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Turnaround Topics

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The Missing Link to Successful Company Turnarounds

Balance Sheet Management Is Only Part of the Story

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The first rule that every restructuring professional learns is "cash is king!" We dive into bank accounts and financial records and work furiously to develop cash-flow projections that stakeholders will use in a variety of ways to make critical decisions. We then tackle the assets, making a list and attaching a valuation to each. Also early on in the fact-gathering process, we identify the liabilities, known and estimated, and whether they must be adjusted in the restructuring process.

Weeks and months can pass, with numerous hours billed, and eventually we complete our assignment and prepare to depart. Often, there is not enough focus on a crucial question: "Who exactly is going to implement the turnaround." Turnaround professionals are typically great at identifying the problems and developing solutions, but they ultimately will not be executing the plans they have developed — the company's management team will, and it is often not the right management team for the turnaround to be enduring.

With the advent of the chief restructuring officer (CRO) role during the 1990s, the industry developed a point of view that management should focus intently on running the business during the restructuring process and let outside professionals, a CRO or advisers, handle the specialized aspects of the turnaround and legal processes. In hindsight, this approach was most appropriate in cases of balance sheet restructurings. The "good company/bad balance sheet" restructurings were relatively straightforward to accomplish: Agree on the enterprise value, determine the debt capacity and negotiate how to allocate value and recovery among stakeholders. (Note that I did not say this was "easy.") In instances of "bad company/bad balance sheet," restructuring professionals focus more intently on operations, quickly stopping losses and improving cash flow with the use of interim senior managers — primarily chief executive officers (CEOs) and chief financial officers (CFOs). Interim managers could make the necessary changes that incumbent management could not — or would not — to guide the company to stability.

As we consider clients' outcomes years after restructuring, which ones were successes, and which were failures or continue to languish? As we think about the leadership and management teams in place as we finalized the turnaround plans, it was the management team's leadership, skills and execution, not the balance sheet management, that ultimately had the most bearing on the outcome.

Why is this little trip down memory lane relevant to our profession today? The current challenges that our clients face in the near term will only be overcome by managers who are responsive to the new economic order. Retail is an industry with which we are all familiar — either as consumers or professionals — so let's use some retail examples to make the points that follow. Companies used to succeed because they had a competitive advantage, the so-called better mousetrap or unique offering, like the Apple iPod replacing the compact disc players. Alternatively, there may have been enough customer demand to allow "me-too" companies to make just enough profit (or borrow enough money) to stay in business. Examples such as JC Penney and Sears come to mind.

Today, information transparency obliterates much of the old-line competitive advantage that produced consistently high returns on investments (ROIs) in most successful businesses. Amazon has upended customer loyalty as it relates to thousands of products. Consumers no longer need to rely on their favorite retailers to feel confident about the value of a purchase. Rather, they can comparison-shop features and prices on their electronic devices at the mall or at home.

Even large-ticket items are becoming more vulnerable to instantaneous comparison shopping, as evidenced by the high volume of appliances, furniture and luxury goods that are sold through the e-commerce channel. How are management teams going to address this attack on the traditional concept of competitive advantage?

The second variable that defines the new normal is speed. How quickly can the company get its products to the customer, and how long will customers' tastes and purchasing habits remain intact? The first dimension of speed relates to getting the customer what they want quickly. Zara, a Spanish retailer, can design and manufacture apparel and have it in their 1,700+ stores within two weeks vs. the typical six-month cycle for most apparel manufacturers. Since Zara has developed an unconventional approach to design and manufacturing, it has nearly eliminated its dependence on guessing what the consumer wants.

Another speed variable addresses the manufacturing timeline. Conceived originally in the business-to-business realm, the "just-in-time" inventory approach is now just one of the principles of lean manufacturing: producing what your customer wants, in the quantities they want, where they want and without delay. For 30 years, restructuring professionals have been able to reduce costs and improve clients' performance by adopting these practices.

However, we have recently begun to see the risks of prizing speed at all costs. The impact of natural disasters on supply chains is one example. Consumers' fickle preferences, and a company's time frame to adjust to those changes, are others. For instance, Americans today prefer healthier options; note the growth of Whole Foods locations, the lower-calorie and vegetable-based choices at McDonald's, and the organic food aisles at the supermarket. Yet Starbucks has succeeded in convincing consumers that they really do need a 530-calorie Caffé Vanilla Frappuccino to start the day. Restructuring tombstones are packed with companies that either failed to see changes occurring or reacted too slowly. As such, management approaches and styles that created great companies 20 years ago will not suffice in the years ahead. The following are descriptions of some traditional and new normal executive roles that will be necessary for success in the next wave of restructurings and turnarounds.

CEO

Traditionally, CEOs have reached the executive suite by demonstrating strong functional expertise in sales, marketing, finance or technology. They have a personal career history of "hitting the numbers." In family-owned or managed companies, the CEO was often the founder or a next-generation family member, with deep experience within the company but little experience outside it. CEOs were expected to drive the organization's financial performance through hierarchical directives. This person was also the frontline leader of the organization, with the rest of the executive team and employees following behind. For example, consider Mickey Drexler and his tenure at clothing retailer The Gap during the 1990s. Drexler's almost-magical ability to define a popular clothing style based on plain jeans and pocket tees largely came from his fashion instincts, but when consumer preferences began to change, Drexler and The Gap failed to respond quickly enough to changing market research trends or what was happening at the store level. Historically, CEOs have gotten their organizations in trouble by focusing too much on a single aspect of their business.

