

RESTRUCTURING IN THE RECESSION

BIC
Behrendt
International Consulting

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Financial Crisis and Recession in Turkey

Crisis Chain Reactions - Possible Crisis Effects on Your Business

How to Cope with the Crisis – Defining the Workstreams

Tokens, Time, Trust – Providing First Aid

The Big Picture – A new Company Structure

Defining the Details

The Restructuring Office – Successful Implementation Approaches

The Restructuring Team

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The Financial Crisis

„The current crisis marks the end of an era of credit expansion based on the dollar as the international reserve currency. The periodic crises were part of a larger boom-bust process. The current crisis is the culmination of a super-boom that has lasted for more than 60 years.”

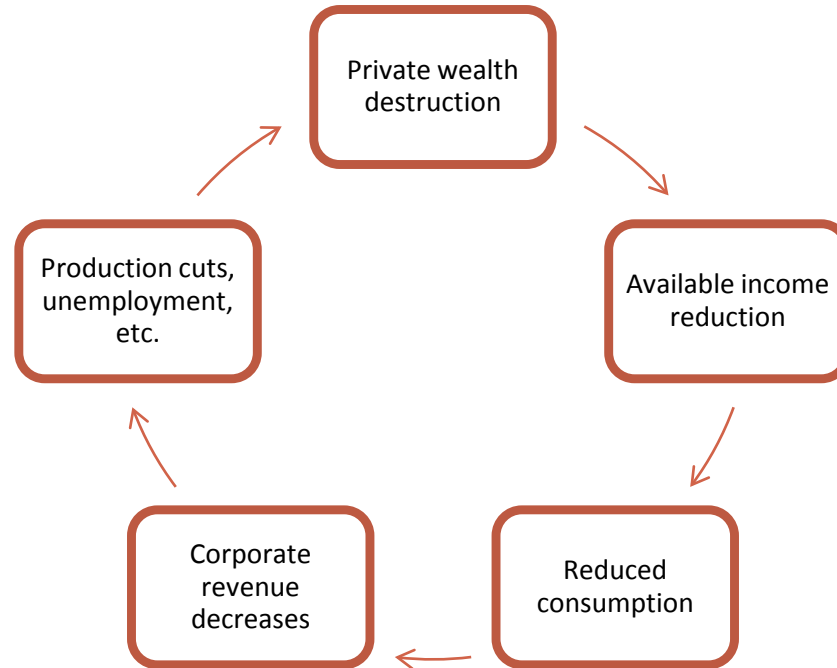
“Credit expansion must now be followed by a period of contraction, because some of the new credit instruments and practices are unsound and unsustainable.”

(George Soros, in: Financial Times, 15.12.2008)

The Financial Crisis – Some Hypotheses

1. The period of high liquidity, cheap credits, and highly leveraged buy-outs is gone, and will not return for at least several years.
2. Even with central bank rates at record lows, and significant monetary easing, both consumer and corporate loans will not become cheap due to increased prices for risk.
3. The Anglo-Saxon and, to less extent, the European banking system will need years to de-leverage, and to digest still pending writedowns on asset values. After this period, banks will be much smaller, and much more focussed on traditional banking business.
4. At the end of that transition period, the US Dollar will have lost significant parts of its role as international reserve currency, and Asian banks will play a much bigger role in the world.
5. After the changes following the 2001 banking crisis, Turkish banks are healthier than their European counterparts, only endangered by increasing defaults of credit card and corporate loans, and by their connections to the international banking system. However, the Turkish banking system will continue to operate without major defaults. Obtaining credit from Turkish banks will become more difficult and more expensive, partly due to increased risk aversion, partly due to a crowding-out effect from public institutions.

