BUSINESS RESTRUCTURING

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RESTRUCTURING

More than cost-cutting

When it comes to restructuring, many businesses make the mistake of scrambling for short-term cuts, but taking the time to set strategic goals can help avoid long-term losses

Tim Cooper

When experienced finance leader Amrish Shah worked at Unilever, he faced the task of restructuring its central European ice cream business due to rapidly melting profits. Some companies may have concentrated only on cutting costs in such a perilous situation.

But a cost-only focus would never have sufficed as it risked weak commitment or resistance from employees, with no brighter future to inspire them, says Shah.

"Instead, we decided the restructuring plan must go hand in hand with a five-year strategy of reinvesting benefits to deliver a winning, thriving organisation. It was rewarding to be part of that compelling change narrative."

The outcome was Unilever was able to action most of the restructure plans within two years and financial results were in line with, or better than, the business case. You might say they had it licked.

This is a familiar dilemma for many finance and operations leaders, but it is becoming more urgent in the coronavirus pandemic. Many are under intense pressure to cut costs quickly. But if they do it too hastily, it could damage the company's long-term prospects.

Shah says, as organisations have become more sophisticated, agile and responsive to market needs, business restructures should now aim far beyond simple capacity and headcount reduction. Unless it is a desperate bid for short-term survival, the main goal should be to improve long-term health and capacity.

Such a strategic focus could encompass many factors, such as freeing capital to invest in growth, divesting units that no longer fit your portfolio, strengthening supply and distribution networks, reducing risk or boosting competitiveness.

For example, a restructure following a merger could create cost synergies. But a higher priority should be to boost competitiveness by, say, increasing influence with distributors and enabling the new group to commercialise its intellectual property across geographies.

COVID-related uncertainty is triggering a vast array of business restructuring activities. These range from formal insolvency procedures to restructuring debt, redesigning operating models and supply chains, managing new areas of risk and negotiating long-term stakeholder support.

But, too often, leaders are forced to react to the crisis so quickly that they act irrationally. For example, they forego strategic analysis for an easier top-slicing approach, cutting a set percentage of costs from every department.

This sweeping approach often fails because it removes critical areas that support future sales or growth. For example, removing a company's product development team may improve short-term profit, but badly damage future sales.

To manage this challenge, chief financial officers should start by running a thorough strategic analysis of every cost in the business, estimating the long-term effect of cutting each on metrics such as sales, profitability and customer loyalty.

Ben Collett, managing director of UK advisory at Duff & Phelps, says: "When markets change rapidly, companies often need restructures to define and accelerate the operating and financial responses needed. They may need to reduce costs in line with lower demand or prices, or make costs more flexible to match uncertain demand.

"But successful business restructures tend to feature much wider strategic goals that position them for future growth. These may include customer service improvement, new product development, investment in plant and machinery, supply chain streamlining and working capital efficiency."

A current example is the risks highlighted by the pandemic of using supply chains in far-off countries. If such a chain breaks, it could take weeks or months to restart, overshadowing cost-savings benefits.

Many businesses are looking to move supply chains nearer their home markets, enabling them to fix disruptions faster, flex for demand changes, and reduce stock and working capital.

Andros Payne, managing partner at advisory firm Humatica, says another opportunity comes from the dramatic acceleration of technological advances and learning during the pandemic, for example with collaboration tools and online retail apps.

"That has opened an opportunity to rethink the organisational set up for many," he says. "But too often companies forget such strategic benefits as they rush to cut costs."

Robert Schach, managing editor at *Debtwire*, says the goal of many current restructures is to ready businesses to bounce back in an economic recovery.

"There will be a pent-up demand after the latest lockdowns," he says. "If you think your earnings can return to previous levels, you can avoid the distractions of cost-cutting pressure. Focus on managing your liquidity and postponing rather than cutting costs, for example through tax deferrals. This will allow you to focus on more core strategies.

"If you anticipate more long-term damage, for example in the hospitality and airline sectors, you may have to look more at your cost base and or need a financial restructure."

