What is turnaround?

Why is turnaround an important issue?

It is a blunt fact that every day, businesses fail.
In fact to be more accurate, in a normal year on average around 50 companies go into liquidation on every business day of the year. During the 1992 recession that figure went up to over 90 and for 2009/2010 the figure is expected to be 101.

And that's just the companies. What about the sole traders and partnerships that go under as well?

By any standards that is a colossal waste. A waste of resources and potential, a waste of jobs and livelihoods and a waste of entrepreneurial effort and talent. A waste that destroys peoples happiness, livelihoods and sometimes even lives.

And that's why turnaround and business rescue is important for all of us.
This White Paper is intended to describe both what turnaround is and to give some guidance that we hope will enable you to make sure that any businesses that you are involved with will avoid becoming such a statistic.

So why do businesses fail?

Business failures are a bit like fires. Something smouldering may be difficult to see but can be relatively easy to put out with little damage or risk if caught early. Once a fire is really ablaze, it is much more obvious but can be much more difficult to put out as it has become dangerous to deal with, consuming resources and crucially cash.

As the old saying has it, cash is king. And no one believes this more firmly than turnaround practitioners. Because fundamentally businesses fail when they run out of cash.

And while there are well established ways of tackling businesses that are starting to burn their cash, one of the major problems for turnaround professionals is that we are often called in too late.

What causes business failure?

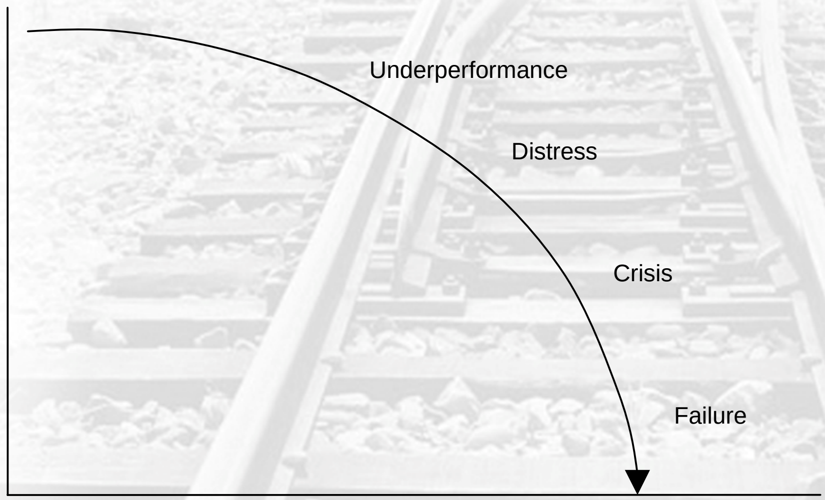
There are really four types of business failure.

Firstly there is the start up that never does. It's a well known statistic that most businesses cease trading within their first three years. It is an inevitable result of the willingness of entrepreneurs to take risks that results in many businesses being founded on the belief that there is a market for a product, which sadly turns out not to be the case. Given how difficult it can be to raise money in the UK for a new venture, there are also many businesses that have so few resources to start with that a relatively small set back in the early years are sufficient to kill them, where a larger business will pull through.

Having got through these critical first three years, business failures then fall into three main camps.
Catastrophic business failures where the business suddenly 'falls off a cliff', whilst often being high profile, are actually very rare and are usually due to the impact of some traumatic event such as a major fraud, lost litigation or sudden change in regulations.

Overtrading is a relatively common cause of business failure in boom times as businesses grow faster than their cash resources can support.

But most failures follow what has come to be known as the business decline curve where a business that is underperforming, starts to become distressed and as the decline steepens, falls into crisis and eventual failure.



How do you spot the warning signs?

The frightening thing about the decline curve is how problems start to compound each other as the business descends the slope.

The underperforming business makes less profits than its competitors. Less profit means less to reinvest to keep up to date or develop new products. Slowly, it slips behind and over time market reputation and market share is lost and eventually the first losses are incurred.