World Recession



- Financial market crisis spills over to real economy
 - Reduced liquidity, reduced availability of credit
 - Private wealth reduction („pulverized pensions“)
- Reduced available income and increased uncertainty cause reduced consumption
- Reduced consumption decreases corporate income
- Corporate income decreases are reflected in less demand for own supplies, less employees, which again leads to reduced available income, and reduced consumption
- Negative expectations enhance vicious cycle

The Recession – Some Hypotheses

1. Adjusting to a new general equilibrium will take time, and it will be on a lower level compared to the situation before the crisis. Asset prices will not return to their previous level for a long period, therefore the negative wealth effects are lasting.
2. The times of „consumption on credit“, both for individuals and for nations, are over. This will cause significant decreases both for world final consumption and for the corresponding demand for intermediate goods. After the crisis, Western countries will have much less economic power.
3. The drop in demand is too big to be compensated for by central banks and governments. Apart from the positive effect of having a smoothing effect on economic activity, activities by central banks and governments will inevitably lead to higher inflation.
4. Due to its increased connection to the world markets, Turkey is affected by decreased international demand, as well as by decreased domestic demand. This cannot be compensated for by stimulative measures by the government. These measures will extend the necessary adjustment process, and cause a crowding-out for private and corporate credit.
5. Nobody, including public institutions, knows how the world economy will look like in one or two years time. The crisis will last for at least another year, maybe slightly shorter in Turkey, but the Turkish economy will probably shrink more than in 2001.

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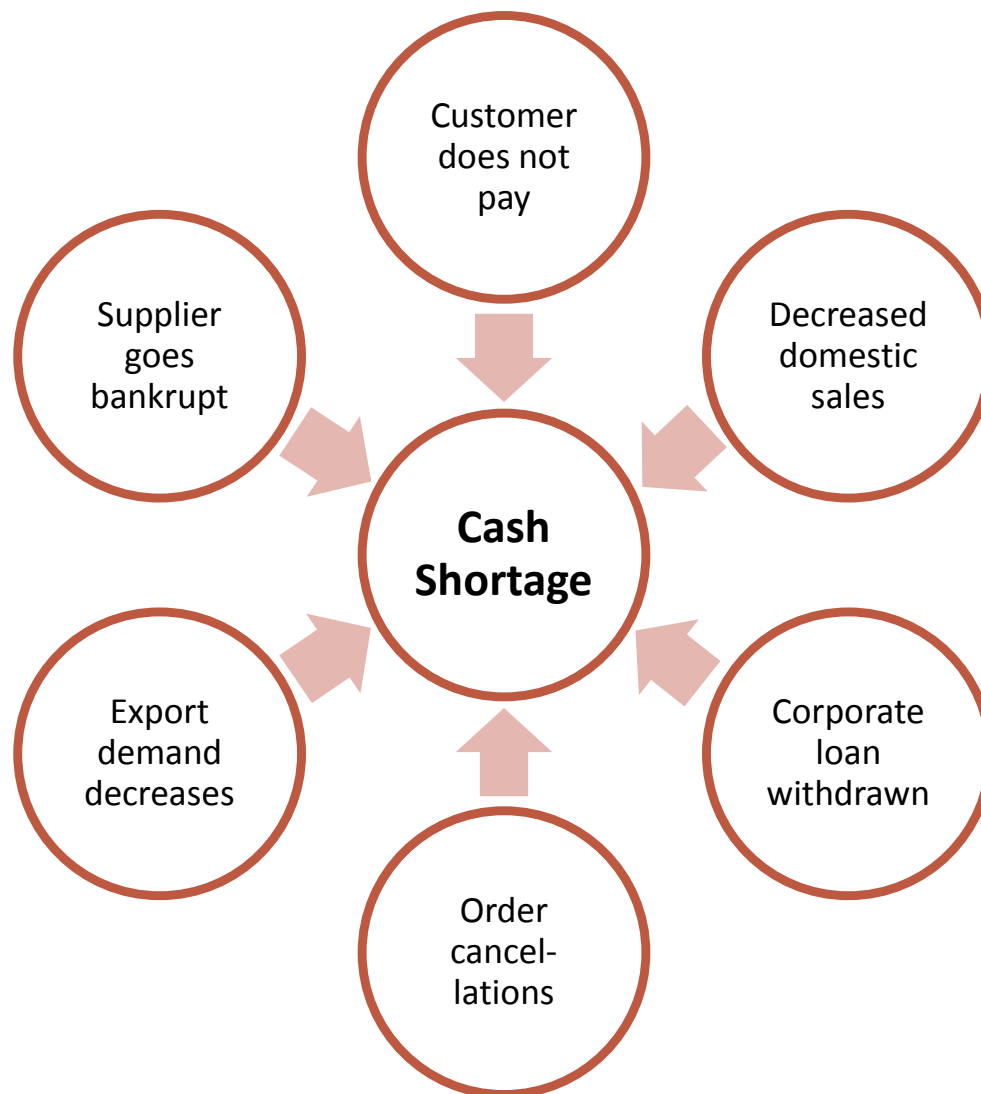
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Crisis Chain Reactions - Examples



