

Interpersonal Skills Can Make or Break a Workout

By Gerald M. Sherman

A turnaround advisor's abilities with people are often more important than business skills.

Workout officers or lenders managing a workout typically think of the turnaround consultant's role in terms of their institution's basic goals:

- Get the borrower's loan back in proper proportion with the collateral supporting the debt.
- Get the borrower's loan payments made every month.
- Get the company back over breakeven.
- Get the borrower refinanced with another lender.
- Get the company sold, *etc.*

In more difficult situations, the goal might be to see a borrower's issues resolved through a well-managed Chapter 11 reorganization or, when there's no other choice, to liquidate effectively. These goals are entirely appropriate. At the same time, given the understandable focus on them, the more subtle yet crucial skills of a turnaround consultant receive far less emphasis than they merit. This article, the first in a series, will examine five interpersonal skills that are often central to a consultant's success by presenting case studies that illustrate their importance.

First the Basics

Turnaround consultants are generally referred (or hired directly by the lender) based on prior experiences or their ability to demonstrate competence. Typically, competence is defined by the ability to manage the aspects of the turnaround that the workout officer or lender most typically sees:

- Facility with financial statements and financial projections
- The ability to understand the basic aspects of different loan accommodations

- The ability to understand the banker's issues and needs
- Knowledge of the key legal issues relevant to the situation
- Good business instincts and a knack for speaking the lender's language

Clearly, these are important skills and attributes. At the same time, they're often just a part of what is needed.

Five Crucial Interpersonal Skills

In addition, turnaround consultants need five interpersonal skills. They need the ability to:

- develop trust.
- lead people experiencing severe pressure.
- manage difficult interpersonal issues.
- work with difficult and dysfunctional personalities.
- quickly build a team.

Develop Trust

To be truly effective, the turnaround consultant must be trusted by the client. Often, the client's economic life is on the line and hard decisions have to be made—decisions that are often far different from what the client would choose on his or her own. Clearly, this process can only work well when the client has a level of comfort with the consultant.

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Case Study: Trust

The family was traumatized. After generating profits during each of its first 51 years in business, their company's entire \$3.3 million book value had been lost in just 24 months. Furthermore, the company's decline coincided with the retirement of the company's founder, the father of the three sons who had taken over management. Liquidity was gone and the business's longtime key vendor was insisting on a first-lien position on future inventory (and proceeds) being shipped in. Further, the company's bank had frozen its line of credit and insisted that a consultant be hired to help manage the situation.

After being retained, the consultant began by interviewing each of the three brothers along with several other key employees. Based on these discussions, it became clear that the family was a tight-knit but cloistered group. Further, the brothers quickly demonstrated that they were ill prepared to take over. Finally, it became apparent that the family relied heavily on a CPA who was enabling the brothers' mismanagement and financial excesses.

Based on those observations, the consultant firmed up two major findings. First, he determined that the company needed a major overhaul of both its management team and management practices in order to survive long term. Second, he determined that he needed to develop trust with the brothers before attempting to push for the major organizational changes that would eventually be needed. During the first few months of the engagement, the consultant focused on liquidity, margins, effective project management and creditor issues. At the same time, he worked very carefully with the brothers to help them begin to look at their management issues.

Fortunately, the company was able to regain profitability within eight months, and two major battles with the bank concluded successfully. With those strides, the consultant began to sense that the brothers had come to accept his presence and appreciate his contributions. As progress continued, the consultant began to put forward the concept that the company should hire a chief operating officer (COO) who could take over day-to-day management and free up the brothers to focus on their strengths: sales and field operations.

Even with the trust that had developed, one of the brothers still called the suggestion for a professional COO a "bombshell." Eventually, after 18 months, the

opportunity to hire a COO who had worked with the consultant at another client developed. Having been given the opportunity to fully process the concept, the brothers accepted the consultant's recommendation, and the new COO was hired to continue the effort of overhauling the company on a full-time basis. With this hire, the consultant's investment in developing trust had paid off, as he was able to introduce a permanent, essential level of professionalism to this well-meaning but ill-prepared group.

