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Strategy

Fast and focused

Rewriting the rules for a successful turnaround

By Lars Börjesson, Per Hellberg, Joachim Warnberg and Magnus B. Andersson

Executives at most failing companies keep trying the same old turnaround tactics—and many of their companies keep failing. One Nordic manufacturer took a different approach to successfully reversing the slide in its performance. Here are five key lessons the company learned along the way.

It was the kind of news that CEOs dread. The financial estimates that had just landed on Anton Alakoski's desk would, if they proved correct, send his company's annual revenue far below shareholders' expectations—and put margins under water. It had already been a woeful week for Alakoski: The estimates arrived just days after forecasts that predicted declines in unit sales in three of Martti Industrial's four product sectors.

Fast-forward 18 months. Today, the CEO of the Nordic industrial equipment maker has reason to smile. Alakoski and his team have put a stop to five years of declining operating income, to the point where Martti is back in the black. And strong prospects have now replaced the negative outlook: Profits are expected to climb steadily through 2009.

Unlike many troubled companies, Martti found a way out of its predicament. The company's recovery was the result of a deliberate approach that was significantly different from conventional turnaround tactics. Essentially, Martti approached its challenges from the

A turnaround situation requires a rapid response and taut, disciplined planning.

standpoint of value—beginning with initiatives that would restore lost shareholder value and confidence the fastest and then moving to those that would help retain that value. "Martti" is a real company. Although actual names and other details have been altered to ensure the company's anonymity, the story of its turnaround is very real too. Moreover, it is not an isolated example: Through research, observations and client work, Accenture has identified a number of other once-poor performers—companies whose growth strategies had backfired and whose product plans no longer matched their core competencies—that returned to breakeven within 12 months and from there went on to robust profitability. Our studies of their turnaround initiatives reveal a number of fundamental principles that are broadly applicable across many manufacturing industry sectors and can help troubled companies get back on the path to high performance.

Turnaround talk is nothing new, of course. The plight of struggling companies has been studied for years by management experts and academics alike, while countless column inches have been devoted to turnaround practices and guidelines. The impact has been modest, however. Harvard Business School change expert John Kotter notes that fewer than 15 of the 100 or so companies he has studied have managed to correct their poor performance.[1]

Conventional illusions

A company does not have to be in the red to be in trouble. It may simply turn in consistently subpar results compared with other companies in its industry—lackluster performance that can last for years and that can feed on itself.

Regardless of the degree of difficulty, many managers of troubled companies still fall back on con-ventional change management responses in their attempts to dig out. These typically involve a measured, sequential approach—working through an exhaustive review of the problem, then on to design, implementation and realization. But a turnaround situation demands a more rapid response. Planning has to be taut and very disciplined. Implementation must start as soon as possible.

Some managers try to grow their way out of trouble, perhaps under the illusion that the company's cost base is fixed and will not increase as sales increase. But Accenture has observed that additional growth under these circumstances often leads to additional risk and complexity without much return in terms of margin. Indeed, it's not uncommon for newer sales contracts to be less profitable than earlier wins.

Other managers think there is an easy solution to the problem. The result: inadequate actions—such as partial divestitures, plant closures and layoffs—that only accelerate the company's decline by weakening an already shaky platform. As for those who see an acquisition as a way out, these executives often find that they cannot implement and execute as confidently as their M&A strategies might lead them to believe.

Martti Industrial's competitive situation is a familiar one for executives in many mature industrial manufacturing sectors. It faces many tough competitors from the United States, Europe, Japan and, increasingly, China. Opportunities for clear differentiation are hard to come by as Martti's products become commoditized. And the company is in a sector where trustworthy customer relationships really matter.

[1] John Kotter, "Winning at Change," *Leader to Leader*, No.10, Fall 1998

Martti had been spun off as a growth play by a European engineering conglomerate, and it had recently launched impressive new products. Still, by 2005, despite a decent reception for the new equipment, the company was generating significant losses. It captured only marginal market share and came nowhere near its target of being in the industry's top three.

In fact, Martti's profitability was about 20 percent below plan, and the company barely made it into the top 10 in its industry. Only one of its four main product families was turning in a reasonable performance. Inadequate distribution capabilities, a fragmented supply chain network, a poorly funded product portfolio—these and other factors added up to small volumes spread thinly across all markets and products that sold at negative margins. The outlook for 2006 was even gloomier.

When Alakoski took the helm in 2005, the stakes were very clear. He knew he did not have much time to act. (On average, CEOs are given only about 20 months to show that a major decision has paid off on the bottom line.) He also knew that Martti did not need a "realignment" or a "reorganization"—it needed a *turnaround*: a drastic restructuring designed to introduce a rapid, positive and sustainable change. The new CEO faced a mountainous challenge: turn the company's huge losses into profits within 24 months and develop a strategy for subsequent sustainable profitability.

