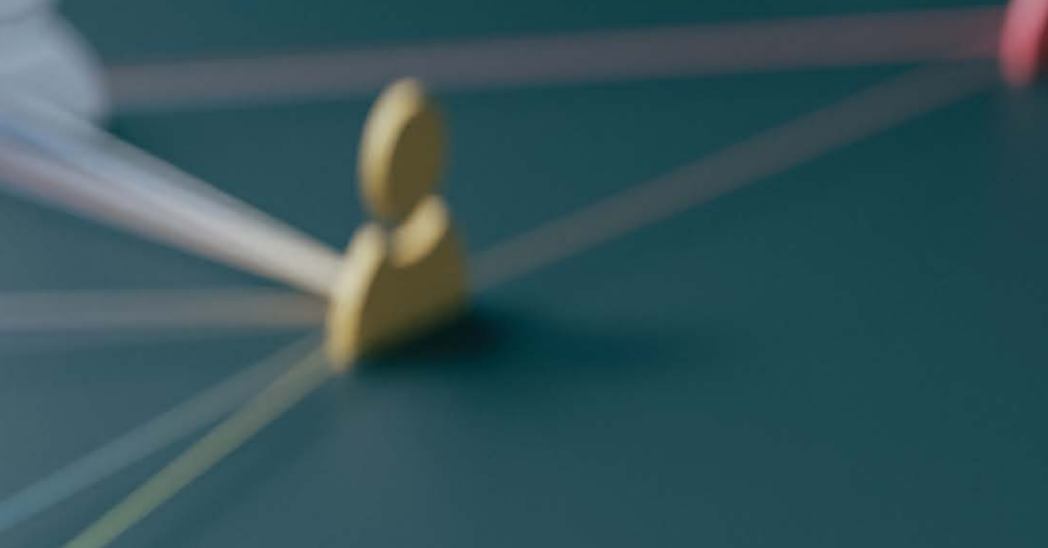
HOW A CRO CAN BE A TOOL FOR WINNING FRIENDS & INFLUENCING PEOPLE



BY ISAAC LEE, MANAGING DIRECTOR, ANKURA &
WILLIAM SCHUMACHER, COUNSEL, WINTHROP & WEINSTINE, P.A.

Distressed situations are disruptive. Not only is the company facing financial difficulties—such as declining cash flows and other financial performance metrics, along with potential defaults under debt documents—stakeholders often have lost faith in the current management's ability to navigate the distress and correct the company's course. It is within these distressed workout situations that chief restructuring officers (CROs) or chief transformation officers act as a critical tool to win friends and influence people both within the organization and among external stakeholders to right the company's course.

A CRO is an agent of change in an organization going through distress, whether financially, operationally, or otherwise. CROs complement existing management as an effective interim member of management and officer of the company who manages and implements the workout, turnaround, and restructuring. In essence, CROs function as a form of interim management and utilize their expertise in operations, finance, distressed situations, and restructuring to implement corrective change in the company.

Although a CRO adds an outside voice, this role is different than an independent director, though a company should also consider appointing an independent director as part of implementing a CRO engagement. An independent director with restructuring experience can serve as an important liaison between a CRO and the board of directors and/or restructuring committee. By ensuring that a CRO reports directly to the board or restructuring committee, a CRO can work effectively to implement turnaround strategies.

How Can CROs Enact Change?

Restructuring or turning around a business is a complex, fast-paced, stressful endeavor. Often, current management is not able to lead this process while also managing day-to-day operations. This scenario is where a CRO can add value. Broadly,

continued on page 8

continued from page 7

CROs provide an outside, independent perspective on areas that need to be improved, eliminated, or added to a company's operational competencies or to the company's back-office support (such as finance, accounting, and HR). This includes evaluating elimination of business lines and reduction in force, cost, and vendor optimization, as well as performance improvement.

Critically, however, CROs are not an institutionalized part of the company. They can bridge the gap between stakeholders that are internal (such as management) and external (like lenders and shareholders), which improves credibility with an independent and objective perspective. This ability becomes extremely important when evaluating the company's liquidity runway. Understanding and evaluating the liquidity runway and what levers can be pulled between internal and external stakeholders is the critical first step for any CRO on Day 1 because this informs what immediate and long-term steps the CRO and, ultimately, the board of directors must undertake to turn around the company.

Through an independent, objective perspective and by maintaining effective communications with the board of directors, management, employees, creditors, and vendors, a CRO can bring credibility and objectivity to the restructuring process. This position allows the CRO to manage expectations for internal and external stakeholders and build a strong rapport with both. A CRO's ability to manage and liaise with lenders and vendors is critical to liquidity initiatives and liability management, which are essential components that must be addressed to drive and create stability in the restructuring process.

In turn, by creating stability in the process and building a consensus among stakeholders as to the direction of the company's turnaround, a CRO can implement a restructuring strategy to streamline operations, repair the company's balance sheet, improve financial reporting, identify cash saving opportunities, and retain talent.

Ultimately, how quickly a CRO can lead a company out of distress and implement turnaround actions will be dictated by the level of distress of the company, the ability to win friends among the internal and external stakeholders, and the CRO's ability to drive these stakeholders toward a restructuring plan (that is, influence the stakeholders to achieve a consensus on a workout plan).

What Does a CRO Need?

A CRO's engagement and role should be clearly defined and agreed upon. The engagement letter is the place that this information should be set forth with:

- A clearly defined role.
- Outlined authority and responsibilities.
- Direct reporting to board of directors (not current management).
- Director and officer insurance for CRO.

