

Chapter 1

Restructuring for Success: The 10-Minute Check

Why You Need to Restructure

What exactly is business restructuring? In most cases, the term refers to a turnaround tactic used by distressed companies in an attempt to correct a declining financial situation or climb out of bankruptcy. But business restructuring carries a variety of meanings in business. For a private equity (PE) company, it may mean “financial” restructuring, cleaning and reorganizing the financial books using certain methods of financing, loans, or debt structures. For a chief executive officer (CEO), it may mean cutting heads through reductions in force (RIF) to decrease selling, general, and administrative (SG&A) expense dollars. To me, and for NexGen, it represents a way to build a competitive advantage, which is a good

thing, very different from the negative connotations associated with the phrase today.

NexGen is my advisory firm, and we operate by partnering with companies to deliver a vision, strategy, and “playbook” on how to effectively restructure an organization, take costs and waste out of its processes, and design a robust business model. Our patent pending framework drives companies to focus investments and resources on the business core activities, facilitating the reallocation of funds toward growth initiatives, resulting in an increase in revenue and profit margins.

When done correctly, business restructuring is transformational; it offers a way to right-size the company, improve business processes, allocate the right resources against the right activities, and create substantial self-investments geared toward future growth. The scope of this book focuses on “operational” restructuring, a way to fundamentally change your cost structure to deliver the highest value at the lowest cost to your customer. To achieve this, you will need to take a holistic approach and execute a rigid playbook; otherwise, you will not see optimal results. If this is something you cannot commit to for the long haul, do not bother getting started. It is a journey that can take years. It is not for the CEO who wants an instant fix, nor is it for the one managing the business quarter to quarter. There are quick wins when you restructure, but the most impactful changes happen in cycles, and that takes time. Fortunately, if you are dedicated to reading this book, you are already off to a good start.

How do you know if you need to undertake the long journey of restructuring? Well, there is no easy way to determine when you need to restructure, but general guidelines, based on events that may occur within your company, can help you answer that question. Every company, regardless of size or product offering, should take a hard look at itself every year using a rigorous self-assessment to determine what is working in its organization as well as what is not. It is also essential to understand the external environment and

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how that impacts your business today as well as in the future. Too often we are backward looking and fail to anticipate and properly prepare for crises before they occur. A proactive approach is critical when assessing external market conditions, competitors, and the state of your company.

Exhibit 1.1 demonstrates what I have found to be the natural continuum of a company's thought process when it believes it needs to make improvements. Being cognizant of this cycle and knowing where you fit will help guide you to achieving sustained results.

Usually when my team and I go into a company that thinks it wants to do restructuring, we can already feel the sense of chaos in the environment. The CEO or PE firm has contacted us because the company needs help. Yet, at the topmost level, we get the sense from the leadership team that things are under control. At least that is what most of the leaders are saying. Why would the CEO say things need to be improved but members of the leadership team

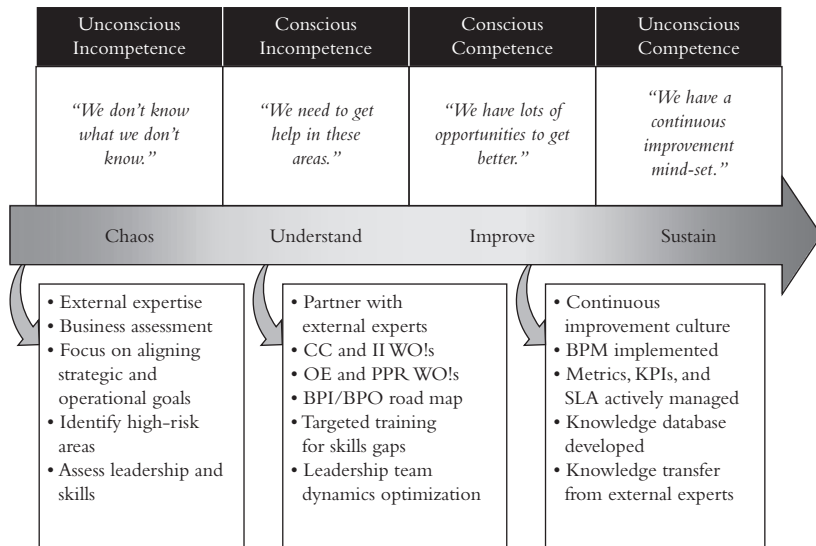


Exhibit 1.1 Conscious/Unconscious Chart

claim things are not that bad? Because their decisions and actions caused the problems in the first place! It is a direct reflection on them as leaders. This is even more prevalent in companies with long-tenured executives who grew up in the company. We call this “Unconscious Incompetence,” and it is the worst place your company could be on the continuum.

