CORPORATE FINANCIAL & TURNAROUND ADVISORS

THE TURNAROUND PROCESS

Is Your Business In Crisis?

First things first; if you are a business owner who finds his business in trouble, now is the time to admit there is a problem that will not fix itself and; that you need an outside expert who has the skill-set and the experience to (1) identify the source of your problems; (2) develop an efficient and strategic blueprint to fix the problems, prevent them from recurring in the future and; to (3) put your company on a course to meet your life goals in the shortest time possible.

The Stages of a Turnaround

While every situation is different with its own unique aspects, generally there are three phases to a successful turnaround. These primary phases are (1) the assessment phase, (2) the implementation phase and, (3) the recovery phase. The assessment phase is a thorough and in-depth process where the turnaround strategies are developed. It is critical to have a plan and goals to use as steering points while we navigate the turnaround process. The next phase is when those steps are implemented. This last phase is designed to firmly set and maintain a course toward the company's/owners long-term goals and exit strategy.

Prepare For Your Consultant

Get your accounting system as up to date as possible and provide the following items in an electronic/spreadsheet format:

- ❑ Last year's year-end financial statement (P&L and Balance Sheet)along with your YTD corporate financial statement
- ❑ A general ledger for the last six-months
- ❑ The last three years of your CPA prepared financial statements
- ❑ The last three years of filed business tax returns
- ❑ An organization chart including total compensation cost to the company (wages, taxes, incentive, benefits, etc.) for each employee
- ❑ Job descriptions for each employee
- ❑ Imagine you are starting your business as a brand new enterprise. Who would you absolutely need to make things happen? Make a list of those people.

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- ❑ On an employee list, indicate who is contributing to the most profitable parts of the company and who is contributing the least.
- ❑ Make a list of all contracts/agreements that the company has with its suppliers, employees, unions, creditors, etc.
- ❑ A breakdown of the company's business lines, target markets, currents trends and potential risks
- ❑ Copies of any financing proposals you may be considering
- ❑ Make a list of any money that you or the company borrowed for business purposes (amount, payments, interest rate and terms)
- ❑ Prepare a list of key contacts he will need to work with within your organization for (1) accounting, (2) personnel and (3) other key managers. The list should include email addresses, office, cell and home phone numbers.

Assessment Stage

During this phase, your turnaround practitioner will slice and dice the financial data you have provided in order to identify all of the problems and determine the best strategies to implement. He will also determine the future viability of your business. This process may involve several meetings with you and your staff and requests for more information. At the conclusion of this phase, which can take a week or two, you should receive a report detailing your situation. While it is likely that the report will focus on financial information, it may also contain observations and recommendations about personnel, management and marketing practices.

Implementation Stage

This is where the real turnaround begins. It is best to let your turnaround practitioner drive this process forward. It is best if there is an authoritative internal "champion" who will work closely with your turnaround practitioner to implement the plan on a daily basis. It is very important to note that the plan will not work if senior management does not fully embrace the plan in its entirety as well as the concepts behind it. You should expect to see a plan that addresses the following items:

- ❑ The future of the company you built is at stake so take action now – today. Don't hesitate.
- ❑ Prepare a 13-week Cash Plan to identify true cash flow and sources of cash burn. The top page should summarize all inflows and outflows. It should project cash inflows and outflows for the next 13 weeks.
- ❑ Identify mission critical vendors and put on "keep current" list.
- ❑ Create an organization chart of what the organization will look like after the turnaround.
- ❑ Imagine you are starting your business as a brand new enterprise. Which positions and individuals would you absolutely need to make things happen? Terminate everyone else. Make sure to eliminate those positions that are not critical, not major contributors or problem makers. No one is irreplaceable. Make these changes all in the same day.

