

## The Principles and Practices of the Turnaround Process

*The turnaround process has become well defined and is supported by a recognized body of knowledge (BOK) developed by the Association of Certified Turnaround Professionals (ACTP). This article discusses the five stages of a turnaround and provides insight into the distinct aspects of each stage.*

By Thomas D. Hays, III, CTP

**T**he turnaround process has become well defined and is supported by a recognized body of knowledge (BOK) developed by the Association of Certified Turnaround Professionals (ACTP). This methodology has been found to be particularly effective.

The BOK is a core curriculum of universal, tangible principles and practices required of the profession and related disciplines. It lists specific topics in three general areas that are germane to the turnaround professional: management, law, and accounting.

The document was created by an ACTP faculty working in conjunction with turnaround professionals. Faculty members included Dr. Harlan Platt of Northeastern University, Dr. Grant Newton of Pepperdine University, Dr. Charles Hofer of the University of Georgia, and others. The BOK has undergone two revisions, with the addition of bankruptcy law guidelines for Mexico and Canada and the addition of a contracts area to the legal section. It is once again under review.

ACTP was founded in 1993 by the Turnaround Management Association (TMA). It is the sole international organization dedicated to developing, monitoring, and maintaining a program of certification for professionals engaged in the turnaround, crisis management, restructuring, and renewal of troubled businesses, organizations, and associations. ACTP's certification program is designed to encourage professional excellence and to provide an objective measure and recognition of expertise.

### Body of Knowledge

I was among the first of more than 500 individuals to date who have participated in the certification process. That participation exposed me to the BOK (<http://64.71.174.152/apps/knowledge.asp>). During my initial review of the BOK, I was particularly impressed with the management section, which outlines a process to follow during a turnaround. It allowed me to explain clearly to all stakeholders what needed to be done at each stage of a turnaround. Because most turnaround managers are brought in when there is trouble and the course of action is not clear, the ability to explain the process simply becomes particularly important.

The process follows the corporate governance model reflecting a director's point of view. The areas of most immediate interest to a secured lender are addressed in the three critical success questions for a turnaround:

1. Can one or more viable core businesses be identified, or can the existing businesses be fixed?
2. Are adequate human or organizational resources available, or can they be obtained?
3. Is adequate bridge financing in place or can it be obtained?

While those questions are key in determining whether a business can or should be saved, it is essential that a lender also analyze a company's prospects beyond making sure that a plan is in place. The plan must be executable, and it must lead to a recovery higher than that produced through a liquidation or sale of the business.

The five distinct stages of a turnaround are: management change, situation analysis, emergency action, business restructuring, return to normal.

The Turnaround Matrix on page 30, summarizes the objectives for each stage as well as the actions required in each of the businesses functional areas.

Once the three critical success questions have been resolved, having the secured lender ensure that the turnaround process is followed as described in the BOK greatly enhances the probability of a favorable outcome. In my opinion, the Business Restructuring stage is the most troublesome. Although the crisis portion of the turnaround has passed, the company remains fragile. Constant vigilance must be maintained to prevent backsliding.

If a company that just recently came through a crisis falls back, its chances of success shrink dramatically. A second crisis will cost the company its credibility with the outside world, financial resources, and perhaps most important, the focus and trust of its employees.

### About the Association of Certified Turnaround Professionals

The Association of Certified Turnaround Professionals (ACTP) is the sole international organization dedicated to developing, monitoring, and maintaining a program of certification for professionals engaged in the turnaround, crisis management, restructuring, and renewal of troubled businesses, organizations and associations.

ACTP's certification program is designed to encourage professional excellence and to provide an objective measure and recognition of expertise.

To become a Certified Turnaround Professional (CTP), practitioners must meet stringent standards of education, experience, and professional conduct, which have been developed and are administered by the ACTP Standards Committee in conjunction with the ACTP Faculty.