To fund these losses, a business in distress starts to stretch and juggle its cash. The bank manager wants security and personal guarantees as the account starts to be constantly up against the overdraft limit and the business starts to delay sending in management accounts, the business starts to delay payments to suppliers or make round sum payments on account as a way of stretching the available cash. The staff know that the business has problems and morale and quality of output sinks.
By the time it is in a crisis the finance director has jumped ship or is on long term sick leave. The business is on stop with its suppliers and the CCJs are being received. The business can't purchase materials to complete orders and invoice the customer and it can't collect the cash from the customer until it has delivered the complete order.

If it cannot get the cash in to pay the rent or the wages at the end of the month, suddenly it's all over.

What causes normal business failure?

So how do businesses get themselves into these sorts of situations?
There seem to be five main contributing factors to most 'normal' business failures in varying degrees
.
First and foremost there are management problems. The autocratic managing director who's drive has been vital in the past but is now driving the business into the ground while simultaneously driving away anyone who tries to disagree; the board dispute that has led to civil war; the lack of anyone who really understands what the numbers are telling them; the family company run in the interest of 'family members' and not the 'business's

needs'. Any and all of these sorts of issues can prevent the business recognising or dealing with the problems facing it.

Every business needs to have an eye out for the strategy challenges that it will inevitably face, whether these are changes in the market and customers demands; changes in technology that mean reinvesting and moving on; or changes in the competition which require improved efficiencies to keep the cost base competitive.

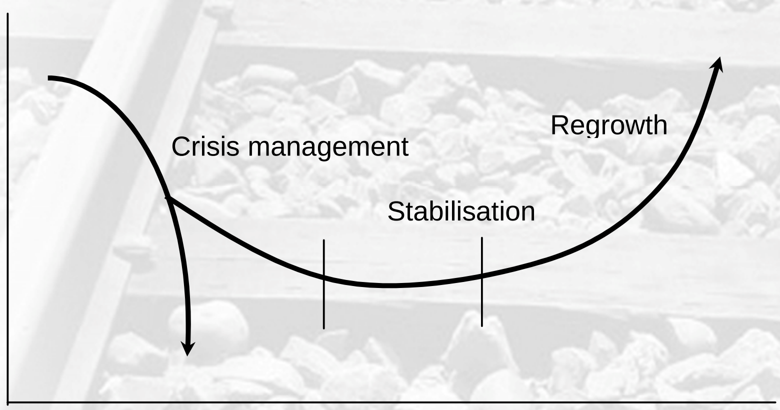
The third area is a lack of financial control where it is usual to find that cash has become tied up in excess stock or debtors; and that management do not have accurate costings so they do not really know how much margin they are making on the different areas of its business.

Fourthly there is a lack of operational control of both hard issues such as up to date machinery and efficient factory layout; and soft issues of organisational structure and staff management.

Finally there are the 'big projects', the new computer system, the problem acquisition, the new product launch, the premises move. Anything that adds extra disruption to the business, while taking away cash and management time can prove to be the straw that breaks the camel's back.

What is turnaround?

At its simplest, turnaround is about reversing the decline curve and by doing so restoring stability to the business and regrowing its value



What is involved in turning a business around?

Spotting the problem is the first task in any turnaround. The starting point is for the business' management or its advisors to spot that the business has a problem that needs to be fixed.

Surviving the crisis is the second because unfortunately it is generally only once the business has reached some form of cash crisis that management can be persuaded to call for help. So the immediate task for a turnaround professional is usually to resolve some form of financial crisis so as to give them time to carry out the turnaround.

Putting together a plan is the third requirement as having stabilised the business a turnaround plan has to be put together that sets out how the business is to be restored to health.

And finally doing it is the crucial task. To really make a difference, the plan and all the changes that this means in how the business has been run needs to be made to happen.

What happens in a turnaround?

The turnaround curve divides into a number of distinct phases.

The early days of any turnaround are generally an exercise in crisis management and are focused on stabilising the financial position of the business. This involves taking firm control of the cash by taking charge of the cheque books and installing strong cash controls and cashflow forecasting. The emphasis is then on getting as much cash in as possible by improving control of the debtor book and collections, reducing unnecessary stock levels and disposing of surplus equipment; whilst also strictly controlling the cash going out by reaching agreements with suppliers as to payment terms and shutting or radically restructuring areas of the business which are losing cash.

