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HOW CAN TURNAROUND PROFESSIONALS MAKE THINGS HAPPEN?

By Bennett E. McClellan with Neil Minihane

OVERVIEW

Turnaround artists are both respected and feared in the management field. You often learn a company is in trouble when the turnaround artist arrives. Everybody in the company expects a shakeup. Send out the resumes, the sheriff just rode into town.

Neil Minihane chuckles at the image of the turnaround artist as somebody with a short temper and a bad attitude. A West Point graduate who still gets up early and wears a high-and-tight haircut, Minihane insists, "I'm a turnaround guy. Not a turnaround artist. Not a turnaround expert. Just a turnaround guy." In other words, he's a normal human being with a job to do.

He explains, "The most important thing you need to affect a turnaround is leadership, and specifically communications skills. The reality is, I don't do any of the heavy lifting. What I provide is a structured approach management can grasp, understand and buy into. The other thing you need is the analytical ability to translate facts into something people can act on."

Minihane started his turnaround career 15 years ago after leaving the Army as an Airborne Ranger. As a freelance restructurer he has mainly worked for Private Equity firms and privately-held companies. Minihane says, "I'm much more of an 'aim before you fire' person and would rather use a rifle than a shotgun. However, there is a time and place for each." For Minihane, turnarounds involve more science than gut feeling. Turnarounds are about engineering, Minihane's major at West Point, not art.

THE WORLD CHANGED, MANAGEMENT MISSED IT

One of the leading reasons why good companies get into trouble is that they fail to respond to changes in their environments. They get deeper into trouble when they spend too much time justifying why no response is required. Companies typically call in turnaround guys only when forced to by third parties like banks threatening to call their loans.

Minihane asserts, "People always act too late. Always. Everybody has excuses. And it's typically more than two or three quarters of patterned behaviors. It's not like suddenly a fire shows up in a factory. It's habitual for the management team."

When a company misses trends and falls behind, the top line and margins slide over a period of time. Managers and their boards strategize to reverse the revenue declines as they love feeling like they are driving growth. Nobody likes ratcheting back, retrenching or shelving the grand plan when reality intrudes.

Minihane says, "The environment is always changing. Changes in the top line and margins often drive the need for transformation or restructuring." He cites a list of possible factors that can lead to revenue and margin decline. There are industry trends, legal changes, environmental changes, customer changes, changes in the economy, changes driven by competition, vendor-led changes. He says, "None of these things are under the company's control. Revenue and margin growth are long-term propositions and often require capital. If a company falls behind, cash becomes tight and investing in the future becomes problematic. But what a company can do to adapt to change in the short term is re-scale operations and bring costs in line with actual top line and margin results."

Minihane suggests board members stay alert for signs of continual "over promise and under delivery." Minihane tells the story of a company he was asked to evaluate. He looked at the reports management had made to the board on a quarterly basis over a two year period. He discovered that the same promises were made repeatedly quarter after quarter. The same projects. The same new customer acquisitions. The same improved margins. Only the dates had changed.

Trouble is not brewing - it has already brewed - when a management team continually misses deliveries, misses financial targets, offers up excuses for not obtaining promised results or reducing costs, or fails to produce new fully-loaded profitable customers. Yet boards are often reluctant to act.

ENTER THE TURNAROUND GUY

Minihane shares another example of a commercial construction company whose revenue dropped from $310 million to $140 million in less than two quarters. He suggests that the precipitous decline in the top line was not a result of habitual behaviors, but of external events. The year was 2008. Nonetheless, the company's cash flow went negative. The management team decided to "ride it out" operationally. They restructured the balance sheet, but not the operations and footprint.

Two years later, Minihane was called in. *Two years later*. By that point it was a crisis. The cash reserves had been depleted and the lenders were fatigued. The company had operated smartly during the housing expansion. Management just refused to believe the ride was over.

When the ride is over, management has to do something different. Minihane uses a five-phase process for helping managers figure out what to do. He asserts that regardless of the nature of the firm, "Every turnaround has these five phases. What varies from company to company and industry to industry is where and when you put your focus, time and energy."

The five phases of a turnaround include evaluation, management change, emergency action, stabilization, and normalization or return to growth. The last phase may involve the company continuing on independently or it may involve a liquidation of some kind.

