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The First Step To Business Revitalization

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Revitalizing a Financially Distressed Client

By James E. Rudnicki

Your phone rings and it's one of your best clients. The financial results are in and his business has suffered a staggering loss. Worse yet, they are short on cash, the Bank is not cooperating, and key suppliers and employees are becoming nervous. He wants to meet with you as soon as possible.

Perhaps you've been through a similar situation. Many lawyers have been. I believe most were very comfortable giving the legal advice their client sought. I also believe most became <u>un</u>comfortable when the discussion changed to business advice – or more specifically, how the company could survive its immediate crisis and then revitalize itself.

Below is a summary of my seven-step formula for helping a financially distressed company do just that. After working with almost 100 such companies, I can tell you firsthand that the ones who follow this formula have a good chance at recovery. The ones who do not, however, are generally doomed to failure... regardless of the quality of the legal advice they receive.

Step one: Get control of the cash. Tell your client to immediately focus their efforts on preparing a <u>realistic</u> week by week cash flow forecast for at least the next several months. Without it, they are flying blind. By realistic I mean that the cash receipts should be forecast a little below management's "best estimate", while the cash disbursements should be forecast a little higher. This way any variance from actual is more likely to be a pleasant surprise, instead of a disaster.

If the forecast shows that the company is going to run out of cash, you will quickly get a key insight into your client's likelihood for success. If management's immediate reaction is to do some serious cost cutting the business will probably survive. When they want to wait or make excuses it will most likely fail.

Step two: Determine the break-even point. Ask your client to tell you what the businesses monthly sales would have to be to cover its expenses or "break-even" on a cash basis. To determine this they will need to know what percent of the average sales dollar is left after they pay for all the costs that vary with the level of sales. If what's left is 20% of the sales dollar and monthly fixed expenses are $100,000 the sales break-even point is $500,000 (i.e. $100,000 divided by 20% equals $500,000).

In most of the situations I have worked with the original break-even point turned out to be much higher than the current level of sales and the challenge became keeping the business viable until both the fixed and variable expenses could be cut and the sales increased.

Step three: Listen for the solution. Why "listen" instead of "look"? Well, I have seen numerous situations where the employees had been trying to tell senior management how to cut expenses and boost sales – but no one was willing to listen. Now is the time for your client's management to set aside their egos, ask <u>lots</u> of questions and really listen to the answers. "What do we need to change?" "Where can we save money?" "What would you do if you were in charge?"

You might also want to suggest that they consider having the same sort of discussions with key suppliers and customers. These "stakeholders" usually already know that the company has problems and they can oftentimes be a very good source of ideas. Besides, they might even find a frank discussion about <u>solutions</u> reassuring!

Step four: Stop the worst bleeding. In many cases, your client will have a product, plant or division that is losing lots of money. It might even be what the business was begun many years earlier to do, but time has passed it by. Tell your client to make the hard decision. Fix it, sell it or shut it down. Now.

This approach will conserve cash and show everyone that your client is serious about saving the rest of the business.

Step five: Look to "free up" cash. With rare exception, your seriously troubled clients won't be able to borrow any more money. (The rare exceptions usually occur when the owners are willing to put substantial non-business assets at risk and pay exorbitant borrowing costs.) At the same time management will need to find additional cash to keep the company going. The solution is usually to "free up" cash from within the business.

To start, you should determine whether your client is doing enough to collect its past due receivables. Oftentimes they are not. Slow moving inventories, supplies and other materials should then be evaluated to see whether they can be liquidated. This generally makes sense even if they have to be sold at less than their original cost. Management should also be told to cut back on all nonessential expenditures. Where possible any idle machinery and empty buildings should be converted into cash. And don't forget about the ideas that came from listening to the employees, suppliers and customers!

Step six: Find the positives. Ask your client's management to make a list of what's still right about the company. They are going to need to build off of these positives.

As part of this process your client should identify their most optimistic employees. Remember the old saying "You can teach everything but a good attitude". Make sure that your client rebuilds around persons who have one.

Step seven: Develop the plan. Now that your client has hopefully created some breathing room and accumulated all this great information, what are they going to do next? Without being too fancy, they need to prepare a written strategy along with a timeline and some long and short term goals. Not a "dust-catcher" for the shelf, but a well thought out plan that gets communicated, implemented and regularly reevaluated. This last step may very well be the most important piece of advice that you give them.

Obviously, none of this is easy. But by combining the above seven-step formula with good legal advice your client will have its best chance to survive the immediate crisis and then revitalize itself.

James E. Rudnicki is the president of Rudnicki & Associates, LLC, a Sugar Grove, Illinois consulting firm that specializes in helping financially troubled companies to survive and then revitalize them.