VIEWPOINT

Rapid Improvement: Turning On A Dime

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One of a series of opinion columns by bankruptcy industry participants.

There has been a dramatic increase in the amount of capital available in the marketplace. Investors such as hedge funds, private equity firms and second-lien lenders are emerging as competitive players to the traditional commercial bank lenders in the financing arena.

These players are investing at all levels of the capital structure, including first-lien revolvers, second-lien term loans, unsecured term loans and equity infusions. Although this influx of capital offers companies more available options to deal with an overleveraged balance sheet, it also increases the temptation for management to refinance its problems away for another day.

Partly driven by the increase of available capital in search of deals, management can be lulled into focusing solely on a balance sheet restructuring. Members of management easily can convince themselves – and attempt to sway their constituencies – that the primary issue facing the company is an overleveraged balance sheet and once fixed, the company will thrive. However, financial fixes aren't in and of themselves long-term solutions. To the extent interest rates rise, industries and markets change or the economy slumps, a company may find itself in the same distressed situation if the underlying drivers of value deterioration aren't addressed.

Astute management must address both the capital structure and the underlying fundamental drivers affecting revenue, costs and profitability on a strategic and operational level. The management team of a furniture manufacturer that was recently undergoing significant distress did just that. Upon taking control of the business, the new management team set a five-stage turnaround process in motion:

- <u>Strategy</u> – Gained an understanding of the market size and landscape, identified best opportunities and developed a plan to focus efforts on specific product categories and channels of trade.
- <u>Structure</u> – Created a focused marketing, channel and sales structure to support and develop targeted market segments, transitioning from an independent sales representative structure to a direct account management organization.
- <u>People</u> – Recruited and hired the right people (80 within a year) with the experience and skill set to implement the strategy.
- <u>Focus</u> – Shifted the company's direction from a furniture- only business to a consumer-packaged goods company to expand its product line within key customers.
- <u>Execution</u> – Brought in operational and financial restructuring professionals to assist to fix the business and the balance sheet.

Upon reaching the execution phase, executives in troubled waters may not know where to turn for assistance. Operational and strategic consulting aren't new product offerings. Traditional strategic and operational consultants have been advising companies for years in the development of revenue enhancement, operational improvement and cost reduction initiatives. Techniques such as lean manufacturing, six sigma principles, kaizen events, etc. were introduced as methods to enhance operations. However, such methodologies can take years to design and implement. As distressed companies and investors look to increase value, especially given the shift in the players at the investing table, there is

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little patience for the long-term, theoretical process- improvement methodologies of traditional strategy consulting shops. Companies and investors are seeking rapid improvement.

Speed and a sense of urgency are the mantra of turnaround shops. However, many reorganization advisers have been involved in restructurings where the end game was a balance sheet restructuring or an asset sale. In such circumstances, the marching order is often one of “don’t rock the boat.” The view is that the new owners or equity holders can deal with the operational turnaround. In such circumstances, fixing the business is often deemed risky due to unforeseen consequences that could jeopardize the asset sale or recapitalization. As part of the restructuring process, turnaround consultants may review and analyze a company’s strategic and operational plan to assess risks and potential exposure for the lenders, but stop short of actually developing and executing the plan. As such, turnaround advisers who have only worked in this context may bring the requisite need for speed, but likely won’t possess the operational expertise that is actually needed by management.

A management team looking to fix the underlying operating problems of its business requires an adviser that properly blends the methodologies of traditional strategy and performance improvement with the sense of urgency and change management techniques offered by crisis-oriented turnaround shops. Such advisers must be able to provide true operational improvement in a condensed timeframe with a “roll-up your sleeves and get to work” approach.

In the case of the furniture manufacturer, management engaged an advisory team that combined traditional financial restructuring with revenue enhancement, operational improvement, cost reduction, change-management and other performance improvement methodologies. A new product development process, strategic sourcing structure and cost reduction initiatives were quickly developed and implemented. Buy-in was achieved through traditional change-management techniques (in an expedited form) such as project sponsorship, project teams and workshops, allowing long-term value to be created. Rather than only focus on the restructuring of its balance sheet, the furniture manufacturer made a real change in its business structure by addressing the key drivers of profitability.

In today’s capital-rich environment that offers distressed companies a plethora of financing options, companies must be cautious in putting a “band-aid” on a distressed situation by only focusing on fixing the balance sheet and not on the fundamental issues driving business valuation. A dual-path turnaround approach is key to finding the solutions that will maximize financial results and drive value creation in the long term. However, as time is the enemy for a distressed company due to liquidity constraints, customer and employee concerns and competitive pressures, a rapid recovery approach must be taken to ensure that value isn’t lost and results are quickly realized. Crisis managers with strategic and operational improvement expertise that are used to working under time and resource constraints provide valuable solutions for these distressed companies.

(The views expressed in the article are held by the authors and are not necessarily representative of FTI Consulting.)

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