Minihane's approach typically does not involve exiting the core business. He works with companies in the $50 million to $500 million range. They are either stand-alone entities or divisions of larger enterprises. The companies grew to their current size for good reasons. They also got in trouble for some fairly predictable reasons.

Minihane seeks to understand both parts of the company's story. What fueled the company's growth? What caused its decline? Minihane describes his methodology for each phase of a turnaround in the sections that follow. He concludes with some lessons for those who want to avoid meeting a Turnaround Guy.

Evaluation Phase

During the evaluation phase, you are trying to determine the levers that control change within the industry and company. You need to figure out what went wrong. You need to assess why things went wrong. You are looking for people who know what happened, why it happened and what can be done about it.

Minihane notes that there are a number of change agent roles possible in any turnaround. Any one individual cannot play all the roles. During the evaluation phase, Minihane looks for managers in the company who can help take on responsibility for moving the company forward again.

He describes several kinds of change agents. The first kind is the executor. That's not the same thing as executioner. Instead, *executors* are the people who are good at getting things done in the company. They are the people who will eventually be responsible for implementing the solution.

The second kind of change agent is the custodian. *Custodians* are people with knowledge of the business and the history of the company. They have client connections and vendor relationships. They often know exactly what went wrong and what could be done to fix the business.

The third kind of change agent is the coach. Minihane classifies himself as a coach. *Coaches* are the ones who say, "Here's where we're going and here's why." The coach's job is to make sure everybody understands the plan and is working to make it happen, while getting the right people in the right seats on the bus.

Minihane also describes his roles as fact finder and silo buster. He spends the majority of his time in the evaluation phase talking with people, listening to their stories and trying to piece together a comprehensive picture of events.

He says, "Once you hear the story, you follow the threads. You find out if the story is true or not. You look at the data. You are going to need buy-in to implement the changes you propose. You need to have the facts and you need to anticipate the roadblocks. We spend a lot of time mining data to create graphs and visual tools, and hours on the floor to determine what to look for in the data."

As a silo buster, Minihane explains that the change agent has to break down the silos across the company. A common problem is that different people have different information. There is no one repository of data. Minihane has to cross organizational barriers to gather and share all the relevant data.

Minihane says, "Typically management won't like what I'm finding. Every time you pick up a rock, there's a snake pit underneath."

To ensure objectivity, Minihane says, "I typically do not report to the management team directly. I'll share everything with them. I'll be transparent with them. But part of the deal is that I have unfiltered access to the board. The management team cannot fire me, but the board can. The management team will always know everything I present to the board before it is shared, and often prepare their rebuttal if management and I agree to disagree."

The change agent can be held accountable for his actions at the board level, but should not have to worry about offending the incumbent executives in an effort to resurrect the company. In family-owned and controlled companies this requires a lot of deft and honest efforts.

Management Change Phase

Minihane emphasizes that the independence of the change agent should not be an excuse for arrogance or poor manners. He believes that the best possible outcome for the company is literally for management to change their minds and their actions.

"You'd like the management team to stick around. They have valuable knowledge and they often know what to do to get things right. But they will either have to change their minds, change their actions, or you will have to change some people."

Minihane's view of "management change" over "change management" runs contrary to the image of turnaround guys who come in, fire the CEO, fire the management team, and then get new people to come in.

Minihane asks, "What do the new guys know? Why would they do any better job than the old team? And by the way, you will probably have to pay them a whole lot more as their reputations are now on the line for a situation they did not create. It's easy for a new executive team to make the excuse, 'What could I do? It was broken before I arrived.' In the end, the reality is that if you can change the mindset of the current team or make a few select changes - without compromising your values -the current executives can better make the grueling decisions on how to best change this business."

Minihane provokes change by inviting his friend DAN to meet the management team. DAN stands for **D**enial, **A**rrogance and **N**ostalgia.

- **D**enial is denial of the problem despite broken bank covenants, revenue declines, margin erosion, negative cash flow, order cancellations, and vendors refusing to deliver parts.
- **A**rrogance emerges when management believes it has been through this situation before, knows how to solve it, and does not need outside help. They plan to ride it out while pursuing their plans.
- **N**ostalgia is wishing things were as they used to be. The company never had this problem (fill in the blank) back in the day.