# TURNAROUND MATRIX

STAGE:	MANAGEMENT CHANGE	SITUATION ANALYSIS	EMERGENCY ACTION	BUSINESS RESTRUCTURING	RETURN TO NORMAL
OBJECTIVE	1. Select top management team 2. Weed out impediments	1. Can it survive? 2. Identify strategy 3. Develop preliminary action plan	1. Survival 2. Positive cash flow 3. Raise cash for strategy 4. Protect future resources	1. Enhance profitability through operations 2. Restructure business for increased profitability and return on assets	1. Institutionalize emphasis on profitability 2. Seek profitable growth 3. Build competitive strengths
COMMENTS	1. Select turnaround manager 2. Replace some or all of top management	1. Determine nature of turnaround 2. Three success requirements	1. Taking charge 2. Getting control of cash		
FINANCIAL	N/A	1. Cash flow 2. Break-even 3. Profitability 4. Balance sheet	1. Debt restructuring 2. Working capital improvements 3. Cost reductions 4. Profitability analysis	1. Liquidity improvement 2. Balance sheet improvement 3. Control system development 4. Managerial accounting systems 5. Sale of non prod. assets 6. Eliminate "creative" accounting	1. Strategic accounting and control systems 2. Restructure long term financing 3. Develop formal stock valuation and buy back system
MARKETING	N/A	1. Product/service analysis 2. Distribution analysis 3. Sales and marketing strategies and systems	1. Correct under pricing 2. Product line pruning 3. Weak customers/distributors 4. S&M in line with avgs.	1. Product line and competitive pricing 2. Existing and new products 3. Customer and distributor mix 4. Improve S&M effectiveness	1. Explore new markets and segments 2. Find industry restructuring opportunities 3. Value added chain restructuring 4. Synergistic diversification
MANUFACTURING/ OPERATIONS	N/A	1. Facilities and equipment 2. Systems and procedures 3. Supplier analysis	1. Shut down operations 2. Reduce work force 3. Reduce inventory 4. Control purchases 5. Increasing productivity	1. Productivity improvement programs 2. Periodic overhead analysis 3. Profit improvement programs	1. Restructure for competitive advantage 2. Consider strategic alliances
ENGINEERING/ R&D	N/A	1. New product 2. Product improvement 3. Process improvement 4. Productivity improvement	1. Accelerate high potential 2. Eliminate tangential	1. Customer oriented new products 2. Economic value added analysis	1. Establish tech monitoring 2. Seek strategic leverage on engineering and R&D
ORGANIZATION/PEOPLE	N/A	1. Organizational structure 2. MIS 3. Accounting and control 4. Performance & compensation		1. Improve people mix 2. Restructure for competitive effectiveness 3. Comp. to reinforce turnaround 4. Think profits and ROI	1. Institutionalize training and management development 2. Restructure occasionally to reflect changes in strategy and environment
PERSONNEL	N/A	1. Middle and first line 2. Operating personnel 3. Recruitment, selection, training	1. Change status QUO 2. Reward those who change 3. Sanction those who don't		
OTHER		1. Assess strategic position 2. Viability assessment			

While the lender is an active participant throughout the process, care must be taken to insure that the lender is not deemed in control, which may lead to a potential lender's liability action.

It is far easier to convince stakeholders to buy into a suitable course of action, once they understand there is a robust process in place. In addition, the process provides a framework to focus on important issues that must be addressed in an orderly fashion.

## Stage 1: Management Change Phase

From the perspectives of the board of directors and the secured lender, the key task to be completed early in a turnaround is to put in place a top management team that embraces the need for change and corporate renewal to carry out the turnaround process. Clearly, incompetent individuals and those who are resistant to change have caused the failures of many businesses.

A board should hire an experienced turnaround specialist, corporate lawyer, and/or an investment banker to help with the process. The turnaround professional may act as either an advisor or become part of the management team depending upon the skill of the in place management. Because the board is "betting the company" on a course of action, it has an obligation to all stakeholders to make sure capable people are in place to advise and assist in the turnaround process.