Crisis Chain Reactions – Three common elements

- **„Tokens“** – All critical restructuring projects need to focus on cash preservation
 - In the end, all critical situations culminate in cash shortages
 - Main reason for insolvencies is not over-indebtedness but inability to fulfill payment obligations
 - In the long run, low profitability or losses poses threats to a company - but in the short run, only lack of cash can kill it
- **Time** – Critical developments need fast restructuring measures
 - Immediate action is required for preserving cash
 - Information about available time for restructuring is required
 - Restructuring measures are only meaningful if they are becoming effective in the available time frame
- **Trust** – Restructuring can only work if all stakeholders trust in its success
 - If stakeholders start to lose trust in the business, they may trigger the insolvency that restructuring tries to avoid
 - A credible restructuring plan and tailor-made communication strategy required to maintain trust among stakeholders in difficult company situation

Crisis Chain Reactions – Restructuring Methodology

In the short run,
measures have to focus on
preserving or creating cash,
winning time, and maintaining
trust...

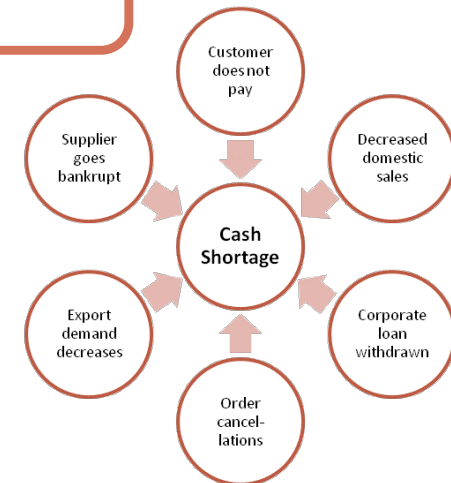


In the longer run,
restructuring has to result in
stopping loss-making activities,
and returning to profitability

In the short run,
the methodology applied can be
similar for all restructuring
cases....



In the longer run,
no restructuring case is like the
other, and restructuring projects
require tailor-made solutions



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What means „Restructuring“?

Replacing an existing structure with a new one

- Debt (or debt-equity) restructuring
- Asset restructuring
- Operational restructuring
- Organizational restructuring
- Legal restructuring
-

IT Group 2001

- Debt
- Assets
- Organization
- Operations
- HR
- Legal

Turkish Textile Company 2009

- Organization
- HR
- Operations
- Strategy
- Product portfolio

Retail Group 2008

- Legal
- Tax
- Participations
- HR
- Assets
- Organization

Restructuring Project Phases

Phase 1: Health Check & First Aid

Duration: 1 – 2 weeks

- High-level analysis of the problem
- Definition of first-aid measures
- Survivability forecast – available time for measures
- Decision on speed and priorities for next steps

Phase 2: Diagnosis & Therapy Definition

Duration: 1 – 3 months

- Detailed analysis in relevant workstreams and areas
- Developing a company model for analyzing effects of different models, scenarios, stress testing
- Developing different possible target structures
- Decision on model and implementation plan

Phase 3: Therapy & Cure

Duration: 3 – 18 months

- Working out details of the chosen solution for every workstream
- Implementing the defined solution
- Following up results, measuring restructuring performance

Different from classic projects, analysis, design and implementation tasks are overlapping