Minihane says, "We get everybody in a room to address one of the big problems. Typically, I'll have five proposed solutions to the problem. The management team will shoot down each one, often for valid reasons."

> *"They will say, 'OK, we're good. We'll see you later.'*
>
> *"And I'll say, 'No, we're staying in this room until you decide to do something different. It might not be good, but it's going to be something different. We're not going to do the same things we have been doing because that's why we're in this situation. "*

Minihane continues, "If they can't admit that DAN is in the room, then you need to change the management team." He notes that often only a few people need to go. Sometimes it's the CEO; sometimes it's other executives. Once key blockers leave, the remaining people realize that the situation is serious and that the turnaround guy is not going to go away.

Emergency Action Phase

The emergency action phase has three elements. Minihane does not have a catchy acronym, like DAN, but he says the phases are pretty easy to remember. You have to focus on the *problem(s)*, develop definitive *solutions* backed by hard numbers, and you have to detail out an *improvement process* for each. The drastic moves here are driven by cash levels and cash flow. Cash buys time and the luxury to make smaller incremental changes.

The Problem

Minihane says that the problem in a turnaround is simple. You have to generate free cash flow. You are not doing enough of that. That's the problem.

He notes that a lot of factors may contribute to the problem. For example, costs are too high. Productivity is too low. Indirect labor is disproportionate. There are too many people hanging around adding little value. SG&A is too high as a percentage of sales.

Minihane says, "For each one of those factors, we develop a different metric to help management understand how that factor contributes to the problem. We do a lot of data mining. We may come up with 50 charts for each factor, but only use five or six in talking with the extended management team."

He gives the example of graphing SG&A over time. His data mining efforts show that SG&A has gone up as a percentage of sales over the past 10 years. He does not attempt to explain why. Instead, he focuses on the effect that shift has had on margins.

"We show the company, that's where the margin went. To get that margin back, SG&A needs to be this percentage of sales. How will we get there?"

The Solution

In the solution stage, Minihane pushes management to make commitments to turn those lost dollars into actionable items. Solutions are often apparent once the problem and its contributing factors are fully acknowledged. If direct manufacturing cost is too high, the solution is to find ways to bring direct costs down. If SG&A is too high, it's the same solution. Reduce SG&A in relationship to sales.

"It really comes down to the metrics," Minihane says. "When you start focusing on reducing costs, you have to start monitoring productivity daily. Six Sigma, total quality management, just-in-time manufacturing, they are all driven by data. What is happening on the shop floor? What is happening in the billing and collections department? The sales arena? What is happening at the clinics?"

At the clinics?

Minihane relates the story of a recent turnaround project. The company was a medical services provider with 60 clinics.

"They are not making widgets, but they are delivering discrete services. They are not a manufacturing company, but the process is the same be it production, distribution or services. We can figure out what each procedure costs. We can figure out which providers are paying on time. We begin monitoring things daily and following up on those inputs. When somebody starts doing something that loses money, we flag it. Right away. Everyone hears about it and realizes we are following up on the data and correcting actions in real time."

The Improvement Process

The improvement process involves applying the solution to solve the problem. Relentlessly. It all comes down to execution: the outcome of a poor plan properly executed is much better than that of a great plan poorly executed.

The improvement process is also about staying focused. Minihane says, "What you find is that whatever you watch, whatever you measure, gets addressed. You watch the costs, and sure enough, costs will start coming down."

The improvement process also involves breaking down assumptions of what can and cannot be done. Minihane comments, "All costs are variable. Even fixed costs are variable. It's the time frame that it takes to change things that confuses some people. Someone says, 'My SG&A expenses are fixed.' I say, 'No, they are not.' It might take some time and it might cost something to change them, but they can be changed."

Minihane muses that at some point people start getting the message. He says, "You are trying to get a mentality into a culture. A turnaround is going to take 12 to 18 months. The culture is the hardest part to change. Once people get the mentality, I often find that I have to go back and say, 'You're doing great, but maybe a little too great!' People start spending too much time saving pennies and miss the forest through the trees."