- ❑ Confer with company CPA regarding findings, accounting process, capital restructure and tax issues.
- ❑ Make a list of the monies owed to you, and collect as much of it as possible. Pay the necessary items like taxes and overhead costs, but delay paying other bills by working with suppliers and other creditors.
- ❑ Know your cash flow. Prepare a worst-case 12-month cash flow scenario. Consider a 10-20 percent drop in revenues if appropriate and identify what changes you would make and when.
- ❑ Arrange a standstill agreement with any lenders or creditors threatening action.
- ❑ Implement a formal cost curtailment initiative. Cut all unnecessary costs/expenses. Implement salary reductions beginning with executive management. After initial round of cuts, offer rewards to employees who find new cost saving items or strategies.
- ❑ Restructure the accounting system, correct incorrect/improper entries and reorganize the financial reporting process.
- ❑ Identify critical KPI’s
- ❑ Review all agreements, contracts and insurance policies to discover opportunities for savings. Solicit new bids to reduce overhead.
- ❑ Reduce fixed cost and implement better controls/processes for variable costs.
- ❑ Perform a gross margin analysis and an extrapolated net margin analysis on all business lines to determine bottom line contribution. Rebuild your firm around the profitable pieces of your business. Eliminate, close or sell all business segments that are marginally profitable or less. Eliminate the employees in these “loosing” business units. Raise prices on low margin business before deciding to eliminate unprofitable business lines/units. Do it immediately.
- ❑ Find opportunities to consolidate and curtail overhead.
- ❑ Identify backup vendors (just in case).
- ❑ Identify potential internal and external risks including market trends.
- ❑ Capitalization restructure recommendations
- ❑ Reassess and identify opportunities to streamline organization and governance structure.
- ❑ Identify critical management areas and reestablish chiefs of those areas with **full** accountability for results.
- ❑ Standardize weekly and monthly and report to executive management
- ❑ 5. Negotiate discounts by class
- ❑ 6. Cancel all non-union contracts.
- ❑ Consider soliciting RFP's for improved services, supplies or parts.
- ❑ Eliminate seniority and sacred cows among departments especially for underperforming areas.
- ❑ Hold regular cost cutting meetings – perhaps monthly. Change the participants of the meetings in order to get differing points of view.
- ❑ Renegotiate terms and amounts with key creditors. Offer short payoffs.
- ❑ Tighten up on collections. Shorten up your receivables cycle however you can. Consider more aggressive collection techniques.
- ❑ Identify critical employees and be prepared to offer them a loyalty bonus if it becomes necessary. Typically, this procedure involves a bonus of 7% to 15% of their base pay in exchange for their signature on a one-year contract that they can’t cancel. Often payments are staged over the contract period.
- ❑ Outsource when possible. Keeping fixed costs low is key in downturns. One way of doing this is to outsource non-core services, projects, or expertise versus keeping them in-house. This should be looked at on a case-by-case basis.

- ❑ Depending on the seriousness of your situation, begin to accrue money weekly in a separate account to handle typical workout costs such as employee severance, professional fees and a pre-bankruptcy war chest.
- ❑ Keep inventory lean. Blow out as much inventory as possible. Sell old inventory for whatever you can get but sell it now. Make sure sales and operations have daily or weekly communication. Set and measure inventory targets.
- ❑ Consider changing your sales commission schedule. Reduce regular commissions based on volume and pay more for increased profit margins, etc.
- ❑ Weed out unprofitable customers. Every company has customers that cost more than they add to the bottom line. Identify them, evaluate how to make them profitable customers, and if that is not possible, politely hand them to your competition.
- ❑ Explore the pros and cons of alternative financing such as an asset-based lender or factoring receivables.

While your turnaround team is working with your staff to implement the plan components, there are things the owners or executive managers should keep in mind.

- ❑ Take care of your personal financial circumstances. You must have personal financial security to focus on the turnaround.
- ❑ Get control of your cash. Approve all purchases and sign every check personally.
- ❑ Calculate the date the doors will close if no changes are made. Do this with the entire executive management team. Do it after hours. Make sure everyone buys into making serious major changes.
- ❑ Keep payroll taxes and union benefits current. Not only are you personally liable for these obligations but, you can be held criminally liable for any misdirection of these funds since by law they do not belong to your or your company.
- ❑ Before trying to borrow more money, think carefully about whether your business is likely to do better in the near future or if you are only likely to compound your debt problems by borrowing more money.
- ❑ If you do decide to apply for a new loan or to consolidate old ones, be forthright in disclosing the financial condition of your business. If you misrepresent your debts to get a loan, the law may regard your new debt as having been obtained by fraud. This would mean you are personally liable for the debts, even if you go through bankruptcy.
- ❑ Be Careful About Transferring Business Property. Creditors are used to ferreting out hidden assets. An owner shouldn’t (1) transfer assets to friends or relatives in an effort to hide them from creditors or from the bankruptcy court, or (2) conceal property or income from a court.
- ❑ 10. Don’t Borrow From the Company’s Pension Plan. Many pension plans don’t allow you to borrow (or remove) money from the plan account. If you do, you could be assessed a penalty of up to 115% of the “borrowed” money. Worse, the plan could be "disqualified," meaning that all deductions would be disallowed, all plan assets distributed, and income tax and late payment penalties applied.
- ❑ Make sure your insurance policies have been renewed and will be in place for at least 12-months.
- ❑ Extend your suppliers as much as possible (stretch out your payables). Stay in touch with your important vendors. Slow payment with communication is preferable to no communication. Chances are they have been through some tough times themselves and may be more understanding than you anticipate. This can buy you at least 30 days of extra cash flow. Set a maximum number of days for payment with your vendors and do not go beyond that time limit without a phone call.
- ❑ Talk to your banker and get any forbearance agreements needed to continue. Be honest with your banker and understand that you are making him and her look bad to bank superiors. Be careful with this step. You should strongly consider using your professional turnaround practitioner to assist you with this, since it can backfire.