Shah says business restructures are usually painful for any organisation due to the associated uncertainty and impact on people. They can lower motivation among employees, customers and suppliers, because they cannot see what is in it for them.

He recommends doing the hard work first to identify the exact problems to fix, communicating transparently and empathising with individual and team concerns.

"Articulate clearly the change in direction and why it is necessary for the organisation to thrive in future," says Shah. "It may take time for stated benefits to materialise, so measure interim operational performance and progress as success markers, sharing progress regularly.

"Keep reminding all stakeholders of the overarching narrative and check its impact on morale and daily focus. Minimising personnel losses also implies you will support growth opportunities for key personnel. All these things will build trust and unification."

Another danger in restructuring is doing it too late to catch up with market changes. Companies often restructure only after they have started experiencing financial pain.

Payne says: "It usually takes time for a new organisational set-up to become fully effective. So it is critical to anticipate future customer needs and competitive moves to align the business in advance.

"Leaders also tend to underestimate the disruption involved. They think it just involves shifting employees into new silos. They miss the impact of changes on management processes and interactions at lower levels in the organisation. It is important to work out the details around that impact before a new set-up goes live.

"This creates lots of work on top of business as usual. Managers mostly do not dedicate enough time to it. But it can avoid potentially disastrous consequences."

Yet another challenge is that leaders can be reluctant to involve other managers in their plans, fearing biased thinking or pre-emptive resignations.

This is a fundamental error, says Payne. Managers at different levels understand the trade-offs, costs and potential gains of proposed changes better than anyone.

"But potential adverse effects can cloud their thinking," he says. "The challenge is therefore to set up a collaborative, evidence-based, non-threatening process with managers to define the new structure."

Before you start any reorganisation, analyse your customers' future needs and preferences over various time horizons and align the planned new structure with these.

"If executed and communicated well, everyone knows their role, who they report to, what you expect of them, what has changed and how their performance will be measured," says Payne. "All these things are worked out beforehand, with the accountable managers, to avoid disruption later."

Though a singular cost-cutting focus is undesirable, analysing cost competitiveness is crucial because a lack of it can be a weakness.

Julian Gething, corporate restructuring partner at McKinsey & Company, says if companies cannot compete on costs, they need to be more agile, focusing on areas such as quality and service to justify a higher price.

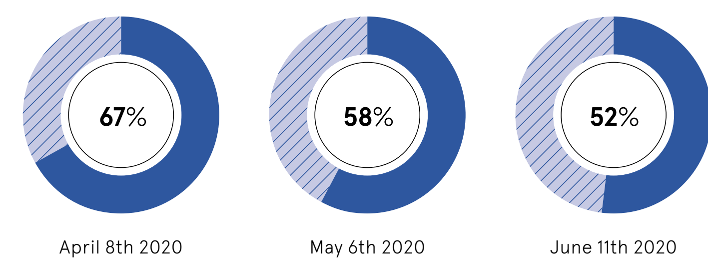
Innovation is also key to catch up or leap ahead, for example creating a strategic advantage through digital routes to market.

Finding success through restructures is a never-ending task, though. "Businesses face ever-changing macro environments and customer and competitor behaviours," Gething cautions. "Achieving strategic goals requires continuous improvement. Once you think you have finished, start again." ●

> "Successful business restructures tend to feature much wider strategic goals that position them for future growth

CFOS' COST-CUTTING IMPULSE IS WANING AS COVID PROGRESSES

Percentage of American CFOs who said they were "deferring or canceling planned investments" as a result of COVID-19



