

When Small Firms start to Fail – Visit a Turnaround Advisor

It's every entrepreneurs nightmare - your small business is suddenly in decline, why is this, what is causing the problem? Should I invest more money to solve the problem or will it just go away? However, warns business recovery expert Alan Cornwall, the symptoms are always a sign of a deeper malaise and the treatment must be carefully managed by a specialist to be effective.

There are many reasons why small, owner/managed companies fail. There have been a number of academic studies made since 1976, which have measured the causes of decline. Each study on its own, at best, provides a list of causes. However, if we investigate the findings of the studies as a whole, we can rank the list of failures into importance. If we concentrate on these reasons and suggest remedies and solutions, the Turnaround Advisor can target potential problems and avert any catastrophic failures, which may be just around the corner.

A number of causes are significant. Internal causes include the following:-

High Cost Structure –

Competitors are continually looking for radical ways to reduce their costs. Firms that fail to respond quickly will find themselves in trouble. Even small manufacturers are outsourcing the supply of W.I.P. and even finished goods to the Far East, where labour costs are dramatically less. Service businesses tend to get into trouble by failing to cut overheads early enough in a business turnaround.

• Poor Marketing –

Again, the competition is rapidly modifying products to match the rapid advances in technology. At a higher level, the market itself will be changing, discarding obsolete products in favour of new innovative products and solutions. Firms that fail to respond will be

under price pressure and maybe ultimate extinction.

▪ Acquisitions –

Opportunities are rarely forecasted and planned in advance. High risk growth strategies occur by surprise, as the opportunity presents itself.

The small, under-resourced business places itself in great danger by undertaking knee-jerk decisions. Other studies show a much higher than expected failure of MBO / MBI's in any case.

▪ Financial Policy –

Cashflow pressures caused by any number of reasons – predominantly insufficient profitability – can be eased by adopting relevant solutions such as Sale & Leaseback of existing assets and Invoice Discounting / Factoring. If these solutions are made in order to alleviate pressure instead of funding growth, then failure is just around the corner. These solutions are expensive – especially when things get really tight.

▪ An external factor is

Competition -

Any small business is vulnerable to the control exerted on the market by market leaders. If the small business is the rapid technology sector, then they will be at extreme risk. New product development times and costs may never be recovered. Money spent in developing a Brand from scratch is always more expensive than estimated. These costs are very expensive and only market leaders can easily afford them.

The study of the frequency of failures has highlighted three major causes, which are far more significant than the examples described above:-

- **Poor Management**
- **Inadequate Financial Control**
- **Changes in Market Demand**

Poor Management

The personal characteristics of the chief executive and key managers play a major role in causing decline. Sheer incompetence or lack of interest in the business is a common characteristic. There are a number of defects commonly evident:

- *Autocratic Rule*

By their very nature it is common for small owner/managed firms to have a dominant decision maker, who will not tolerate dissent. In many cases this is good – where leader is also competent. However, if the autocrat has an attitude problem, or lacks the intellectual capability to deal with problems, the business is doomed.

- Neglect of the Core Business

When small firms reach a stable stage of development, there is a natural desire to expand. If the strategy adopted is one of diversification, the key management could easily be sidetracked with resources and time being diverted from the core business. The consequences can be catastrophic, as the cashflow provided by the core activities disappears very quickly.

- Lack of Management Depth

Even if the Chief Executive is not an autocrat, he or she may make the fateful error in promoting loyal and trusted members of the company into executive positions, which are beyond their skill or competency levels. These poor decisions usually result in rather slow declines in the firm's performance.

Inadequate Financial Control

With the advent of information technology, business control has improved over the past 20 years. However, this is still seen as being the second most frequent factor causing failure.

Many accounting systems have been poorly designed. They are too complex and produce the wrong information for general management (although adequate for accountants). It is very common in small firms to see many hours of overhead to input data, which is wasted because it is difficult to analyse by general management.

Inadequate costing is very common amongst failing businesses. Firms often have a wide variety of products manufactured in house or sourced outside, being distributed to different market sectors. It is imperative that the direct costs are accurate and that overheads can be apportioned to the appropriate market or customer group. Only

with this information, will the Head of Sales be able to price his products to gain maximum contribution.

Changes in Market Demand

A change in demand for a product or service, or a change in the pattern of demand to which a firm does not respond, is the third most frequent cause of failure. The long term decline of whole industries, the outsourcing of manufacturing to the emerging economies and global consolidation of services have all had a drastic effect on the small business. In many cases, small enterprises exist solely to supply components and services to local, very large Industries. Recent rapid declines in the car, electronics and ceramic industries have decimated local small enterprises.

Taking appropriate Advice does Work

There has been an interesting finding following a study of the CVA mechanism. A Corporate Voluntary Arrangement is an alternative to an Administrative Receivership or Liquidation. It allows the management to attempt a financial restructure under the protection of a moratorium, preventing a minority of creditors forcing a collapse for their own ends. In fact, all CVA's are subject to a vote of acceptance by the majority of creditors.

The study involved in part, a comprehensive interview with the companies that had undertaken a CVA. The CVA process involves trauma and stress for the company – the immediate cash pressure prior to a CVA was replaced with a prolonged period of performance pressure, while the CVA was working through. The majority of CVA's last over 12 months – many run for 5 years, and the pressure on management was considerable. In many cases, it will have damaged the company's ability to survive.

It is clear that, as shown in these extreme cases, there is a strong need for owner/managers to have some sort of support to help navigate through these tricky periods and to leave the company in reasonable shape to carry on and prosper.

The most important request from the owners of companies in CVA was for a service that would provide for companies delivered by businessmen from a business perspective, rather than a professional, legal or accounting advice.

The rapid rise in IVA solutions to personal insolvency has led to the emergence of large volume-driven advice companies. Some of these firms purport to provide a similar service to companies, but in practice, company rescue is too complex a problem to be handled economically by volume, low-cost firms of advisors. Insolvency Practitioners are generally too expensive to give the ongoing support that is required, although the particular skilled service during the legal procedure is excellent value.

There are a small number of dedicated advisors: - rescue consultants, trouble-shooters but more commonly referred to as Turnaround Advisors, who have the skills and experience to work with the owner/managers of distressed businesses. More importantly, they will be good value for money and paid, in the main part, by performance.

Turnaround Advisors

The Turnaround Advisor should be able to undertake the following vital services:-

Immediate Diagnostic

It is essential that the immediate threats facing the company, Directors and Shareholders are recognised and prioritised.

Intervention

Expert cashflow management is vital to stabilise the crisis. The advisor should relieve stress by directly talking to creditors and Bankers.

Insolvency

It may be necessary to adopt an insolvency solution, in which case, the advisor should be knowledgeable about procedures and be able to list various options open to owners.

Rescue Finance

Often, existing funding arrangements are inappropriate and the advisor should have an extensive range of contacts amongst lenders, to effect any immediate re-financing, that is necessary. This should also include access to new capital from potential Investors.

Interim Management & Non-Executive Directorships

Following a successful intervention, there is need for a stabilising phase. In order to prevent a reversal, the advisor must be able to provide supporting management skills to ensure the success is continued.

Independent studies have shown that in the case of CVA's, a company in CVA which has employed the services of a reputable, turnaround advisor, has a 74% chance of surviving through the crisis and well into the CVA period.

In general, a failing company is well advised to employ the services of a turnaround specialist to, hopefully, prevent any insolvency occurring, to stabilise the business and to build a foundation to implement growth strategies for the future.

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