GETTY

OFFLOAD OR OVERHAUL?

There is no simple formula for FDs looking to restructure in a time of recovery, as Sally Percy discovers

As the economic indicators continue to point towards a sustained recovery, organisations are turning their attention towards parts of their businesses that they may not need to keep during growth. Underperforming units and subsidiaries that may have been patched up and dragged through the recession may now begin to look increasingly superfluous. Restructuring or disposal may be the solution, but both come with cost - and risk - attached.

So how can management accurately assess whether a restructuring is necessary or if the business can continue unchanged? And how can they identify those areas ripe for attention? "A restructuring will either be caused by a necessity, in which case you have no choice, or it will be caused by recognition that a business can make better cash returns and better profits through a restructuring," says Simon Poulton, a former group finance director of ARC International who is now an interim CFO. "If the economics of restructuring are positive, there is little justification for not doing it."

Meanwhile, BDO advisory partner Matthew Tait argues that now is actually an ideal time to restructure since interest rates are low yet economic indicators are increasingly positive. "Mending your roof when the sun is shining is more sensible than mending it when it's raining," he says.

When burdened with an unprofitable division or subsidiary, an organisation usually has three options: restructure it, sell it or close it. Assuming that it wants to avoid the last option on the basis that it won't generate future value for the business (although it might be the most sensible solution in certain circumstances), it then needs to assess the pros and cons of both restructuring and disposal in terms of cost, investment of management time and the best outcome for the business in the long term.

The conundrum of whether it is cost-effective to sell or restructure an underperforming division or subsidiary is never straightforward, since it will usually depend on circumstances and company strategy. As Tait puts it: "It's defining what the core of your business is and what benefit the subsidiary is bringing to the long-term future. For example, will selling it enable your business to concentrate on its core products and create opportunities for it to purchase other businesses?"

MAKING THE DECISION

When deciding whether to restructure or sell, Poulton recommends making good use of forecasting. A forecast can be used to predict the costs and revenues that will be incurred with both scenarios and how these will impact on profitability. But he also points out: "It's always easier to sell a good business than it is to sell a bad business." As a result, even if your end goal is to offload a division in the medium term, it will probably be worth investing in restructuring in the short term to make that business attractive to a wide range of potential purchasers.

"If you can't engender an auction for a disposal, you can end up on the back foot when you're trying to sell the business because buyers will take advantage of the fact that nobody else wants it," says Poulton. "The best situation is to have fixed the business to

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MAKING REDUNDANCIES

Businesses must abide by employment legislation when reducing headcount

- Employers must use a fair way of selecting employees for redundancy, ie, level of experience or capability to do the job. Employees cannot be selected for redundancy on the grounds of age, gender, pregnancy or disability.
- Fair ways of selecting employees for redundancy include 'last in, first out', asking for volunteers, and using disciplinary records and appraisals.
- An employer can make an employee redundant without following a selection process if the job no longer exists.
- Employees are normally entitled to statutory redundancy pay if they have been working for their current employer for two years or more. They get half a week's pay for each full year they were under 22; one week's pay for each full year they were 22 or older, but under 41; and one and a half week's pay for each full year they were 41 or older.
- Redundancy pay (including severance pay) under £30,000 is not taxable.
- An employee is not entitled to redundancy pay if they refuse suitable alternative work without good reason.
- Employees being made redundant must be given a notice period. The statutory redundancy notice periods are: at least one week's notice if an employee has been employed between one month and two years; or one week's notice for each year if an employee has been employed between two and 12 years; or 12 weeks' notice if an employee has been employed for 12 years or more.
- Besides statutory redundancy pay, employers should either pay their employees through their notice period or pay them in lieu of notice.
- Employees are entitled to a consultation with their employer if they are being made redundant. The employer should explain the reasons for redundancy and outline any alternatives.
- Employees who have been continuously employed for two years by the date their notice period ends are allowed reasonable time off to look for another job or to arrange training to help them find a job.

get the premium on disposal." And if your company does have a business to sell, now is a good time to do it since the flood of cheap money in the market means that both private equity houses and trade buyers are hungry for mergers and acquisitions.

Mark Dewar, senior managing director at FTI Consulting, identifies four areas that are typically targeted in a restructuring programme: headcount, process improvement, property costs, and supply chain and procurement. Reducing headcount is expensive, he says, due to outlay on payments. And where groups operate across different jurisdictions, they must comply with local labour laws that may be onerous.

In addition, where an organisation has to pay out significant sums in redundancy payments and related costs, it may not realise the benefits immediately, or to any fixed timescale. Dewar also warns that a common mistake is to make a large proportion of the workforce redundant and then hire them back as temps and contractors. Process improvement, such as reorganising a factory floor, can bring cost benefits but these are not usually large or immediate. The real cost savings, says Dewar, can be made in property, where expensive leases can be exited or renegotiated, and in negotiating preferential payment terms with suppliers. However, the difficulty with these latter two approaches is that an organisation normally has to be large to be able to exert sufficient leverage to get results.

