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Turnaround Topics

Management - The "Wild Card" in Chapter 11

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So much of a bankruptcy relates to balance sheets, cash flows, claims, counter-claims, motions, reporting requirements, fee petitions and other quantitative and procedural requirements that the professionals and constituents must sometimes force themselves to remember the importance of the debtor's management. Ultimately, most conflicts over forecasts, asset valuations, and other quantitative disputes derive from the human issues of credibility, trust, and competence.

To be effective, turnaround consultants must never be management's puppets; however, they must present a convincing assessment of management and organizational strategy implicitly or explicitly in the plan of reorganization. The turnaround consultant is expected to develop or assess a reorganization plan in all facets, including financial viability, business/marketing strategy, and operations in all functional areas. Unique attributes of the turnaround consultant also include the ability to address management's competence as well as critical "voids" in the management team.

The information and viewpoints upon which the reorganization plan is predicated are drawn from the debtor's management, employees, books and records, research, and stakeholders (including non-creditors such as customers). Debtor's turnaround consultant develops the DIP plan by nurturing the necessarily delicate "balance of interests" among the debtor and creditors.

A truly workable plan is often the result of a significant internal debate within the debtor's organization. Turnaround experts work to develop a consensus among the CEO and the key executives. To be implementable, the plan must be internally "sold" to the CEO and/or the management team. This can often require overcoming conflicts as heated as those which may occur with external stakeholders.

The plan may be treading upon the CEO's cherished turf. For example, it may recommend the replacement of some key executives who helped "build the business", but are now counter-productive to the firm's recovery. Recommendations may include a headcount reduction in a culture where no one has ever been fired except for incompetence, where a product line has never been discontinued, where obsolete inventory has never been written down, or where an unprofitable "profit center" has never been closed.

In the extreme case, turnaround consultants may conclude the interests of the company are best served by terminating the CEO or transforming his or her function to a more limited chairman's role while recruiting a strong president to operate the business. Human nature being what is, this recommendation does not often gain the support of the CEO (who may be the majority shareholder).

The turnaround consultant explains to the CEO his or her right to respectfully disagree with such recommendations in the plan, and, if appropriate, highlight these "points of difference". In the implementation stage, a change of management may be necessary if these differences remain irreconcilable.

In most instances, the stakeholder's perception of the management team has been tarnished and/or discredited by those events which led to the company's filing. Management is frequently viewed as lacking the experience and/or fortitude to adopt the harsh measures frequently required to ameliorate the problems. Management's prior projections and expectations may have been overly optimistic, leaving a residue of mistrust among stakeholders. A stakeholder's perception of what is "really happening"

within the firm is often incomplete (even when the stakeholders and/or their representatives may have remained quite close to events).

The perception of management by the turnaround consultant falls along a broad spectrum ranging from:

- (a) competent to manage the firm through the crisis, bankruptcy, and emerge from bankruptcy;
- (b) competent but lacking the toughness and resolution to impose self-sacrifice and harsh measures upon the organization (wielding the "ax");
- (c) competent but lacking the depth and/or breadth of talent to carry out an extraordinary task under extraordinary circumstances;
- (d) lacking a full sense of appreciation of:
 - (1) the depth of the company's problems;
 - (2) the likelihood that the company may collapse if the present course is followed to its logical conclusion,
 - (3) the futility of clinging to the belief that some improbable "special event" (bank's loosening of the purse strings, capital infusion, refinancing, sale of all or part of the company, success of the new product line, sharply increased sales volume, giant new contract, award from winning the long-standing lawsuit, etc.) will and must occur which will single-handedly vanquish the painful crisis,
 - (4) the qualitative difference between the current crisis and those prior "troubled times" through which the company has successfully emerged,
- (e) fully occupied by the task of managing the business, necessitating additional resources to manage the crisis,
- (f) competent but sufficiently discredited by the unfortunate turn of events to require the presence of a new catalytic force within the company around which stakeholders (and perhaps employees and unions) can rally,
- (g) lacking competence.

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A good implement used for assessing management may be the company's degree of financial difficulty; however, this is not always the case. A turnaround consultant's assessment of management may be harsh in some instances where the numbers aren't all that bad, and favorable where the numbers are disastrous. For instance, capital-intensive companies operating in a period of weak demand can post alarming financial results because management inexperienced with crises may have difficulty envisioning the sale or re-deployment of "white elephant" assets. However, once asset re-deployment is accomplished, the existing management may be qualified to operate the downsized company more efficiently than new management.

In conclusion, one should expect the debtor's turnaround consultant to develop, communicate, and implement a clear point-of-view regarding the debtor's management. Otherwise, the inevitable conflicts between DIP management and creditors can add cost and reduce the likelihood of successful emergence from Chapter 11. ■