Lead People Experiencing Severe Pressure

While leadership does require trust, the turnaround advisor must also demonstrate a number of additional traits in order to lead. Vision, determination, decisiveness, stark honesty and empathy are critical to leading an organization whose very existence is at risk.

Case Study: Leadership

This \$30 million manufacturer had emerged from bankruptcy in 2005 and was in severe difficulty again. The company had a negative net worth in excess of \$12 million and was losing an average of \$250,000 a month. Most critically, the company was dominated by an owner who adamantly did things his way, didn't welcome differing opinions and had demonstrated little ability to adapt. In this case, the turnaround advisor had been appointed chief restructuring officer and, accordingly, had virtually total authority. At the same time, the staff was disheartened, cynical and tired. Despite this, senior management remained uniformly loyal to the company, if not to the owner, and was anxious to work toward a successful restructuring.

The first challenge was to develop a vision for the future of the company. To be accepted, the vision had to be viewed as both addressing the company's core issues and having a chance at success. During the initial weeks of the assignment, the consultant invested the time needed to get to know each of the managers—both their professional points of view and their personal circumstances. In particular, he made sure that each senior manager knew he or she was appreciated as a person. Over the same period, he was able to conclude that the company could be viable if

new investment was attracted and control could be completely wrested from current ownership.

To get senior management on board, the consultant was very clear about his vision—both the opportunities and the challenges—and he was careful not to oversell. Rather, he acknowledged the hurdles ahead and the risk of simply running out of cash before an investor could be brought in. He also stated clearly that he would take the heat for implementing plans and strategies that ran counter to the policies of ownership. Senior management got on board and worked as a team to address day-to-day issues as well as work with prospective turnaround investors. Over the next six months, there were numerous setbacks, along with some victories, and the consultant's consistent determination to move ahead helped the team maintain its efforts. In the ninth month, all the hard work was rewarded when the company generated EBITDA (earnings before interest, taxes, depreciation and amortization) of \$350,000. As this article was written, the investment environment had weakened with the economy, and the consultant continues to lead the team in the effort to maintain operations while a permanent solution is sought.

Manage Difficult Interpersonal Issues

Within a financially troubled business, owners and senior managers will often have significantly different points of view regarding major business issues: terminating a controversial employee, closing a questionable branch, investing in a new territory, winding down the business completely, *etc.* Furthermore, the turnaround advisor will typically be put directly in the middle of these disagreements. The ability to manage the resolution of such disagreements, while still maintaining effective relationships with all parties, can sometimes be central to progress.

Case Study: Interpersonal Disagreements

Two owners had operated a relatively large, albeit one-branch, furniture and appliance retailer that did as much as \$15 million annually during its peak years. The advent of big-box stores, along with the owners'

weaknesses as managers, had brought the company to a point where losses were accumulating and liquidity was drying up. At the same time, there was considerable equity in the company's real estate, and a reasonably successful liquidation would leave the two owners with several million dollars each. One owner, the typically more passive of the two, was ready to close and move on; the other, who was far more domineering, was adamant about "staying the course." As equal partners, they were deadlocked. The turnaround advisor was retained to help develop a course of action. While he brought no preconceived notions to the engagement, he very quickly determined that the business had little prospect for future profitability. Furthermore, it also became clear that cash would run out within a relatively short period of time.

Recognizing the strength of conviction of the owner who wanted to stay the course, the consultant concluded that a strategic effort would be needed to get to an agreement that both made business sense and would preserve his relationships with each principal. His first step was to fully hear out both owners on why they felt as they did. With that knowledge in hand, the consultant held a series of meetings over two weeks where all of the potential turnaround plans and options were considered.

Early in the process, the possibility of an outright sale was eliminated as unrealistic. As a second step, the consultant proposed that the owner who wanted to remain buy out the other. This also proved unrealistic, since financing couldn't be arranged and the selling partner wasn't prepared to take back paper.