Slightly better, though not ideal, is the company that knows it needs help but also thinks it has the answers to most of the problems. Not really knowing what the root cause issues are, and therefore not being competent to make the correct systemic changes, is a drain on company resources and finances. The worst thing you can do is make assumptions about what you believe the issues are. I call it “intuitive analysis.” We had a client who told us the “superstar” finance person knew what was wrong and “where all the dead bodies were.” We discovered that she had assumed a lot of the issues, and the company had never done a thorough analysis using data to validate her recommendations. In the end, she was right about the surface issues but not about the root causes. If you do not fix the root cause and only fix the symptoms, you will enter a never-ending cycle of fixing the same issue over and over. If you have not identified the issues using facts, data, and analysis, you do not truly understand the root causes and therefore you are not ready to move down the continuum. This is what we call “Conscious Incompetence.”

The next phase of the continuum is “Conscious Competence.” Here you have conducted an assessment and understand the source of your issues, as quantified with data-driven evidence. During the assessment, as you peel back the onion and delve deeper into the organization, the opportunities and issues start to surface. Now that you understand the issues, you are conscious of them, but inept when it comes to implementing the changes. You need external resources to help you execute, as with all the continuum’s phases.

The final stage of the process is “Unconscious Competence.” When you move into action and are conscious of the changes

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required and have built a competency to make the improvements, you will be able to deliver results by lowering costs and growing profit. Continuous improvement becomes part of the way you run your business. You know how to identify root cause issues and you have embedded the improvement mind-set into the culture through training. You are efficient and effective and able to flex your cost structure. It is a way to gain an advantage over your competitors, prevail in a market downturn, or turn around your company when it is in decline.

Quick Tip

- 🗨️ A quick 45- to 60-day assessment by external experts will help you focus on the right issues to attack and is well worth the money.

Are Your Key Financial Indicators Telling You Something?

Getting ahead of your competitors and gaining a competitive advantage is a key reason to perform restructuring. The ability to change cost structure and pricing strategies is an important driver of success in the competitive marketplace. When lower prices are necessary to gain market share, a flexible cost system allows you to change direction without negatively impacting operating margin. Having lower costs and superior service, being able to increase prices in a robust economy or lower prices in a market downturn, are paramount to increasing or maintaining operating margin. Both contribute to increased cash flows, freeing up funds for operating expenses, capital investments, and/or acquisitions.

If you struggle either to increase or to maintain operating margin, some key indicators related to your cost structure will point to common issues immediately. The two important financial indicators in Exhibit 1.2 outline some of the metrics you should be looking at carefully on a regular basis. The exhibit presents a couple of

Metric	Best in Class
Revenue growth	9% improvement
Profitability	9% improvement

Exhibit 1.2 Year-Over-Year Financial Indicators

SOURCE: Aberdeen Group—October 17, 2007

A benchmark study by Aberdeen Group, a Harte-Hanks company, co-sponsored by Dundas, iDashboards, Insightformation, Corda, and Actuate.

best-in-class benchmarks that you can use to compare against your own performance. How well do you match up against benchmark?

Other indicators including cash flow, SG&A as a percentage of revenue, full-time equivalents (FTEs) as a percentage of revenue, and specific departmental budgets as a percentage of revenue (such as research and development [R&D] or marketing) will also give you an indication of how well you are doing against benchmark, if you can trend them monthly, quarterly, and annually. David Hatch, Research Director of the Business Intelligence practice at the Aberdeen Group, a premier research and analysis firm, said this about measuring key indicators:

Businesses thrive or fail based on their ability to identify, define, track and act upon key performance metrics/indicators (KPIs). Executives and line-of-business management are increasingly feeling the pressure to establish the right KPIs to enable timelier and more accurate decisions. The faster and more accurately KPIs can be accessed, reviewed, analyzed and acted upon, the better chance an organization has for success.¹

When assessing the financial “health” of a company, visible symptoms may or may not be obvious. The obvious financial symptoms included a negative or declining cash flow and reduction in operating margin percentage. Another very telling financial indicator is SG&A. When evaluating SG&A as a percentage of revenue and comparing it against the total number of employees, typically, the smaller the percentage SG&A is of revenue, the better. Most industries should focus on assessing opportunities to eliminate cost from