James Bracewell, finance director with premium pet food manufacturer MPM Products, was involved in a restructuring project with a previous employer, which resulted in the business turning a £400,000 loss into a £1.4m profit over a 12-month period. "The challenge is having the information to hand to make decisions," he says. "You need to have the information around what is working and what isn't. Once you have that, the decisions are pretty obvious." He advises acting quickly and decisively. "Don't take half-measures and don't compromise. You almost have to go further than you think you need to."

Regardless of whether an organisation decides to restructure a loss-making division or dispose of it, there will likely

be significant costs involved. These include the fees of lawyers, accountants, restructuring consultants and other professional advisers. In the case of an operational restructuring of a division, budgets will need to be adjusted to cover redundancies, relocating people, and opening and closing warehouses and offices. A restructuring project can also act as a drain on senior resources with the result being that the management team takes its eyes off the day-to-day running of the business and neglects relationships with customers and suppliers.

Nevertheless, despite the fact that some stakeholders may baulk (shareholders keen on immediate returns, for instance), the expense of a restructuring or disposal should not be an excuse for putting it off. "The cost that doesn't sit on the P&L is the opportunity cost of not doing something," says Bracewell. "If you don't do it now, you are going to have to do it in six, 12 or 18 months' time. If there's something fundamentally unstable around your business, you've got to fix it."

HAVING A PLAN

Owners of privately-managed companies tend to take a long-term approach towards solving problems in a business because of their personal commitment. Where external investors and stakeholders are involved, there can be more pressure for a

HIRING PROFESSIONAL ADVISERS

If your business is planning to work with professional advisers on a restructuring project, it makes sense to engage them at the outset. Then they can help the management team to scope out the work that needs to be done, use analytics and benchmarking techniques to challenge management proposals, and come up with a detailed implementation plan that outlines the savings that need to be achieved.

The cost of using a consultancy will vary according to the size of the organisation being restructured, the scale and complexity of the work, and how much day-to-day involvement the management team has in the project. A medium-to-large corporate undertaking a restructuring programme of between three and six months could spend £200,000 to £500,000 on consultancy fees, for example, while a global group might invest millions. An experienced chief restructuring officer operating at board level will cost in the region of £50,000 per month, with some costing more.

'quick fix', however. Poulton says that having a good three- or five-year business plan is key here. If shareholders and other stakeholders such as banks can see what the business plan is set to deliver over the coming years in terms of generating cash and improving profitability, and they are comfortable with it, then they should support it, he says.

Dewar maintains that FDs have an important role to play in a restructuring process. "The FD is a good central control function to make sure that costs come out," he says. He adds that when an external consultancy is brought in, it will be most effective if it can work alongside the management team – "not only in the identification of opportunities, but also in the delivery of them. So they are seen to be owning them and implementing them".

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If a management team has built up a business from scratch, it can sometimes struggle to make the difficult decisions that are needed. "If a business has fallen on hard times, the incumbent management is often feeling awkward and difficult about it because it's not what it wanted," says Poulton. "A process of denial sometimes sets in. But a good management team will grasp the nettle and get on with it."

Bracewell believes that focusing on the figures and strategy helps FDs to distance themselves from the emotional aspects of restructuring. "The challenge comes for the MD, the sales director and the operations director, who are more involved in the day-to-day elements," he says. That's why he believes it helps to get professional support from a corporate restructuring or accountancy firm. "They have the ability to disconnect the emotions from the reality," he says. "And you need to take advice to give you the confidence that you're doing it properly." Depending on the complexities involved, the timescales of a turnaround project can vary greatly. Some companies are continuously restructuring themselves, for example. But Poulton puts a "sensible restructure with refinancing" at six months, while he says disposals typically last for between three and six months.

Ultimately, the success of a restructuring project will vary according to what the management team set out to achieve in the first place. In many cases, the survival of a business and the return to profitability will be considered success enough. Management teams will also monitor return on investment (ROI), to see how much they need to spend to take cost out and what the payback will be. In a disposal scenario, net present value and ROI matter as both the seller and the purchaser will want to evaluate what an entity is worth. Banks, meanwhile, will measure success by a business being able to repay its debt and meet its covenants. In Bracewell's case, his business measured success by the return on capital employed as well as profitability and staying inside banking covenants.

A well-executed restructuring programme can make a dramatic difference to a company. "Restructuring is almost seen as a dirty word," says Bracewell. "But even in a strongly-performing business, you have to constantly look at restructuring to make sure it's performing as well as it could do.

"The way to grow and respond to the competition is to be innovative across the board. Part of that is how you structure yourself."