Workstream „Finance & Legal“

- Accounting / controlling, income statement
- Accounting / controlling, balance-sheet related
- Finance / Treasury: Cash man., liquidity planning
- Finance: Debt & equity structure, risk management, banking & investor relations
- Tax: Income taxes, VAT, special consumption taxes, stopaj, wage-based taxes, SSK&Bagkur, special restructuring tax laws
- Legal: corporate law, articles of association, third-party contracts, insolvency law, special restructuring laws

Workstream „Organization & HR“

- Organizational chart (management structure, legal structure, profit/cost center structure)
- Employee analysis, legal aspects – salaries & remuneration, contractual & legal rights, outsourced personnel, relation to capacity planning
- Employee analysis, abilities – standarizing skill set definitions, standarizing job descriptions, key personnel definition
- Collective labour agreements - existing agreements, players, upcoming negotiatons

Workstream „Operations“

- Sales: Forecast & scenarios, price sensitivity analysis, customer analysis
- Production: High-level production planning, capacity planning
- Purchasing: MRP, Supplier analysis
- Overhead analysis and allocation system
- Inventory analysis
- Value chain analysis, outsourcing options
- Cost behaviour analysis – fixed vs. variable cost in relation to time

Workstream „Strategy“

- Strategy review compared to expected economic scenario
- Review product life cycles
- Definition of key growth and investment areas
- Definiton of disinvestment areas
- Review marketing & PR measures
- Communication strategy

Each workstream provides different perspectives on the company

Each workstream is managed separately in each project phase

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Health Check & First Aid

- **Targets**
 - High-level analysis of the crisis-induced problems
 - Survivability forecast – definition of available time for restructuring measures
 - Definition of first-aid measures
 - Decision on speed and priorities for next steps
- **Focus**
 - Main workstream *Finance & Legal* („Tokens, time, trust“) – focus on cash and liquidity
 - Supporting activities by workstreams *Operations / Organization & HR / Strategy*
- **Methodology**
 - Structured interviews with top management / owners
 - Review and modification of cash forecasting system, survivability forecasting model
- **Team**
 - Company: General management, finance management
 - BIC: Engagement leader + 3-5 people
- **Duration:** 1 – 2 weeks
- **Output**
 - Initial management report with recommendations
 - Survivability forecasting model
 - Suggestions first-aid-measures

Survivability Forecast

- **Results Cash Forecast: „Survivability Forecast“**
 - Cash availability in weeks without cash inflows from sales
 - Cash availability in weeks under regular conditions
 - Modify min-max assumptions for creating different scenarios
 - Modify assumptions for certain customers / customer types
 - Cash availability in weeks assuming constant F/X rates
 - Modify future F/X rates for creating different F/X scenarios
 - Cash availability in weeks under different scenarios
 - Add further stress tests (e.g. Credit withdrawal) to create additional scenarios
- **Targets**
 - ***Minimum 1 month cash availability without any cash inflows from sales***
 - ***Minimum 3 months cash availability under regular conditions (min income scenario)***
- ***Identify critical scenarios for further observation and definition of counter-measures***
 - F/X developments
 - Serious payment delays from specific customers
 - Special cash-effective events

First Aid Measures

- **Starting point: cash forecast**
 - Individual case-by-case modifications according to list below
 - Measure effects on targets under different scenarios
- **Level 1: Operative cash flow**
 - Cash inflow (cash collection, credit limits, modified payment terms)
 - Cash outflows overhead suppliers, direct suppliers, tax & SSK, salaries
- **Level 2: Debt and equity structure**
 - Short-term debt (suppliers, other debt obligations due after 3 months)
 - Long-term debt (banks, others)
 - Equity (existing shareholders, new shareholders, mezzanine capital)
- **Level 3: Asset restructuring**
 - Current assets (debtors, non-cash current assets, inventories)
 - Financial assets
 - Material assets
- **Target: Extend cash availability to 1 month without / 3 months with minimum cash inflows**