Once the bleeding has been stopped, sound foundations need to be laid for the subsequent successful regrowth of the company. This often involves a period of 'stabilisation' during which time the areas that are to be developed are identified and the necessary investment in people, operating efficiencies, new products, marketing and so on are arranged as well as putting in place the necessary finance.

The final phase where all the pain becomes really worthwhile is in the regrowth of the business and its value in accordance with the plan.

What help does a turnaround practitioner give?

In a turnaround the business is likely to need help from people who are familiar with this type of crisis situation and who possess the specific experience and skills needed to deal with it. These are the turnaround practitioners (or 'company doctors').

The business will need help with analysis of the position, an experienced eye to look over how deep is the crisis, assess the options and make an informed judgement as to whether the business is saveable.

To deal with the situation the business will need someone willing and able to act as a crisis manager who can deal with issues with the urgency and sometimes ruthlessness that they require.
They also need to be someone who can cope with challenges and difficulties in a professional way.

They require a body of specialist knowledge of commercial and insolvency issues such as wrongful trading and redundancy law to be able to both manage the risks; and to manage the interests of key stakeholders such as banks so that they will support the business through its difficulties.

The help provided by a turnaround practitioner is generally therefore extremely 'hands on' in nature. These are not professional advisors like the accountant or the lawyer who, however close the relationship, do remain outside advisors. These are the doers who become part of the business as directors to take charge and drive through change for the time needed to make the plan happen.

They often work alone but increasingly are operating as teams, often in conjunction with or organised through the firms who are also involved in supplying in specialists on a temporary basis known as interim managers to deal with particular functional aspects of the business (e.g. a temporary finance director or an production director) as may be required to turn the business' performance around.

Who else provides help?

Turnaround practitioners are not the only people that a business will need. As a turnaround affects all areas of the business, so the business often tends to need assistance from a broad range of specialists.

If the business is in a severe crisis often formal insolvency advice will be needed at the outset by the directors from either lawyers or an insolvency practitioner (or 'IP') as to whether they are safe to continue trading the business. As well as being able to advise on use of any of the business rescue procedures under the Insolvency Act such as a Company Voluntary Arrangement, an IP will be able to assist the directors in assessing their position and often in having initial discussions with the bank to gain support for a turnaround as well as introducing or working with a turnaround practitioner.

Often there is a need to raise new or replacement finance to provide funds to deal with the initial crisis or to support the subsequent recovery and regrowth of the business and these funds will come from specialist asset financiers either directly or more usually through a broker who knows the market and is used to placing such business.

Legal advice is almost always required and the business will need a recovery specialist as a lead advisor who can call upon expertise within his or her firm across a wide range of areas such as insolvency and debt collection in the early stages; through employment and redundancy issues when it comes to restructuring the business as well as contractual disputes if there are problem contracts; right through to corporate finance specialists if there is a need to raise new equity or arrange a sale of the business.

The range of flexible resources provided by Interim Managers are increasingly important as the business will normally require different types of help at different phases of the turnaround. A typical case might require a lot of help from an interim finance manager on tightening up management of its cash to survive an initial crisis. This might be followed by an operations specialist to sort our manufacturing problems once the position has been stabilised and then a marketing specialist to help grow the sales, the whole process perhaps overseen by the turnaround practitioner responsible for delivery of the entire strategy.

This White Paper is based on an article written by Mark Blayney that first appeared in the "Turnaround Guide 2004-2005" published by the Turnaround Management Association (UK). It has been updated to reflect more recent figures.

Mark Blayney is the managing director of Creative Strategy, a business turnaround and strategy consultancy and Creative Finance, a finance brokerage specialising in raising cash for businesses in difficulty. He is the author of *Turning Your Business Around: How to spot the warning signs and keep your business healthy; Selling Your Business for all its worth; and Buying a business and making it work* (How To Books Limited, Oxford 2002, 2003 and 2005, available through www.turnaroundhelp.co.uk) and a past director of the UK Chapter of the Turnaround Management Association.