Additionally, a CRO should strongly consider advocating for a board restructuring committee with an independent director who is intimately familiar with restructuring. A CRO should also engage restructuring/bankruptcy counsel at the outset to operate as the CRO's right hand to work at the direction of the CRO, management team, and board. Bankruptcy counsel is a critical partner in obtaining stakeholder buy-in, especially in circumstances where the management team and board are unfamiliar with the legal and practical options available both in and out of court to achieve a successful financial and/or operational restructuring of the company.

Finally, as a first-day practice, a CRO should have an information request list ready to go to get baseline information from internal stakeholders and immediately begin gaining in-depth familiarity with the company.

What are Challenges to a CRO's Engagement—and How to Avoid Them?

Once in place, a CRO must be careful to navigate internal politics and avoid any warring factions. As discussed above, a CRO must also have a clear role or mission from the outset. Without this clear directive, a CRO can flounder, and the turnaround could then fail. Most importantly, a CRO must be an agent of change who wins friends—internal and external—and who can then influence these friends (that is, stakeholders). Without buy-in from these stakeholders—including lenders, shareholders, vendors, employees, management, and board of directors—a CRO will fail before they can even develop a turnaround plan.

A CRO is often brought into a situation by a lender or equity sponsor without the support of the current management team. This dysfunction creates a trust deficit between the CRO and management team, which can become a major obstacle to a CRO making inroads with the executive team. When CROs are brought in by an stakeholder, management can often perceive them as supporting that stakeholder's interests, wanting to replace the management team, or assigning blame to current management for the company's financial and/or operational distress. A CRO needs to overcome this distrust to effectively implement a restructuring.

Setting the proper tone with management at the outset is critical to overcome this trust deficit, which can be done by implementing a collaborative approach rather than confrontation. Through a collaborative tone, a CRO can gain the support of management to develop and implement a successful restructuring plan. Proper collaboration requires a CRO to communicate frequently with management and to set clear goals. A CRO should also emphasize to management the areas where they can add value and assist management, which creates a collaborative, team-focused environment. One area that can provide immediate value to current management and act as an olive branch is assisting the team in managing liquidity such as preparing a weekly liquidity forecast or developing initiatives to improve cash flow.

A CRO also needs to be a consensus builder. Whenever possible, a CRO will seek to build consensus. When widespread agreement is not possible, CROs must effectively communicate their position, why they have taken that position, and the underlying factors that have led to their conclusion on a particular course of action. This messaging should generally be done in writing (email, letter, etc.) to the management team to ensure that all parties clearly understand the CRO's position.

Conversely, if a CRO is dismissive, communicates opaquely, or tries to run around or over management, the executive team could try to shut out that individual by not sharing important information that will ultimately marginalize the CRO's role. The executive team has home-field advantage and knows more about the business and situation compared to the CRO at the start of an engagement, so a CRO must be cognizant of and careful with their approach and communications with management and executive leadership to first build an appropriate level of trust.

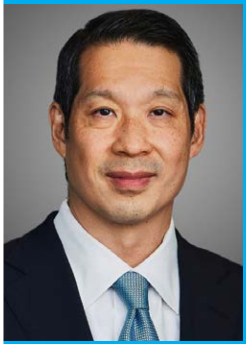
Another challenge that CROs often face with management is keeping the development of a restructuring or turnaround plan confidential until a plan is ready to be announced or implemented. This is a balancing act as to who to bring under the tent with respect to disclosure of the restructuring. Including too many employees will risk causing more damage to the company and limit restructuring options if the plan is leaked. Including too few employees will risk developing a flawed restructuring plan and frustrating a workforce that the CRO needs to cooperate to implement the plan.

Outside of the executive management team, personnel such as department heads or mid-level subject matter experts will need a turnaround plan. A CRO with the assistance of management will have to hand pick who they need to join a small working group to bring into the tent. At the end of the day, it is near impossible to keep the CRO's endeavors completely confidential, and a CRO will need to manage the messaging if certain aspects of a restructuring plan are leaked, whether externally or internally. However, by maintaining clear and concise messaging to management and those employees necessary to the turnaround, a CRO can manage the information flow and minimize the risk of unauthorized or unexpected disclosures.

Conclusion

In any distressed situation, the earlier a CRO is in place, the more options are available to drive a consensus among key stakeholders to achieve a restructuring plan—whether out of court, bankruptcy, or otherwise. Speed is essential because turnaround options will vanish if a company and CRO do not act quickly. Importantly, by installing a CRO as a change agent to establish credibility, objectivity, and stability with stakeholders, a distressed company will gain an important advocate in influencing these same stakeholders in the process to turn around the company.

David M. Tanabe, Esq., of Winthrop & Weinstine, P.A., assisted with background research on this article.



Isaac Lee is a managing director at Ankura with more than 25 years of experience executing a broad range of recapitalization, restructuring, mergers and acquisitions, and corporate finance transactions as well as advising on operational restructuring and liquidity management initiatives. He has significant experience advising various constituencies, including companies, debtors, lenders, creditors, financial sponsors, and hedge funds in both out-of-court and in-court situations. He is currently the chief restructuring officer of Borrego Community Health Foundation.

William Schumacher is counsel at the law firm Winthrop & Weinstine, P.A., and a member of the firm's Creditors' Remedies, Bankruptcy & Workout practice group. He concentrates his practice on creditors' rights, reorganizations, workouts, and bankruptcy—representing a wide variety of stakeholders both in court and out of court in all levels of distressed and insolvency situations.