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SG&A line items. By comparing an individual company to the industry and broader sector, a company can quickly determine if SG&A expense is within reason. The average SG&A as a percentage of revenue for a best-in-class company is between 9 and 12 percent. The average among Fortune 100 companies, however, is between 14 and 16 percent.² Now, drill down to a lower level, and consider the consumer goods sector as an example. Its SG&A average runs in the 19 percent range. For the apparel industry, within the consumer goods sector, the average SG&A as a percentage of revenue is 39 percent.³ The SG&A is considerably higher than best-in-class, Fortune 100, and the consumer goods sector average, while the number of employees is much lower. Each individual company must determine for itself whether the high cost of SG&A is justified. In the apparel industry, much funding is invested in marketing and advertising, as retailers sell new styles at least four times per year. Another reason for the high SG&A for the apparel industry is that most retailers source their goods internationally from local suppliers, which results in high shipping costs, import fees, and considerable logistics management. But even within the apparel industry, some companies have much higher SG&A costs than their competitors.

Why is this? Take a look at Exhibit 1.3. Is it just advertising, or is overhead and structure not optimal? Are there middleman activities that can be eliminated with newly reengineered, robust processes and systems? Can noncore transactional activities be outsourced? This assessment presents the opportunity to take cost out by redesigning the organization structure and reengineering or outsourcing the supporting processes.

The more interesting financial symptoms are those that are not so obvious. In each of NexGen's client companies, little or no technology investments were made toward standardized platforms to maximize efficiency. The existing systems were disparate, stand-alone, self-built platforms that were difficult to integrate. This siloed application resulted in inefficient organizations coupled with disconnected, process-driven systems. Lack of technology investment

BUSINESS RESTRUCTURING

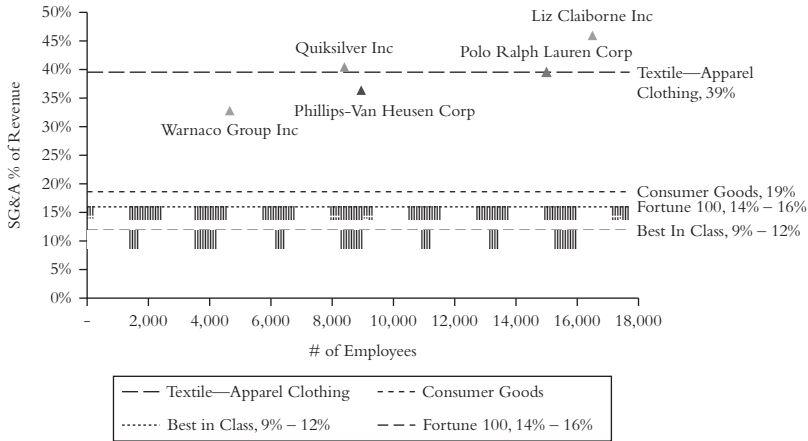


Exhibit 1.3 Year-Over-Year Financial Indicators with Graph (SG&A versus Employees)

SOURCE: SG&A and employee information from finance.google.com year-end 2008.

inhibits the ability of a business to optimize processes and people. In my experience, information technology (IT) capital has a greater impact on work productivity than non-IT related investments. Leading companies use robust technology to support business processes and have the ability to maintain consistent real-time information. They also streamline processes with business partners and customers and make information available on a global scale. Often companies need to make investment or operational decisions but do not have the most comprehensive data. Technology, paired with optimized processes, enables the power of agility and is critical for any company to maintain a competitive edge.

Many of the basic financial indicators that companies track are just not enough to determine how well they are doing. In some cases, these indicators can give the leadership team the wrong message regarding the health of their business. Measuring metrics through detailed dashboards and scorecards of work activities that roll up to your main business processes is required in order to understand the overall health of the company.

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While the SG&A graph displays the financial health of an organization, you can ask yourself some basic questions to determine how the heart of the organization's operations is performing. The financials are backward looking, and as discussed, that is not the best way to understand the future. However, your operations can help you predict challenges and issues that will not show up in the financials for at least a quarter or more.

If we break down the “heart” of the organization into operations, organization, and process, we can ask the right questions and look at the right data to make a quick diagnosis: Are we healthy or not? It is this 10-Minute Check that will tell you how “Conscious” or “Unconscious” you are and the level of restructuring that is required.

I can tell where the company stands on the “Conscious/Unconscious” Continuum just by asking the leadership team a couple of standard questions. In some cases, the leaders cannot answer the questions, and that is the first sign of chaos deeper in the organization. It is dangerous when you think about it. The bottom line is that “strategy is executed from the ranks,”⁴ and it is important to ask the questions to the people in the mid to lower levels of the organization. They know what is going on and will be able to tell you what needs to be fixed.

Quick Tip

- ☞ Conduct “skip-level” meetings with high-potential employees every year. These meetings should be with employees one level below your direct reports. The leadership team should get in this habit as well. The information you gain will be invaluable. These meetings are great ways to understand the true issues hindering your organization.