After four meetings, the consultant made it simple for the owner who wanted to remain. To continue the operations, three steps were needed:

- (1) Quickly invest \$250,000 to provide liquidity.
- (2) Implement a viable turnaround plan to regain profitability.
- (3) In fairness, indemnify the other owner for future losses.

While \$250,000 was available to invest, the owner who wished to continue realized that he didn't want to absorb *all* potential losses going forward. With this realization, he was finally able to come to grips with the fact that liquidation was the only viable alternative. Knowing that the consultant had worked hard to help him find a viable solution that would keep him in business, the client was not angry, despite the fact he didn't get what he wanted. With the decision

made, the owners and the consultant were able to work together comfortably to wind down the business within 75 days after the decision was made.

Work with Difficult and Dysfunctional Personalities

Troubled businesses are often the reflection of troubled personalities. It's not rare for the turnaround consultant to work with a client that flat out doesn't want the consultant's advice—or anyone else's. Another common issue is the simple unwillingness to look at a business's problems realistically. Sometimes, the consultant will find himself or herself working with a client who suffers from significant dysfunction. Often, the issue of difficult and dysfunctional personalities is the greatest challenge the turnaround consultant confronts.

One of the greatest risks is that the consultant can "enable" the client by making too many concessions in the course of doing the work. Typically, this will happen when the client just can't be moved off opinions or attitudes and refuses to listen to differing positions. There can be a very fine line between appropriate accommodation and "enabling"; the consultant has to be very mindful of where that line is. It's perfectly appropriate to make compromises with a client over the entire range of business decisions that have to be made during the course of a turnaround. The key, however, is to maintain the ability to create genuine—if not perfect—solutions. When that isn't possible, the consultant is left with no choice but to resign rather than compromise his or her professional integrity and reputation.

Case Study: Difficult Personalities

This 135-year-old manufacturer was being run by the fifth generation of the founder's family. The company's proprietary product line had become outdated, and the company's industry was going through a major transition due to foreign competition. The 68-year-old CEO had a substance abuse issue and was generally stuck in doing things the same old way. When the consultant was engaged, the company was losing money and its bank was pressing for a refinancing to a new lender. Compounding the issue, the CEO was a board member of the bank financing the company.

In the short term, expenses had to be reduced dramatically, and the company had a long-standing no-layoff policy. After much debate, most of the needed cuts were made. The consultant, however, did agree to go along with retaining a talented designer who was a longtime employee. The designer was known to "overengineer" every job, and this led to weak profits, or even losses, for all their projects. Despite this, the CEO was loyal and simply would not let this designer go. As a result of this process, the consultant was able to learn a great deal about the CEO and to establish a working relationship.

Of greater importance, the company had to get back out in the market and sell its products rather than just wait for orders to show up. Further, it had to begin developing new product offerings. These efforts were modestly successful at best. The CEO never backed the effort enthusiastically.

After the initial crisis, the company was able to maintain marginal profitability for 10 years. Throughout that entire time, the consultant continued to assist the company, working primarily with the CEO's son. Although the consultant didn't get much support from the CEO, and sometimes got outright opposition, his efforts were successful enough to justify the engagement. During this entire period, the consultant and the CEO maintained a respectful, albeit sometimes challenging, relationship. After 10 years, the company had to be sold as it was simply unable to continue to operate independently. The consultant continues to view the engagement as a success given that 10 additional years of independence were attained. Without the ability to establish a functional, if not ideal, working relationship with the CEO, this could not have been achieved.

Quickly Build a Team

More often than not, a distressed company's organization will be, to a lesser or greater degree, dysfunctional. Quite commonly, among other issues, decision-making processes are ineffective; internal communications are disjointed; and organizational discipline is lacking. Coming into a new situation, the turnaround consultant has to work with existing personnel and quickly help mold them into an organization that is more capable of identifying issues; considering solutions; making sound decisions; and, most important, implementing them. Overall, the consultant needs to be able

to organize and facilitate discussions, coordinate the execution of plans and bring a heightened level of accountability to the management team.