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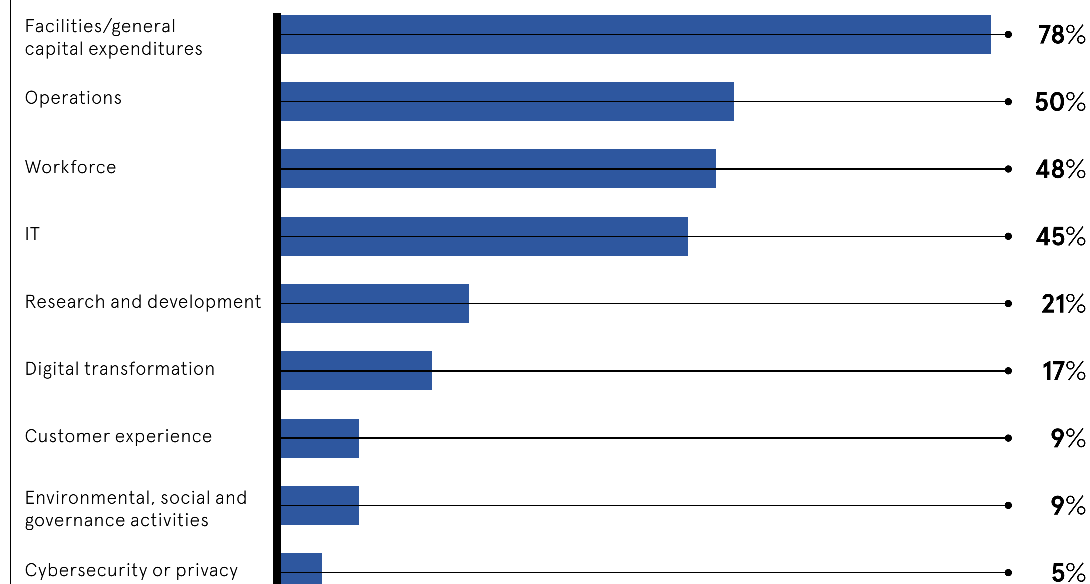
WHERE ARE COMPANIES CUTTING COSTS?

American CFOs state which investment types they are deferring or canceling planned investments as a result of COVID-19



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Solar panel merger shines with empathy

Netherlands-based Esdec is an exciting example of restructuring for growth. In the last 14 months, it has shone in the US solar panel installation market after acquiring and restructuring three local companies. There were no redundancies and Esdec never communicated cost-cutting as a benefit.

All three companies were growing and competing, with overlapping customer bases. This allowed the new team to cut costs by consolidating distribution and supply. But it was not the strategic aim, says Stijn Vos, Esdec's chief executive.

"The strategy was to reduce risk by making our supply chain more reliable," he says. "We started as a small customer for lots of suppliers. The restructure enabled us to cut supplier numbers and build bargaining power. This made us more reliable, reduced our delivery time from fourteen to ten days and enabled our distributors to reduce stock levels and be more flexible with customers."

The result was that customer feedback scores improved every quarter and the firm has grown rapidly this year, despite the coronavirus pandemic.

"We understood the importance of being close to customers in this market," says Vos. "Before the reorganisation, we surveyed and interviewed lots of customers. They wanted reliability. So we implemented a system that monitored reliability from the customer's view and it is increasing now."

To avoid distractions from the strategy, Vos placed the most strategically-minded people in charge of each unit and had them monitor progress against targets regularly.

"Bringing three companies with very different cultures together was complicated," he says. "I decided to move my family from the Netherlands to America to lead the transition. You need a particular knowledge to understand and run this business. I knew I couldn't manage it from overseas.

"Doing that meant the companies could see we were all in this together and it helped break cultural barriers. Another thing we learnt was that transparent and consistent communication is vital. For example, I sent a monthly letter to everyone about actions and progress to keep telling the story."

Andros Payne, managing partner at advisory firm Humatica, which advised on the reorganisation, says Esdec is one of the most exciting restructures for growth he has seen.

"The chief executive and the private equity owner both have high emotional intelligence and empathy," he says. "The CEO was able to anticipate personnel issues and head them off early. Despite all the tensions in the room, a sensitive leader can make it work like a beautiful orchestra.

"They also took time upfront to get deep transparency among the three companies, to understand each other's cultures and ways of working, which promoted trust and collaboration. The communication was all about potential growth and becoming the market leader. When the companies realised they shared the same vision and could achieve it faster together, that was powerful."