## Stage 2: Situation Analysis Phase

The objective of the Situation Analysis stage is to determine the severity of the situation and whether a turnaround is reasonable and practical. Initial fact finding includes interviews with management and employees and detailed analyses of key functional areas in finance, marketing, manufacturing and operations, engineering and research and development, and finally, the organization and staff.

This stage culminates in the formulation of a preliminary action plan to address the most pressing problems. The lender must look for a plan that it finds satisfactory, that has the buy-in of management, and that is achievable. Although a solid plan may be developed using the best minds available, all parties must understand that changes may be necessary, as new facts become known.

During the recent economic downturn, the need for thorough situation analysis has become even more important. The increased difficulties of the current environment presented by issues such as rapid technological obsolescence, decreases in residual value of fixed assets, compressed time frames for turnarounds due to internal lender pressures, foreign competition and lack of sales visibility requires the lender ensure that both key short-term and long-term issues are addressed.

## Stage 3: Emergency Action Phase

The objective of the Emergency Action Phase is to gain control of the situation, particularly the cash, to achieve at least a break-even cash flow. It is especially important that this stage be executed properly. A lender needs to ensure that cash flow is stabilized and assets needed for long-term viability remain unimpaired.

This stage is characterized by the classic actions frequently identified with turnaround managers: layoffs, cost-cutting, plant closings, and abandoning unprofitable product lines or locations, while accelerating high-potential opportunities. The status quo is challenged, and those who actively participate in the plan are rewarded, while those who are unwilling to change are sanctioned.

Frequently, the turnaround professional must provide quick corrective surgery to prepare to sell the organization. If these corrective actions are not deep enough, the business may have to be liquidated.

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As a turnaround manager, I frequently hear myths involving turnarounds. "If I only had more money, everything would be just fine," or "We will grow our way out of the problems." Both beliefs are fatally flawed. A lender who hears rationalizations such as these should guard his purse strings and advance rates.

#### **Stage 4: Business Restructuring Phase**

The objective of the Business Restructuring Phase is to enhance profitability through operational changes and to restructure the business to achieve increased profitability and return on assets. While this may be the most difficult stage, it is also the most important.

In this stage, the emphasis changes from cash to profits. The "heavy lifting" that occurred during the Emergency Action stage gives way to developing the management team. If this stage of a turnaround is not successful, odds are that the company will revert to crisis. The company must concentrate on continued profitability and improved operating efficiencies.

#### **Stage 5: Return to Normal**

The objective of this stage is to institutionalize a permanent change in corporate culture to focus the company on profits and return on investment.

#### **Summary**

There is clear overlap among some of these stages. Frequently, ineffective management does not become apparent until the Situation Analysis or Emergency Action Phases. In addition, cash-flow issues frequently require that portions of the Emergency Action Phase run concurrently with the Situation Analysis stage which, in some cases, also precipitates Management Change.

The odds of a successful turnaround are greatly increased if the turnaround process is followed. **abfj**

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**Thomas D. Hays, III** is a Certified Turnaround Professional and a Principal of Nachman HaysBrownstein, Inc., the premier mid-market turnaround and crisis management firm. He has provided leadership as interim Chief Executive Officer, Chairman or Advisor to the Board in a wide variety of companies both private and public. In addition to his successful turnaround career, Hays has been a key expert in major litigation including the Penn Central Boston Perishable Litigation and Merry-Go-Round.

He is actively involved in improving the turnaround process and is currently President of the Association of Certified Turnaround Professionals. He was Chairman of the Turnaround Management Association (TMA), an international organization of over 6,000 professionals dedicated to corporate renewal. Hays holds the distinction of becoming one of the first Certified Turnaround Professionals (CTP) in the country. He regularly conducts CTP management and accounting review courses.