Today, the successful CEO cannot be one-dimensional. They must have well-developed general business acumen based on cross-functional experiences. CEOs must be able to lead from top to bottom, inspiring managers and employees to interact effectively with customers and peers. They must ensure that the critical intelligence affecting the business is reaching the executive suite. Communication skills have never been more important for the CEO than they are now. CEOs also set the ethical tone for the company and build trust in the organization with outsiders and internal constituencies. More importantly, the CEO works collaboratively, making decisions based on broad criteria with input from key team members. The CEO remains ultimately responsible for setting strategy and delivering results. However, the ability to think and act clearly when adversity strikes is an indispensable skill that the CEO must have to successfully implement any turnaround plan.

CFO

CFOs have often been the unsung heroes of successful restructurings. Their ability to produce accurate and timely financial data at the organizational level has been the key to delivering a believable business plans. Most CFOs began their careers in accounting or internal auditing, or maybe with a Big Four firm, and through that experience became expert "bean counters." As they progressed and/or the company grew, the certified public accountant would advance to become the CFO and take on the responsibility of managing banking and auditing relationships and be the interface with governmental regulators, if necessary. Typically, the CFO would also have responsibility for internal controls and treasury functions.

In the "new normal" world, the CFO's job is evolving dramatically. It might be the most challenging of all the C-level positions, given the breadth of responsibility and the depth of routine tasks. The CFO is still responsible for the book-keeping and reporting functions, both internally and externally. They are still responsible for treasury and cash management, as well as managing the bankers and the auditors. It is now critical that they also have capable lieutenants overseeing these functions. What has changed for the CFO is the focus.

CFOs now need to spend the majority of their time thinking strategically about the future. A 21st-century CFO will be a close business partner of the CEO and a vital member of the senior leadership team. They will be at the table from the beginning, when the company looks at strategic opportunities, as their role will be to assess the economics and evaluate the risks. This will be true whether the company is expanding or contracting, acquiring businesses or selling them. The challenge lies in the CFO's critical-thinking abilities as he/she reaches the executive suite. A CFO must have the ability to change orientation from one of precise execution to that of strategic risk-taker and leader. A CFO whose prior experiences were exclusively within the finance function (*i.e.*, controller or treasurer) might find it more difficult to be a contemporary CFO without operational or general management experience.

Chief Sales and Marketing Officer

We are using the term "Chief Sales and Marketing Officer" as the new-fangled title for the person in charge of the interface between customers and the company's products or services. Historically, sales and marketing roles were separate functions, with one function holding more organizational influence than the other. In brick-and-mortar stores, sales were within the purview of store managers, who were part of the operation's function. The marketing department resided at the corporate offices and oversaw advertising and promotion.

Today, sales and marketing functions are blurring, driven in part by the effects of social media, digital marketing and online selling. When we consider this role in terms of its importance to the success of a turnaround plan, it is hard to think of anything more important than the company's interface with customers. The age of information and digital connectivity makes this increasingly challenging, and the sales and marketing executives of the past might struggle with adapting to this new world order. Similarly, those who understand the power of social media and limitless information probably lack the experience that would allow them to be successful organizational leaders. Finding effective sales and marketing leaders is a perplexing challenge for all companies, but especially for a company implementing a turnaround.

Chief Supply-Chain Management Officer

Given today's rapidly changing consumer preferences and the speed that is required to either take advantage of, or stave off, competition, the individual responsible for linking planning, procurement, manufacturing/operations and logistics is winning an increasingly important role in the C-suite. This role might be a replacement for the historically prevalent chief operating officer (COO). Over the last 20 years, as purchasing and warehousing became more expensive, supply-chain managers played a significant role in driving cost efficiencies through strategic partnering with vendors and suppliers. Supply-chain activities gained sophistication with increases in global sourcing and as a result of lean manufacturing initiatives. In addition, today's supply-chain executives are taking the lead in defining how a company will achieve sustainability of its objectives. Although the "CSCMO" title is contrived to make the point, this new and evolving role is necessary to the success of a restructured company. An otherwise-sound turnaround plan could fail if the organization cannot coordinate these important, though mundane, activities.

Chief Information Officer

Chief information officers (CIOs) of the past grew up functionally. The common thinking was that good technology people could excel in any company or industry as long as they knew their hardware, software and IT talent. They were logical, detailed and sequential thinkers. As we look to the CIOs of the future, they will need more than a foundation in technology, but CIOs will need to know how to apply technology to business strategy. Business analytics is the fastest growing major at our undergraduate business schools, and for good reason. How to profit from today's data mining tools and understand ROI driven by technology and information systems are now critical responsibilities for CIOs. No longer will CIOs be successful by managing projects well; they must identify and manage the *right* projects.

The Right C-Suite

In addition to the C-level executive roles discussed above, other executive roles might be important to a company's future success. Regardless of the titles, a company will need someone responsible for legal and regulatory matters, talent management, and areas that include engineering, investment management, geographical operations, or research and development. Practically speaking, no C-level job is getting easier in the "new normal" world. Responsibilities are broadening while organizations are flattening, and there is now more to be done with fewer people.

Tomorrow's executives must be expert communicators and motivators. They must be skilled at coordinating and collaborating with business partners to provide the flexibility that is needed to respond to changes. They must be able to react quickly and cut through the clutter of data and ensure that the right team is consulted when important decisions are to be made. Executives with these characteristics and skills are key to winning or losing the turnaround game. Restructuring professionals should focus as much on the need for an effective and capable management team as they do on balance sheet management to ensure that their clients are positioned to be successful in the long term. abi

Editor's Note: *For more on this topic, purchase* The Chief Restructuring Officer's Guide to Bankruptcy: Views from Leading Insolvency Professionals *(ABI, 2013), available at the ABI Bookstore (bookstore.abi.org).*

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