Convincing Owner-CEOs to Let Go and Trust a Professional Turnaround Practitioner

When companies begin to underperform, they should seek out advisors they trust to provide critically needed advice and direction. If businesses followed this simple suggestion, practitioner members within the turnaround industry would find few new clients. So why are they so busy? An analysis of clients, combined with an anecdotal review of other cases, suggests the following outcome of turnaround and crisis management consulting projects involving privately owned, closely held companies that have revenues of less than $100 million:

In highly distressed cases, the outcome is generally more negative when an existing owner - management team remains in place than when the group is supplemented by turnaround or crisis advisor, or even sometimes replaced.

Middle market company owner-CEOs generally are neither trained nor equipped to be turnaround managers. Can incumbent owner-CEOs understand the critical differences between their role and that of a turnaround CEO/CRO? Often the answer is no, and there may not be a trusted advisor around who is willing to spell out to an owner-CEO his limitations.

Although turnaround practitioners pride themselves on their crisis management and operational skills, it is abundantly clear that they need to develop another important trait. Turnaround advisors must start selling themselves and their skills effectively.

Searching for Answers

Participants in the turnaround industry are familiar with reasons middle market and lower middle market companies underperform. These include:

Management Issues. Management may be incompetent or not adequately motivated.

Operational Issues. A company's operational challenges usually surface as cost, quality, or capacity issues; selling or customer service problems; or financial administration and systems weaknesses.

External Issues. General economic issues, government regulations, foreign and domestic competition, industry consolidation, or loss of product demand can affect companies.

Smaller companies that are privately owned or closely held often have fewer resources, smaller management teams, less-independent advisors, and tighter budgets. When trouble arises, these owner-CEOs turn to one or more members of a small fraternity they trust. These trusted advisors often include:

Board of Directors or Board of Advisors. If one of these has been created, it often is comprised of the same individuals who took the company into rough waters in the first place or of family members who lack adequate business expertise to offer constructive guidance.

Internal Management Teams. As a company's results deteriorate, its managers may become increasingly concerned about their pay checks and their families and may avoid discussing difficult issues with the owner-CEO.

Certified Public Accountants (CPAs). As the world has become more litigious and complicated by legislation such as Sarbanes-Ox ley, some accountants are less willing to interpret their work to the point of providing detailed guidance to management. Such management recommendations also can affect personal tax and estate planning advice offered to business owners and family members. Few professionals or friends like to rock the boat.

Lawyers. The first people to speak truth to the owner are also among the first to be told, "I know how to run my business. I don't need your business advice." Under such circumstances, many lawyers may not want to rock the boat either.

Professional Friends and Colleagues. Although they often are the best sources of information, friends and colleagues also usually are reluctant to risk their relationships by telling each other painful truths that they really need to hear.

Management Consultants. Rarely does a troubled company with stressed liquidity voluntarily retain a management consultant for advice.

Senior Lenders. Until a default occurs, a lender is reluctant to offer a probing analysis of operational issues, preferring to hear any such analysis from a company's management. When a default has occurred, they still lack the leverage to change performance substantially because of concerns over lender liability or equitable subordination issues.

As a company's performance moves from poor to terrible, a number of things begin to happen. The owner-CEO and CFO frequently both encounter substantial changes in their job responsibilities. They become involved with critical, time-consuming problems and responsibilities for which they have little or no training or experience, leading to further decay in the business, while other important duties are neglected. If it hasn't already done so, the company will default on its debt eventually, at which point the lender often will require that a turnaround advisor be retained as part of a forbearance agreement.

Pay Now or Pay Later

To start, a turnaround advisor will be engaged to complete an overview or viability assessment, which will include strategies and recommendations. In the middle market space, a turnaround advisor may recommend that he be retained as interim CEO, interim CRO, or as a full-time, on-site advisor to support existing management.

A range of responses — some of them emotional and others that may be driven by thoughtful deliberation — can be expected. These may include:

- "You have not told me anything that I don't already know. I can make the changes myself."
- "Nobody has the industry skill and experience that we have that would make them capable of taking over my company."
- "All I need is a loan extension or an over-advance for six months, and my company will be fine."
- "I hate this job. I don't even like talking to the VP of manufacturing, who is a 35 percent stockholder and my fraternity brother from college. I don't like talking to lenders, bankers, lawyers, accountants, the CFO, or even the human relations (HR) director. I just want to sell and do product development."

Rarely is the response, "When can you start?"

At this juncture, external pressure may be insufficient to convince an owner-CEO to empower the turnaround or crisis professionals with authority to drive meaningful change. Without needed change, companies often continue their downward spiral, dissipating the incumbent equity and sealing their doom.

Recalcitrant underperforming owner-CEOs must understand that whatever solution they put in place will carry a cost. They can pay the cost of a turnaround advisor and welcome meaningful change, or they can watch as the intrinsic value of the corporation continues to shrink at an ever-increasing rate.

Once turnaround and crisis consultants complete a formal assessment of a company, the CEO must accept that his professional turnaround practitioner possesses:

- A critical understanding of the problems.
- A vision of how the problems can be solved.
- The management skills and abilities to execute a plan.
- The skill to communicate with all key stakeholders and gain their buy-in.
- A capacity to adjust quickly if selected strategies underperform or conditions continue to change or deteriorate.
- The intention to exit the consulting relationship when the business has been improved and it has stabilized.
- The ability to convince lenders to extend terms and provide liquidity upon the presentation of reasonable terms and conditions.

It is an absolute fact that the owner-CEO client must be willing to stop trying to manage and control the turnaround. It is likely that the CEO has either created or contributed significantly to the position the business is currently in. If he continues to manage it is highly likely he will continue to achieve the same results. The owner-CEO needs to get back to focusing on what he does best , which surly is not crisis management. He must step aside and find a different value-added role in the organization that captures his strengths and does not put him in a position where he is destined to fail.

Of course, ownership often retains its controlling position and continues to fight without the support of a turnaround or crisis manager and ultimately takes the company beyond the point of potential recovery. Those cases generally result in liquidations, asset sales, Chapter 1 1 filings designed to facilitate Section 363 sales, and other terminating strategies, which generally leave equity owing high professional fees while having no business to go back to.

Catalyst for Change

Unfortunately, a single, clear-cut solution for convincing an owner-CEO to relinquish control of a company does not exist. A CRO or interim CEO is neither a miracle worker nor an interloper. Such a professional is a catalyst for desperately needed change. Trusted advisors who understand the contribution that a turnaround or crisis manager can make should be enlisted as allies in convincing the owner-CEO to accept such changes. Lawyers and accountants can counsel their clients to have preliminary fact finding discussions with their consultants. This would allow CPAs or attorney s to assist their clients without engaging in the operational conflicts. Capital providers of all varieties can make even more of a difference. They can vigorously suggest more companies establish advisory boards comprised of members from inside and outside the organization. They also can develop stronger internal monitoring systems that will result in speedier, consistent responses to early stage warning signals. It’s an education process that requires all professionals to step to higher levels to help those individuals who often are in denial and do not recognize or understand the depth of their companies’ problems.

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