Case Study: Team Building

A financially strong family owned business bought a company generating about \$12 million in annual revenues out of bankruptcy. While the acquired company's product line was relatively compatible, the underlying reason for the acquisition was to provide each of the owner's two sons their "own business" to operate. The younger son, a high school graduate, was relocated to the new business and was to be groomed by his father. The older brother, who held an MBA, was to remain with the original company and take over day-to-day control. Shortly after the acquisition, the father died unexpectedly, leaving the younger son on his own. At the same time, the new company's business, which was very cyclical, suffered a 65-percent drop in annual revenues over a relatively short period of time. Over the next several years, the original company lent the new business more than \$4 million to fund losses. Finally, the company hired a turnaround consultant and gave him the mandate of developing a plan that would allow the new company to operate without further financial support.

The consultant quickly learned that the company's organization operated in a highly disjointed fashion. The young son, who was CEO, didn't hold staff meetings, have financial reports produced and distributed or encourage coordination between the company's functional groups (sales, finance, engineering, manufacturing and customer service). Given continued losses and the reality that the company might not be able to continue in business, the senior management group was disheartened and nervous. To address the need for a management team that would work together, the consultant created an "executive committee" comprising the senior manager from each functional group and the CEO. Twice each week, the consultant organized and facilitated a committee meeting where both short- and longer-term issues were addressed. Minutes were maintained for each meeting and assignments for follow-up steps were very clearly noted. As a result, the consultant was able to quickly create a level of accountability that hadn't existed before. If, for example, the head of finance agreed to deliver a new

report by a certain date, a paper trail now existed that allowed the consultant to either confirm the new report was done or raise the issue at a committee meeting. The new level of discipline had an immediate benefit—things actually got done when they were supposed to.

The consultant also developed a short-term forecasting process that allowed the group to project and then match the amount of work available each week with factory staffing levels. Previously, the company had maintained a no-layoff policy, despite the substantial losses that had been incurred. This approach was central to getting the company to cash self-sufficiency. The group also restructured the marketing and sales functions and saw meaningful results within six months. Finally, the team came to grips with and terminated several problem employees. One, while talented, was just too difficult a personality to manage. The other was a senior-level manager who simply did not perform.

The executive also created a subgroup that was given the mandate of identifying new revenue opportunities. By the end of the first year of the consultant's assignment, this subgroup had developed three new initiatives. At the same time, the business had managed to operate without additional financial support from its sister company. Early in year two, the consultant handed off leadership of the committee meetings to the younger son, who had proven to be a good student. Shortly thereafter, the consultant was able to reduce his time with the company from about three days a week to six days a month. By the end of year two, the company had become modestly profitable and the consultant's engagement came to an end. Subsequently, the executive committee, which continued to functionally lead the company's activities, made a decision to sell the original core business line that was purchased and refocus the company on one of the new product initiatives. After 10 years, the company continues to operate profitably.

Evaluating a Turnaround Consultant's Interpersonal Capabilities

The interpersonal and team-building capabilities described here are almost always demonstrated

behind closed doors with little or no explicit knowledge on the lender's part. Given their importance, the question is how a workout officer or lender who makes consulting referrals can evaluate a consultant in these areas. A simple approach is to screen prospective consultants by asking them about their experiences, philosophies and techniques developing trust, leading organizations and resolving internal conflicts. Regardless of the substance of the answer, much will be revealed simply by the weight the consultant gives to these areas. When possible, it would also be helpful to get feedback from several of the consultant's past clients. This would likely be the most revealing information available.

Soft Skills for Successful Turnarounds

A turnaround consultant's hard skills—finance, cash flow management, planning, expense management, *etc.*—are critical and on display for the lender or workout officer in virtually every situation. To produce strong results, however, the workout consultant always has to work effectively with client personnel and to become an accepted, vital resource. The skills needed to accomplish this under the pressure of a business in distress, while much less obvious, can be central to eventual success. Every workout officer or lender who makes referrals will be well served to consider a consultant's interpersonal capabilities when identifying preferred turnaround advisors.

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