Health Check – Other Workstreams

- **Targets Workstream Operations, phase 1**
 - Sales forecast and sales scenarios (customer grouping, forecasting scenarios)
 - Capacity usage and capacity needs (PPS, reflection of sales scenarios, existing capacities)
 - Inventory analysis (MRP-based, review inventory duration)

- **Targets workstream Organization & HR, phase 1**
 - Organizational structure - management structure, legal structure, HR structure
 - Assign organizational units and employees to capacity planning units
 - Align organizational structure with profit / cost center structure
 - Employee analysis, legal aspects, relation to capacity planning, outplacement options
 - Collective labour agreements, key players

Trust

- **Target**
 - Have a credible and consistent restructuring plan
 - Communicate it to relevant stakeholders in time
 - Execute it as announced, and keep stakeholders informed about progress
- **Preferred communication strategy**
 - Phase 1: No communication at all (small team, short time)
 - End of phase 1: Announce to internal stakeholders that project is under way
 - Phase 2: Small project team, keep confidential, request confidentiality agreements
 - Different scenarios are being discussed – may cause confusion and distrust
 - End of phase 2, after decision: Communicate plan to effected stakeholders
- **Alternative communication strategy**
 - If trust is already in danger, immediate and continous communication to related parties may be needed
- **Responsible**
 - Company: Top management, if existing involvement of PR department
 - BIC: Engagement leader / support from workstrom *Strategy*

Milestone 1: Results Health Check & First Aid Phase

- **Milestone 1 - main results**
 - Time frame for further work (target min 3 months) is defined
 - System for continuous supervision of cash situation is established
 - Main risk factors to be continuously observed are defined
 - First aid measures to be implemented are defined
- **Milestone 1 – additional results**
 - First analysis results
 - Problem definition
 - Management interviews, plus analysis of the company from three viewpoints provides sufficient information for defining the problem
 - Understanding of necessary „sizing“ and direction of measures (with / without legal restructuring measures, definition of relevant areas to be dealt with, etc.)
 - Understanding of relevant departments and people to participate in further project work
 - Understanding about separability of company (products, departments, profit centers, etc.)

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Diagnosis & Therapy Definition

- **Targets**

- Implementation of agreed first aid measures
- More detailed analysis in relevant workstreams and areas
- Developing different possible target structures and paths to implementation
- Developing a profit-based company model for analyzing effects of different models
- Testing different target structures in defined company simulation model, scenario analysis, stress testing
- Decision on restructuring model and implementation steps

- **Focus**

- Profitability / revenues & expenses (phase 1: cash / cash inflows & cash outflows)
- Parallel work in all four workstreams

- **Methodology**

- At least weekly project meetings with core project team
- Analysis of possible effects for each discussed model for each workstream / area
 - „Homework“ for restructuring team members between meetings
- Development of company model for quantitative testing of defined models
- Writing of a comprehensive analysis report by project team members

Diagnosis & Therapy Definition

- **Team**
 - Company: Core project team from relevant departments
 - BIC: Engagement leader + teammate from phase 1 + additional teammates depending on internal resources
 - Total team size not exceeding 10-12 people, but all core people to be included
- **Duration:** 1 – 3 months
- **Output**
 - Detailed analysis report
 - Financial simulation model
 - Possible target structures and implementation steps
 - Quantitative evaluation of target structures
 - Qualitative evaluation of target structures
 - Decision on target structure and implementation steps

Project Team Phase 2

Board

Mr. CFO (board)
 Mr. Logistics (MK 1) Mr. Controller (MK 1)
 Mr. Lawyer (MK 1) Mr. HR (MK 1)
 Mr. Retail (MK 1) Mr. Accountant (MK 1)

Hr. Dr. Behrendt (nx)

Mr. Controller (CO)	Mr: Lawyer (nx)
Mrs. HR legal (PK)	Mr. Retail (VK)
Mr. Participations(CB)	Mr. Logistikcs (P)
Mrs.Accounting (BW)	Mr. Finance (nx)
Mr.Tax (nx)	

(17 additional people)

Client Responsible

Steering Committee

Project Management

Core Project Team (*temp.*)

