



Most companies will undergo a restructuring process at some point in their life cycle.

It may help to build on success.

“When our business began to experience serious growth, we recognised that things needed to change and that continuing growth depended on a major restructure of the company,” says Vicki Monteith, director of Network Electrical, a company specialising in electrical contracting, building and construction, “Now the business is thriving and we’re looking at how we can structure things to protect the wealth generated.”

It may also be a response to a downturn in profitability. IAG, for example, reported a loss of \$261 million last year. This year, after a major restructure which included shedding 600 staff, their net profit was \$181 million.

“The past year has been one of rebuilding for IAG,” says Managing Director and CEO Michael Wilkins. “We refocused on our core businesses, improved our underwriting disciplines and put decision-making closer to our customers. We have strengthened the business and now have a platform for future success.”

When a company is in trouble, there may be no choice.

“Restructuring becomes essential where there is a potential for a viable business to continue, but the value of the business has decreased below its debt level and the company cannot continue to service its debt,” says Michael Hird, Managing Partner, Worrells Sydney.

Not all restructures are successful. Predictably, the global financial crisis has left an increased number of insolvencies in its wake – though fewer than might have been expected. This may be the result of the unprecedented leniency shown by both the banks and the ATO; companies with a defined and credible restructuring plan have been given a far longer period of grace than in previous downturns. This makes practical sense in an environment where realising assets will generally mean realising a loss, and last December’s statistics suggested that the strategy was working and that the cost of insolvencies had peaked. However, the fourth quarterly Business Stress Report from Restructuring Works showed a steep rise in the June quarter as the number of insolvencies in a year topped 10,000 for the first time. Director Cliff Sanderson suspects that the ‘softly-softly’ approach has done little more than delay the inevitable and that banks are responding to the new figures by appointing more receivers and taking possession of more assets than ever before.

“After the share market crash of 1987 it took four years for insolvencies to peak,” he says. “This raises the debate as to whether 2009 is as bad as it will get or whether the number of insolvencies will get a lot worse.”

The importance of timing

For a struggling company, the factor most likely to affect the outcome of a restructure is when the process began.

“Directors need to get advice the minute they suspect a problem,” says Ian Carson, Managing Partner of PPB’s Melbourne office. “A conversation with an external advisor, lawyer or turnaround practitioner very early on will make sure you have the greatest number of options and that nothing is being overlooked. An experienced professional brings a whole new toolkit to the situation.”

Responding early gives a board time to create a proper restructuring strategy, addressing everything from marketing and product positioning, margins and suppliers through to how the business should be structured financially and whether appropriate people are in place.

“The key is bringing all of this altogether into a proper set of integrated forecasts before you approach your lenders, financiers or creditors,” says Paul Billingham, Grant Thornton’s National Head of Recovery and Reorganisation.

Directors should bear in mind the need to protect themselves, and also that their own interests might be quite different from those of the company. If the company is trading while insolvent, for example, directors are personally liable for the company’s losses.

“These days society is more demanding of corporations,” says Carson. “Brand value is at stake, and companies need advisors who understand that and can see the bigger picture. There’s much more focus on corporate responsibility and people are looking to directors to take the lead. Even if a company is not technically breaking the law, if the public believes they’re ignoring the spirit of the law the brand could be badly damaged. And, while the directors may not end up in prison, a tarnished reputation could put an end to their boardroom career.”

Staying close to management

Directors can only respond to a problem when they’re aware of it – yet, over the past year, Carson has been amazed by some boards’ cavalier attitude to information.

“We’ve seen companies which turn over billions of dollars effectively flying blind because they don’t have cash flow forecasts,” he says.

The board needs to know when finance facilities are due for renewal and that management is engaging with lenders six to nine months ahead of the critical date.

“The questions lenders are asking now are a lot harder than a couple of years ago – and some won’t renew at all,” continues Carson. “The board should be asking management whether there’s any indication that there might be a problem and whether they have alternatives in place. Are they being proactive rather than just waiting to see what happens?”

Directors need regular conversations with the CFO as well as the MD and should be confident that a three-way forecast – profit and loss, budget and balance sheet and cash flow – is being updated each month. There’s no need to pore over every page of figures – directors are entitled to rely on the people who are putting them together. However, they do need to understand what is in the forecasts and to look at the assumptions on which they’re based – where has the information come from and has management reflected on where the market is going?

“Directors need to ask the hard questions and be fully across both the numbers and management’s initiatives,” says Billingham. “They need to know that what’s happening at management level is in alignment with the established vision of where the business is going. If it’s not they’ve either got to redefine the vision or redirect management.”

