Assessing Future Viability: Is a Business Restart Possible?

By Tommy M. Onich

The cold hard facts about business restarts, sometimes disguised as turnarounds.

In the jargon of corporate renewal, two terms are frequently used interchangeably: turnaround and the restart. Often, these are thought of as synonyms. Both are similar in the sense that they require a reversal of fortune.

The underlying concepts, however, are vastly different. A turnaround is transformation tragically delayed. A restart is resurrection. Lenders need to recognize the implications of this distinction. If they do not, any attempt at renewal or recovery can fail.

This article compares turnarounds and restarts. Using case studies, it shows the increased difficulty of business restarts and gives lenders a framework to determine whether or not a restart is a viable possibility.

Turnaround and Restart: A Comparison

The turnaround is metamorphosis delayed and may require a wrenching and intense period of change. It will occur in an organization that still has life. A revenue stream still exists, and the company's doors are not closed. Clients still purchase its products or services. Suppliers continue to support the company in some manner, and it has banking arrangements of some sort. The company possesses an infrastructure that may include hard assets, personnel, an accounting function, management information systems, sales, distribution and marketing. It also has some notion of future revenue potential and possible profits from this revenue.

A company in need of a restart requires much more dramatic change; it actually needs resuscitation. This is the result of catastrophic failure that has been caused by grievous error or misfortune. The effects of many errors may have piled up over time, or a few disastrous errors may have precipitated a rapid decline. In any case, a company that needs a restart has experienced deep and catastrophic failure. The doors of the organization may be shut. Infrastructure will certainly be impaired. Often, many legacy issues have accrued—representing a significant burden and challenge to revival. These issues can be myriad and varied.

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In both of these situations, the same characteristics are required for renewal: competent management, a viable core product or service and sufficient capital to execute a reversal of fortune.

The probability of success, however, differs. We can assess the probability of success based on two factors: the difficulty of restoring health and the resources required to do so. Both difficulty and required resources increase dramatically from turnaround to restart. Even experienced turnaround managers approach the restart with caution.

When Does a Turnaround Slide into a Restart?

While one might expect it would be easy to identify the restart, not all cases are obvious. The key question

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is: Has the organization experienced catastrophic damage? Has it slid down a continuum, dramatically increasing the difficulty of and resources required for recovery?

For example, in my career as a commercial lender, I was given responsibility for a new file. The client produced industrial and commercial windows and sold to both end users and contractors. A simple liquidity review showed that both accounts receivable (A/R) and accounts payable (A/P) were aging and the operating line had been fully used for many months. Of interest, most of the accounts on A/R were aging identically. Although these receivables appeared to be from different entities, they were actually from one company: a company that was in extreme distress. Thus, about 85 percent of revenue and A/R were from an insolvent entity. Internal financial statements did not reveal the situation. Clearly, this borrower was a restart—nearly moribund. It had carelessly bet its existence upon a single relationship that failed. And it had concealed this fact from its lender.

Restarts: A New Level of Difficulty

Another example shows the devilish difficulty of achieving a restart. A storied name in yacht manufacturing, C&C Yachts, produced custom and semicustom yachts in lengths from 36 feet to more than 50 feet. At one time the company was sizable, with manufacturing facilities in both Canada and the United States. It had experienced financial difficulties several times and reduced its manufacturing capacity to one plant in Ontario, Canada. Around 1992 it was placed into receivership and ceased operations.

> *Many companies that appear to be going concerns have already experienced a catastrophic failure.*

Shortly thereafter, C&C was purchased by an investment group from Hong Kong in an attempt at a restart. The group had no experience in turnarounds or business restarts and did not provide sufficient capital.