Extended Project Team (*temp*)

- Due to size, main decision makers are represented in steering committee (no emergency restructuring)
- Full coverage of certain project areas by client (40-60% of worktime provided)
- Extended project team members only involved case by case
- Confidentiality essential (possible effects on employees)

Examples Workstream „Finance & Legal“

- Detailed asset analysis, book vs. Market value
- Detailed debt / equity analysis, shareholder structure analysis (including legal)
- Detailed analysis of projected operational income (revenues / expenses) under different scenarios
- Analysis of overhead cost, cost allocation
- Financial model – pro-forma-financial statements 2-3 yrs back, 3-5 yrs ahead with main positions
- Market risks (currency ,interest, commodities)
- Tax effects of different models
- Legal structure different models

Examples Workstream „Organization & HR“

- Detailed work organizational chart and employee lists in relation to profit centers, capacity planning units
- Assign cost and revenue tags for each capacity unit / profit center
- Employee analysis, abilities – standarizing skill set definitions, standarizing job descriptions, key personnel definition, analyze employee transfer possibilities
- Review collective labour agreements (legal check, analysis of and options for main players)

Examples Workstream „Operations“

- Detailed analysis sales organization
- Review sales forecasting, price sensitivity sales
- Detailed work production planning, capacity planning, materials requirement planning
- Review of main value chains, main processes
- Analysis supplier management
- Identify possible outsourcing opportunities
- Cost driver identification,
- Cost behavior analysis, cost-volume-relationships
- Cost cutting suggestions

Examples Workstream „Strategy“

- Review company strategy in relation to expected scenario after crisis
- Review product positioning according to product life cycle, ability to generate turnover and profits
- Review existing customer portfolio (e.g. ABC analysis, geographical allocation, connection to order and payment behaviour)
- Review investment and marketing plans
 - Potential for growth for certain products / services, and / or customer groups?
 - Key investment areas? Available funds?

Results Diagnosis & Therapy Definition Phase

- **Main results phase 2**
 - Detailed analysis report
 - All relevant findings of interviews, research etc.
 - Model for simulating financial statements for different alternatives / different scenarios
 - Past and future pro-forma balance sheets, income statements, cash flow statements
 - Different possible target structures
 - List with potential alternatives for new structure
 - Qualitative analysis of model with respect to relevant areas (legal effects, tax effects, flexibility, risk, collective labour agreements, etc.)
 - Quantitative analysis of model (in financial simulation model / including cash flows)
 - Calculation of restructuring cost for each alternative
 - Review of possible paths to reach target structure
- **Milestone 2: Company decision about new model to be adopted**
 - Decision on target structure
 - Decision on path and timeframe to reach target structure
 - Decision on implementation model
 - Review of communication strategy

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Therapy & Cure

- **Targets**

- Additional analysis work for chosen model
- Detailed conceptual design for chosen model
 - Decisions on individual assets, participations, departments, employees, etc.
- Implementation measures for all workstreams
 - Carve-out financials, carve-out documentation, new articles of association / corporate agreements, request for binding advice of tax authorities, collective labour agreements, company valuation, organizational changes, change of operational processes, etc.

- **Methodology**

- Parallel work in all four workstreams as much as required
- Formal project work, if necessary definition of subprojects
 - e.g. accounting system customizing and migration, post-closing activities
- Weekly project status meetings with responsables for implementation

- **Team**

- Company: People assigned for implementation tasks from relevant departments
- BIC: Engagement leader + restructuring office + implementation teammembers

- **Duration: 3 – 18 months**

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Restructuring Project Approach

- **Key Success Factors Projects**
 - Involvement of all relevant parties
 - Deep and broad skillsets (expert knowledge) represented in project
 - Confidentiality
 - Speed and rigid decision and implementation process
- **Project Management Requirements**
 - Deep understanding of all workstreams and restructuring issues
 - Application of proven project management methodology
 - *Project manager acts as initial decision maker for all relevant decisions*
- **Restructuring Office**
 - Supports project during all project phases until project completion
 - Provides detailed, phase- and workstream-specific project plans, task lists and checklists
 - Supports project status reports, status meetings, reports to steering committee, etc.
 - Responsible for planning and followup of tasks, timeline, budget, project success (restructuring performance indicators)
 - Responsible for formalized information gathering, documentation, distribution, central point of communication
 - Managed by and reporting to restructuring project manager

