

GETTING FIT FOR THE FUTURE OPERATIONAL AND FINANCIAL RESTRUCTURING

As business failures across all industries and sectors continue to make the news, **Brian Bergin** has some practical advice for companies on their operational and financial restructuring options.



Companies are being forced to examine the way they do business as well as the manner in which they are financed. In doing so, companies are striving to streamline the business, reduce costs, improve cash-flows and secure much-needed financing from lenders or investors to position themselves for growth. There are two interlinked components of any restructuring plan:

- **Operational;**
- and
- **Financial.**

OPERATIONAL RESTRUCTURING

To survive and succeed in the current economic climate where competition is intense and finance limited there is a need to be far more innovative, agile, and cost competitive in order to differentiate oneself. Operational restructuring requires that a detailed review of the business should be performed to identify and eliminate all non essential expenditure. Such a review should be performed on a bottom up basis by project managers who are independent from the areas of the business they are reviewing.

The procurement function in a company becomes critical, generating savings through seeking quotations from alternative suppliers and challenging existing longstanding suppliers to reduce costs. Revisiting longstanding relationships is a crucial component of successful operational restructuring, particularly where the contract or partnership was agreed in different economic circumstances.

Another key area of focus is that of loss-making businesses or activities. Regardless of the initial rationale for a particular business or contract, if the figures don't support its retention and its outlook is poor, do not try to rescue it. Take the hit early and move on to focus on the more lucrative and essential business areas.

Exploration of alternative business practices should also be considered, including analysing whether outsourcing or relocation of aspects of the business to low-cost jurisdictions is appropriate. Above all, successful operational restructuring requires a clinical, challenging mind-set and it is crucial that your people are kept informed of the reasons for and importance of the actions so as to obtain their 'buy-in' to the restructuring. Operational restructuring must be continuous and become part of the

DNA of the business strategy so that 'cost creep' is avoided.

Ultimately the challenge is to maximise cash generation from the business changes implemented. Separate working capital management initiatives must go hand-in-hand with changes to the business. A successful restructuring plan should focus on accelerating collections, further extending payables and reducing inventory. Introducing a system of accountability around working capital metrics can be effective. A key component of cash flow management is a company's capital investment plan.

Companies must examine whether their capital investment budget is realistic and appropriate to the circumstances. This requires that capital projects are supported by a detailed business case. Presently, companies with excess cash may well find that they will get more value for money from their capital spend than was possible a few short years ago and that investment for growth requires capital outlay now. These considerations should form part of the business case underpinning any capital expenditure proposal.

FINANCIAL RESTRUCTURING

Generally, there is no one size that fits all and in most cases the financing proposal that a company undertakes will be specifically designed for its current finance provider. Given the explosion in commercial lending during the recent past, for most companies, their primary source of finance was debt and their partners in a restructuring scenario are lenders. The challenge of renegotiating existing bank facilities, refinancing with alternative lenders or raising new sources of finance should not be underestimated and planning well in advance is vital. The importance of detailed, rigorous operational restructuring and of tackling the issues noted above prior to engagement with lenders cannot be overstated.

Lenders will require that a business undertake extensive operational restructuring prior to any refinancing and failure to take appropriate action will damage management's credibility in negotiations with lenders. In effect, lenders will want to see what sacrifices the company has made prior to entering into a negotiation, in which they may be asked to extend repayment terms, reduce interest

margins or swap debt for equity. The quality of the relationship between the company and its lenders is crucial to the prospects of a successful refinancing. Often the level of trust placed by lenders in the company and its management team is the key factor in the success or otherwise of a refinancing scenario.

Refinancing proposals themselves should be prepared with the lenders in mind, clearly outlining the business case for them in supporting the company into the future and detailing the cost reductions and operational improvements made to date. The timescale for lender support is also important and the proposal must make clear the nature and duration of lender forbearance as lenders cannot be expected to provide open-ended support. Importantly, the company must be able to demonstrate a strategy and return to growth that is realistic and achievable.

Companies should expect to demonstrate past history of budget achievement. Lenders will be cautious in considering projections underpinning a business plan where the company has a record of not achieving budgetary targets. In preparing the projections, management should include both base and downside cases (after consideration of downside risks or sensitivities) and outline the headroom over debt obligations and covenants under both scenarios. Lenders will expect to see the impact on current and proposed finance structures of base and downside sensitised projections and will use this as a key decision-making tool in evaluating the proposal.

For certain companies, equity finance remains an option and there is plenty of interest being shown in Ireland by international investors, albeit focused on particular industries. The best way to tap this potential is to engage a financial advisor with communication channels with these sources of finance. Negotiations with equity providers are complex and the risk exists that either too much or not enough information is shared with the potential investor. This reinforces the importance of having a financial advisor on board to advise on valuations and guide the company through the process of raising equity finance.

CONCLUSION

Operational restructuring requires an honest, challenging appraisal of current

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business practices and relationships together with candid communication with your people and their 'buy-in' to the plan. It must also be continuous and become part of the DNA of the business strategy so that 'cost creep' is avoided. From a financial perspective it is important to recognise that the relationship you have with your bank and other lenders is one of the most valuable assets in your business. For successful financial restructuring it is therefore important to build credibility with your lenders and build on the strength of these relationships. The best way to do this is by maintaining open lines of communication and a 'no surprises' approach. ■

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For more on this topic, see **Restructuring Your Business From Top to Bottom** Accountancy Ireland, Vol 42, No 1, February 2010. <http://www.accountancyireland.ie/Documents/digital/2010/February/24.html>

“**Restructuring Your Business From Top to Bottom**” by Brian Bergin. Accountancy Ireland, Vol 42, No 1, February 2010.

“**Strategic Cost Reduction**” by Tim McCormick. Accountancy Ireland, Vol 41, No 1, February 2009.

“**Insolvent Companies – Advising the Directors**” by James Stafford. Accountancy Ireland, Vol 37, No 3, June 2005.

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