious but limited resource is essential for a successful turnaround. To do this, management must make this a front-end activity. The analysis to use cash should be made prior to committing to a purchase rather than in the check-signing process. Controlling costs by not incurring them is far better than controlling cash by stretching payables. The later strategy will ultimately result in the disbursement of cash and/or litigation, damage vendor relations and utilize significant amounts of management time to negotiate with vendors rather than focus on the turnaround.

While there are many analytical tools and techniques that are recommended, the manager should focus on those that will help to directly and quickly measure and manage cash in vs. cash out. The most effective management tool for this purpose is a rolling, 13-week cashflow and availability forecast. The purpose of this exercise is to forecast cash receipts based on realistic revenue assumptions and accounts receivable collections based on specific payment terms and payment histories. When possible, this portion of the forecast should be developed on a customer-by-customer basis.

The next part of the forecast deals with cash disbursements. Cash disbursements should include actual payroll and payroll taxes, rent, insurance, freight, vendor payments for materials purchased to generate the sales forecasted in this 13-week forecast and as many other specific payments as can be anticipated. It is important to recognize the treatment currently provided by the vendors (COD, CIA, etc). Disbursements would also include capital expenditures that cannot be deferred, lease payments, bank interest and principal.

If the company has a revolving line of credit, be sure to forecast the outstanding loan balance based on disbursements and collections. If borrowing is limited by accounts receivable and inventory levels, be sure to include revolving availability based on the borrowing base formula. If you can control the cash, you can control your destiny.
In a turnaround situation, it is often the case that expectations have not been met and that management’s credibility is lacking both inside and outside the company. Management must immediately begin to restore that credibility. Managers should set expectations by developing realistic operating and financial plans that they are sure they can deliver and hopefully exceed. Do not provide a plan that you think will satisfy bankers, vendors or investors unless you know that you can achieve it. If you don’t meet your own plan, you will never build credibility or the necessary support for your turnaround strategy.

Poor communication or misunderstandings will slow the turnaround and prevent the rebuilding of credibility. Managers need to communicate clearly and simply on a regular and frequent basis at a level that everyone can comprehend. This communication should reach all levels of employees and all stakeholders such as banks, vendors, landlords, investors and customers.

The turnaround plan should be written to avoid any ambiguity and provide for continuity if there are management changes. It should have target dates, hurdles and deliverables and assign responsibility for the deliverables, and for meeting hurdles and target dates. It must establish accountability. When everyone knows what is expected of them and when they must deliver those results, the likelihood of a successful turnaround will dramatically improve. The plan should be communicated to all levels of employees and stakeholders so that everyone feels included in the turnaround process and their expectations are properly established.

Summary

Turning around a business is a very dynamic and difficult task. It requires the full attention and effort of the leadership of the company to create a shared vision for stakeholders, bring about cultural change and assign accountability. The turnaround process is often marked by unexpected developments that need to be aggressively managed. However, by following a proper turnaround methodology, the likelihood of success is vastly improved.

Footnotes

1 Management comfort zone: CEOs and managers are accustomed to roles in which they are developing growth plans, building customer relationships, and developing and launching new products—put another way, "growing the business." When problems develop, many managers are not able to shift their role to one that involves headcount reduction, plant closures, dramatic expense cuts, customer rationalization and product rationalization. Rather than shift their role, these managers will go to great lengths to rationalize a problem or deny there is a problem. By avoiding recognition of the problem, they can continue to focus on growing and building the business rather than on fixing the problem.