As a matter of fact, most operations people know how “immature” or “mature” their processes are and how effectively they can deliver to the customer. They have a good idea of what the customer wants and what new products, offerings, and markets are important to invest in.

They also know what needs to happen to deliver on the strategy yet very often they are not involved in the delivery process. Most strategies are built from the top down, with limited visibility into the day-to-day challenges that stop the company from delivering the highest value to the customer. How can a company’s leadership stay on top of issues and redirect strategies if required? Set up a Strategy Council.

Quick Tip

🔑 Form a *Strategy Council* that includes lower-level operations people and build a strategic architecture that represents what you can truly deliver today and over the next three years. Include this group in merger and acquisition discussions and strategy reviews to get a clear picture of where to invest for organic and inorganic growth opportunities and to help mitigate any roadblocks that may stop you from achieving your short- and long-term strategy.

Go through the 10-Minute Checklist in Exhibit 1.4 and see how you score. You or someone on your team should be able to answer these questions quickly. If it takes days, that is a bad sign.

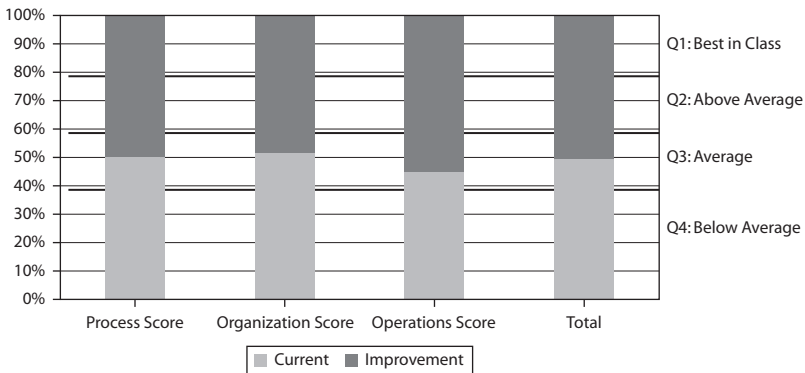


Exhibit 1.4 10-Minute Checklist

SOURCE: Aberdeen Group—Mon Apr 14, 2008

Live Analysis of Operations Management Benchmark Data Reveals Best-In-Class Manufacturing Strategies.

Aberdeen’s benchmark Manufacturing Operations Management Study Senior Analyst Matthew Littlefield.

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Process	Score	Rating
How many of your processes are standardized across the company?		All = 5 Most = 4 Some = 3 Few = 2 None = 1
How many of your processes are automated using a technology platform or tools?		
Which processes do you continually improve to deliver better performance?		
How many of your processes are measured?		
How many of your processes are measured against benchmark?		
How many of your processes are outsourced?		
How many of your processes have process owners?		
How many of your processes have KPIs that are linked to corporate strategy AND operational goals?		
Do you measure the "relationship" with your "customer"?		
Does your customer ever see "defects" out of your process?		
Process Total Score		
Organization	Score	Rating
Do you conduct a company-wide organization analysis of spans of control and number of layers?		All = 5 Most = 4 Some = 3 Few = 2 None = 1 Yes = 5 No = 3 Don't know = 0
How many of your functions conduct an organization analysis of spans of control annually?		
How many of your functions benchmark the number of FTEs annually?		
Do you know the average span of control for managers in your company?		
Do you have centers of excellence for areas of expertise?		
Do you have shared services for administrative and transactional activities?		
Do you have a pay-for-performance compensation plans?		
Do you have an organization that focuses on continuous improvement?		
Do you have a training program for Six Sigma or continuous improvement?		
Organization Total Score		
Operations	Score	Rating
Is your supply chain integrated as one process and organization?		Yes = 5 No = 3 Don't know = 0
Do your policies and procedures get in the way of quick decision making and taking action?		
Do you have too many reports?		
Is data readily available?		
Operations Total Score		
Grand Total Score		

Exhibit 1.4 (Continued)

Was any of the material presented thus far surprising to you? A “yes” answer is a good indicator that you need to take action. Chapter 2 lays out exactly what you need to do.

Notes

1. Operational KPIs and Performance Management by David Hatch, Aberdeen Group, August 2008
2. Deloitte Value Analytics, 2006. Copyright © 2006 Deloitte Development LLC. All rights reserved.
3. Tim Lau, NexGen Advisors Study, 2009.
4. HBR, “Building an Organized Process for Strategy Communication,” *Balanced Scorecard Report 9*, No. 3 (May-June 2007).