Restructuring Performance Indicators

- **Purpose**
 - Restructuring project should only be done if it adds value for the company
 - Cost / benefit analysis for stakeholders required

- **Approach**
 - General approach: comparison situation without vs. with restructuring
 - Problem: No isolated measurement of restructuring effects possible
 - Selection of proxies necessary

- **Restructuring Performance Indicators**
 - Phase 1: Based on liquidity
 - Extension of survivability in % compared to situation before restructuring
 - Phases 2,3: Based on profitability
 - Difference in consolidated net profit after taxes before – after restructuring
 - Split into several time slices may be needed
 - Depending on project, more specific RPI's may be defined
 - Tax savings, increase in average capacity use, # personnel, fluctuation, debt-equity-ratio, specific contribution margins, etc.

Implementation Approaches

- **Model 1: Work with BIC in consulting capacity**
 - Continuous project management by BIC
 - Continuous provision of restructuring office by BIC
 - Implementation completely by client under coordination of BIC

- **Model 2: Co-management**
 - Continuous project management by BIC
 - Continuous provision of restructuring office by BIC
 - Relevant executive functions will be supported by individual co-managers of BIC
 - Common implementation by client and BIC co-managers

- **Model 3: Interim management**
 - Continuous project management by BIC
 - If needed, BIC will provide chief restructuring officer (CRO)
 - Continuous provision of restructuring office by BIC
 - Relevant executive functions will be taken over by an experienced interim manager of BIC
 - Implementation by BIC in executive capacity

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Restructuring Project Team

- **Project Owner**
 - Top management and / or company owners

- **Steering Committee**
 - Project owner, board, top management

- **Project Management / Project Office**
 - BIC partner
 - Second internal project manager (senior manager) to be provided by client
 - Project office staffed by BIC and by client

- **Project Team**
 - Members of client team from all relevant departments
 - Core project team: around 50% availability
 - Extended project team: case by case decision
 - BIC consultants experienced in restructuring projects and / or relevant workstreams
 - Senior managers and specialists from BIC Business Network, under management of BIC project manager
 - Experts and interim managers from partner companies in BIC Partner Network, under management of BIC project manager

BIC Business & Partner Networks

- **BIC Business Network**
 - Seasoned senior managers supporting BIC as independent consultants
 - Normally at least 10 years of management experience and known names in their sectors, or known experts in their special area
 - Cover especially sectoral knowledge and special expertise areas
 - Mainly common project or work experience with BIC
 - Assessment and framework agreement with BIC
 - Under management of BIC project manager

- **BIC partner network**
 - Covers special areas relevant for restructuring projects but not covered by BIC
 - Tax
 - Audit
 - Law
 - Investment banking
 - Interim management
 - Longterm framework agreement
 - Under management of BIC project manager

BIC Business Network

1

- **Identification**
 - Identification of potential candidates
 - Completion of initial application form

2

- **Application Review**
 - Review of the application form and additional documents
 - Crosscheck with required skills
 - Crosscheck with required education and experience

3

- **First Interview**
 - - First round of interview with the potential candidate
 - - Reference check

4

- **Second Interview**
 - Preparation of a case study by the candidate
 - Interview with the BIC senior management

5

- **Framework agreement**
 - Conclusion of a framework agreement between consultant and BIC

Why Restructuring with BIC?

- **Deep functional knowledge, especially in accounting, finance, and restructuring**
- **Hands-on-approach and significant management experience**
- **Application of solutions according to international standards customized for Turkish businesses**
- **Comprehensive BIC Business Network and BIC Partner Network**
- **Highly structured, proven restructuring project management approach**
- **Commitment to speed and rigid decision and implementation process**
- **Moderate fees and success-based fee component**

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