Stabilization Phase

The stabilization phase follows as the clean-up phase for the implemented emergency actions. Minihane comments, "During the emergency action phase you are moving big boulders. You may have had to do 20 - 30% layoffs. The layoff packages are typically not that generous. People are still pretty upset."

Minihane addresses the stabilization phase by again spending time with the people.

He says, "As the stabilization phase happens, you spend a lot of time on the floor, communicating to people. We are now cash positive. Your hard work is paying off. All the bravado of 'this or else' has gone away."

During the stabilization phase, job descriptions are redone and job functions re-defined. Minihane comments, "You continue to ask, what has to be done? What does not have to be done? We need to tweak that, tinker with this. As the process settles down, you often find you still have a few too many people. Some more layoffs happen, but at a much smaller scale."

Minihane explains that the stabilization phase is important because it starts to transition the way people think from fixing problems to rebuilding the company. Minihane comments, "This is a very important part of the turnaround because that's where they start to see all their efforts coming to fruition. The company begins to have some cash to begin reinvesting."

Moving On Phase

The fifth phase could take any number of directions, depending on the planned end game. If the company has avoided bankruptcy, then the fifth phase might be a return to normal business. The company was, at some point, healthy. That may be the normalized outcome. The fifth phase might also find the company re-oriented for growth with a new footprint and cost structure. If the company went into bankruptcy, the fifth phase generally involves the sale of the company, either to the creditors or to a new buyer.

Minihane says, "The fifth phase is my exit cue."

If management was replaced, then one key activity for Minihane during the fifth phase is to bring in new management to replace him. Alternatively, he may need to complete the sale of the company and turn over the keys.

Either way, Minihane starts to get nervous when things are working too well. He has so far declined offers to run recovered companies. "I've not seen many people who are good change agents and also good day-to-day managers. It's a very different skill set. You need to know which you have," Minihane cautions. Minihane notes that good day-to-day mangers generally do not sign up for turnaround assignments, either.

He elaborates, "For an interim management role, I'm paid to get in and out as fast as I can. Clients ask, 'Will I get my money back?' I answer, 'If you don't get your money back in multiples, I'm not doing my job.' But still, in phases four and five, there are diminishing returns."

LIFE AFTER THE TURNAROUND

Minihane sometimes continues a relationship with a firm he's turned around by serving in a short-term, non-executive capacity advising the board. Sometimes he shakes hands with the new owners, and never hears from them again.

What's the aftermath like for those who remain with the company?

Minihane comments that more of his turnarounds result in happy continuations rather than in ugly dissolutions.

He says, "In hindsight, people see - if you did the right job - why you did what you did, and while they were not happy about it, when you come back a year later, they are thankful."

Minihane comments, "None of the companies I work with are the next IPO. I don't do startups. But you've taken a company that's been underperforming, and you put it on a new foundation, often giving it a new strategy and a new mentality. And now the company is chugging along, making incremental changes, making money. Maybe they are not printing money, but they are making money. There are more of those than the train wrecks. "

AVOIDING MR. TURNAROUND

One might draw a number of lessons from Neil Minihane's discussion of what happens during a turnaround to avoid the need to learn about it first-hand. Like the turnaround process Minihane describes, the rules would seem pretty simple:

1. Keep an eye on environmental factors that affect your industry. Adjust your actions when factor changes seem likely to depress the top line and/or margins.
2. Remember that DAN - denial, arrogance and nostalgia - could be in the room. If you find yourself basking in any of these DANgerous states, shake yourself free of them - fast.
3. Act when you see the clues. Don't wait for the clues to become overwhelming evidence of a crisis. The numbers do not lie.

Living through a turnaround is probably no executive's dream assignment. But good companies do get into trouble and may require the services of a turnaround guy. A well-executed turnaround can not only save the company, but can also lead to positive growth prospects.

The most difficult thing for an executive to accept about a turnaround may be this: if you are leading a company that needs a turnaround, you are not the right person for the job. Don't delude yourself. Hire a turnaround specialist. Listen to them. Do what it takes to get your company on track again. And then don't repeat the mistakes that made it necessary for you to hire a turnaround specialist in the first place.

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