Quickly and predictably, C&C ran into serious difficulty. At this point, I was called to evaluate the situation, which was as follows:

- Production had nearly ceased.
- The production team was highly skilled, dysfunctional and poorly led. Margins had fallen and were very low. For some models, they were negative.
- Cost estimates for production had been based upon historical data. These costs from the past had the benefit of economies of scale that current production did not. On the basis of these costs the product was underpriced in the market.
- Some marketing practices destroyed value. Upgrades were "sold" to clients; then the price increase was deducted from the final invoice.
- There had been a fire in the plant, and insurance coverage was insufficient. This impaired working capital and delivery time, causing a negative market perception. Potential customers were concerned about the company's ability to complete its orders.
- C&C was facing serious litigation from order failures or delays from the fire.
- Product quality had deteriorated, as evidenced by warranty repair work.
- The current CEO was inexperienced, even in a custodial environment. He was overwhelmed by the situation.

Three Requirements for a Restart

In this environment, the Hong Kong–based board asked me to consider an attempt to revitalize C&C. The board was willing to provide additional funding to do so. The evidence suggested that this was not a turnaround but rather a second restart that was derived from the first restart:

- Replacing much of the production staff would be difficult. This was a highly specialized niche; finding new staff members would be both difficult and time-consuming.
- Sales were nearly zero and needed to be ramped up. Credibility in the market was a huge issue, however, and it would take significant time

and resources to improve product quality and change market perceptions. *Concurrently,* prices needed to be increased to spread fixed costs over a lower volume.

- Marketing efforts needed to be supported by reestablishing relationships with dealers. Dealers had been ignored while the company faced its challenges.
- The parent company had invested and lost millions of dollars. Although the board was willing to provide additional funding, a review suggested that capital requirements would likely be beyond the investors' tolerance.

C&C was a "restart of a restart." Many grievous mistakes had been made, and the burden of legacy issues was huge. Perhaps resurrection was within the realm of possibility, but it was hard to even estimate the level of difficulty. Of course, this implied that it was also difficult to understand the resources that a restart would require.

C&C was at the far end of the turnaround/restart continuum. It would have required tremendous skill, time, effort and capital to reverse its fortunes. The reader will recall that the parameters for renewal are management, core product and financial resources:

- **Management.** Both the board and current management were inexperienced.
- **Core product.** Given grievous past practices, C&C no longer had a viable core product.
- **Financial resources.** It was unlikely that there would be sufficient capital.

Accordingly, I declined the opportunity to make the attempt and remained as CEO to support a receivership, litigation and liquidation.

Lessons for Lenders

- Corporate renewal is the process of revitalization or the reversal of the status quo in an organization. Three elements are required for success: management, core product and capital.
- These parameters required for success apply to both turnarounds and restarts.
- The turnaround and restart are different creatures, with different levels of difficulty and resources required for renewal.
- Generally, turnarounds apply to operating companies that are still functioning and have some infrastructure.
- Restarts apply to companies that are moribund or nearly so.
- The turnaround is a transformation delayed, the restart is resurrection.
- The restart is not always easy to identify. Many companies that appear to be going concerns have already experienced a catastrophic failure.
- The restart is very difficult. Many corporate renewal specialists avoid participating in restarts.
- Above all, look before you leap. Any attempt at renewal must answer two fundamental questions: What is the business model? Can the criteria for success be met?
- If you do not understand the business model, due diligence has lacked scope and depth.
- If due diligence shows that the parameters for success are unlikely to be met, then liquidation is likely the best option.

Facing Hard Facts

The terms turnaround and business restart are often thought to be synonyms. Certainly they both lie within the purview of corporate renewal. Both models require the same parameters for success. These are: a viable core product, financial resources and management.

They also have significant differences. The turnaround is revitalization delayed and the restart is revival from near death. This means that the restart requires additional resources and talent for success. It represents a tremendous challenge to all stakeholders: employees, board, lenders and shareholders.

It is not always easy to differentiate between the turnaround and restart. Before any attempt at renewal stakeholders must define the business model and determine whether or not it is possible to meet the requirements for success. If this is not the case then the renewal process should not begin.