Boards also need to consider whether management is appropriate for prevailing conditions. In a downturn, someone capable of dealing with the day to day minutiae of a business and eking out the margins could be the one to keep it afloat. As Billingham points out, even in the current environment, poor management remains the most common cause of failure, particularly in the SME sector,

“A lot of Australian businesses have been running for years in a very buoyant economy,” he says. “The underlying value of their assets, particularly real estate, just kept on increasing and there was a lot of competition among lenders to lend. As a result, they’ve been able to get away with not being as strongly or robustly managed as they need to be. Now things have got a bit tighter and a number of companies are struggling to deal with that.

“It’s not that they’re incompetent, more that they lack the ability to run the business in a focused way. They may not have responded to the market. They may have invested unwisely, diversified into areas where they’re not expert or have poor management information systems. A lot of smaller companies and quite a few larger ones don’t really know what margins they’re making or the factors that impact on their profitability and now that’s catching up with them.”

A state of denial

Boards may hesitate to call in professional help even when they’re aware of possible problems.

“Some directors we see have had their heads stuck in the proverbial sand – thinking that, if they ignore the problem long enough, it will go away,” says Hird. “Others have tried refinance, buyouts, quick loans, informal arrangements with creditors – everything they can think of in an attempt to stem the tide.”

Others call for advice then refuse to listen.

“There can be a certain amount of denial – an unwillingness to accept that the picture is as bad as it’s being painted – and that’s quite frustrating,” says Billingham. “When we ask for forecasts for the next 12 or 24 months a classic response is what we call the ‘hockey stick’ forecast – things are bad now and might get a little bit worse, but we’re confident that, in a year or so’s time, everything will be fantastic. Nine times out of 10, there’s no real basis for that, and that’s where a company starts to lose credibility with stakeholders.

“Banks and financiers are looking for a vision but only if it is sustainable, robust and supported by a viable strategy. Retracting the business, perhaps coming down by 10 or 15 per cent, and getting rid of low margin areas so that the company is well positioned to expand when the economy turns is a credible vision. Cutting back on spending isn’t a vision, it’s reacting to circumstances.

“Our view is that if you have a vision and plan to achieve that vision people are going to want to support you. I think the last thing a company should do when things get a bit wobbly is go straight into liquidation; directors owe it to their creditors and shareholders to try to work out an innovative solution.”

Breakout box

When Richard Brown* took over as CEO of a \$130-million dollar company last year the business was at risk of going into administration. There was no cash, management had departed and the senior lender was demanding repayment.

“The upshot was that we had money falling due and payable with insufficient cash to cover it,” says Brown.

The board called in PPB who, working with the new management, began by taking control of short term cash flow.

“We needed time to resolve the challenges and that meant coming to arrangements with creditors,” continues Brown. “PPB identified major creditors and helped us to defer our obligations. They either spoke to creditors on our behalf, came to meetings with us or gave us guidance on how we should deal with creditors ourselves. They also put themselves firmly in the middle of the relationship with our senior lender and I think this was a major contribution. Professionals have a relationship with the banks – they know how banks think and what they’re looking for. Banks also have confidence in them.”

As they managed cash flow on a day to day basis, the board and management were also working on longer term solutions. Eventually they found an investor who was prepared to underwrite a capital raising and who also introduced them to a new senior lender.

“In the end we didn’t need to sell any assets – we reduced our senior debt by more than half in the recapitalisation and all creditors were paid,” says Brown. “It took six months of gruelling work but we moved from a situation where cash was short and our senior lender wanted out to being comfortable with cash and having a senior lender who was happy to be in.”

**Name has been changed.*

Breakout box

Seven tips for success

The Bevington Group has devised seven broad restructuring principles to optimise the chance of success. These principles are:

1. Align structure to strategy. For example, if local conditions are a predominant factor then stress local sales and marketing functions rather than a centralised behemoth which then tries to matrix with local elements.

2. Reduce complexity by designing structure for strategy before you design for specific personnel; not making leadership roles too complex; and minimising the use of matrices, which introduce measurement overhead and a lack of clear direction to the staff.

3. Focus on core activity - remove noise and enhance core, *before* restructuring roles.

4. Create feasible roles. Restructures generally leave an organisation with fewer people to do the same amount of work. It’s vital to understand the current workload of employees in order to design roles that are neither too heavily laden nor, indeed, too light.

5. Balance the Own-Work and Supervisory loads of managers. It’s critical to balance the number of staff directly managed or supervised, staff ability to perform work without supervision and the amount of ‘own work’ managers have to do on top of their leadership activity.

6. Implement with clarity. Clarify roles and responsibilities from the outset, identify all functions (activities, tasks, and decisions) that have to be accomplished for effective operation, clarify who should be involved and be specific about accountability.

7. Maintain flexibility. It important not to cut your resources too fine. Flexibility applies not only to staff members, but to staff capability; leave yourself and your leadership team some room to respond to capability gaps in the new structure.