- Lead your firm with an iron-fist, but try to be as considerate as possible. This is a very difficult time for your staff.
- Contact your customers if your customer facing performance is suffering – Show that you care. Understand how their business is being affected and look for ways you can help. Lasting relationships are built in hard times.
- Look for new market opportunities – When the business climate changes, customer needs change as well (new markets, new products, bundling, expanding smaller parts of your business, etc.).
- Identify leading indicators – Formalize your tracking of leading indicators. Now is the time to improve management reporting; by the time you get the monthly financials it will be too late.
- Monitor your loan covenants closely – Evaluate the terms and conditions of third party covenants. Keep your lender involved - they do not like surprises. Look for a way to maintain a 10% buffer on all covenants.
- Keep inventory lean – Make sure sales and operations have daily or weekly communication. Set and measure inventory targets.
- Weed out unprofitable customers – Every company has customers that cost more than they add to the bottom line. Identify them, evaluate how to make them profitable customers, and if that's not possible, politely hand them to your competition.
- Outsource when possible – Keeping fixed costs low is key in downturns. One way of doing this is to outsource non-core services, projects, or expertise versus keeping them in-house. This should be looked at on a case-by-case basis.

Recovery Stage

After the crisis is solved and you are using the new management techniques and tools you have been given, you and your team need to focus on top-line growth. The following ideas should help to get you pointed down the right path:

- Look for new market opportunities. Remember when the business climate changes, customer needs can change as well. Consider new markets, new products, bundling, etc.
- Identify leading indicators. Formalize your tracking of leading indicators. Now is the time to take advantage of the new tools and professional expertise you have at your disposal. By the time you get the monthly financials it will be too late. So, make sure you have a weekly report that quickly displays critical operations and sales information (KPI’s) and includes your weekly cash plan. Review this with your management team each week.
- Survey your customers, employees and vendors to discover your strengths, weaknesses, opportunities and threats.
- Create a marketing phrase, a unique selling proposition, which summarizes what was learned from your surveys. Use it in all promotion and communication.
- Differentiate your channels of distribution from your competitors. Look for market segments you can excel in.
- Walk the floor. Renowned management guru, Tom Peters, coined the acronym MBWA – management by walking around.
- Encourage department managers to think for themselves. Give them responsibility for their own financial statement. Encourage independent management and new ideas.
- Post monthly departmental goals on large signs in each department. Reduce departmental employees base pay by 5% and then give it back to them in monthly performance bonuses for meeting or exceeding their goals.
- Focus employee morale on positives by sharing good news and formally recognizing effort that goes above and beyond. Name an employee of the month.

- ❑ Enjoy social events with your employees. A team that plays together, stays together.
- ❑ Eliminate all assigned parking. You need to function as a team! Create a parking spot for the employee of the month.
- ❑ Make sure your employee manual is up to date with current laws and employment practices. Have each employee sign for their copy.
- ❑ When delivering superior or special services charge for it. Great customer service is everything but, get paid for it!
- ❑ Do not give discounts for you organizations poor work or products. Redo shoddy workmanship and charge full price for it. Do it right or do not do it at all.
- ❑ Only spend time finding conventional financing once you have at least 2 quarters of profits from continuing operations. Looking for conventional financing before that is a waste of your time.
- ❑ If you plan to sell your business, wait until you have 6 to 8 quarters of profits and positive cash flow.