But Alakoski was not unprepared. He had led a highly successful turnaround initiative before, and now he quickly parsed the challenge into three basic issues:

- How do we stop the bleeding and reach breakeven within 24 months?
- How do we reach a sustainable position where we continually create value for shareholders?
- What type of organization and what kinds of skills are required to enable such comprehensive change?

Due diligence

Beginning in mid-2005, Phase 1 of Martti's recovery initiative focused on developing the turnaround plan. Working with an Accenture strategy team, Martti executives quickly launched a "turnaround due diligence" exercise, drew up a prioritized turnaround plan and crafted a new organization structure. The critical importance of the initiative was reinforced with weekly executive meetings that were used to evaluate, coordinate and emphasize key improvement levers. (The fast pace and focus on detail were a big shift for several managers, and it took time to make sure they were on board with the effort.)

The team emphasized profitability over growth, and shifted the sales and marketing focus toward the most profitable product and customer segments. This strategy, coupled with an assessment of how strategically important each dealer or customer was, often served as a guide for when to say yes or no to a potential new piece of business.

To help make such decisions, the turnaround team introduced a "stoplight" tool for measuring the contribution and profitability of different products. Red stood for a negative contribution—the greater the sales of a product, the higher the operating loss for that product. Yellow meant a product generated a positive sales contribution but a negative operating profit. Green represented positive operating margins and solid sales contributions.

Phase 2 kicked off six months later and called for actions to regain stakeholder confidence. The turnaround had to produce big results

quickly. So the recovery initiative proceeded along two paths. The first one focused on taking control of the short-term agenda—essentially emphasizing operational improvements to make the organization run faster and ensuring that the equipment maker got to breakeven by 2007—while the second aimed at building long-term solutions.

There were four items on the Phase 2 short-term agenda—four key areas where initial analysis had shown inefficiencies and the potential for short-term profitability improvement.

First, direct material purchasing expenditures—which had been incurred either at the product level or the manufacturing site level, and had accounted for more than 70 percent of Martti's total costs—were restructured around a new centralized procurement function. Second, the team working on one important product line sped up its efforts to cut machine weight and improve product performance. Gross margins quickly climbed by 50 percent as logistics, material and warranty costs all declined.

Third, the manufacture of one product was moved out of the United States to reduce costs and establish a new platform for sales growth. And fourth, Martti reset its pricing strategy and reworked its approach to managing its product portfolio to strengthen the product mix in one fiercely competitive segment of the US market. (When the company returned to the black, about 40 percent of its total profitability improvement would come from these changes in pricing and product mix.)

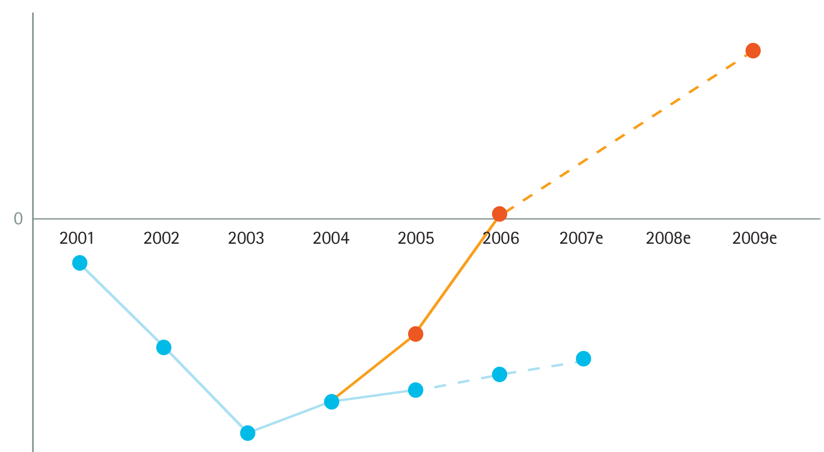
Rethinking the organization

The goal of those early steps was to ensure that volume increases in all product lines and regions would contribute positively to Martti's bottom line. But that couldn't have happened without a rethinking of

Reversing course

By embarking on a drastic restructuring designed to introduce rapid, positive and sustainable change, Martti reversed four years of negative momentum.

Operating income



Actual performance and original forecast before launch of turnaround
Actual performance and forecast after launch of turnaround

The short-term fixes took hold quickly. Martti went from a loss to a modest profit—a year ahead of plan.

the company's organization model and management system. To that end, Alakoski and his managers devised a new operating model (encompassing organization, core processes, management system and key performance indicators) based on principles such as cross-functional collaboration, cost consciousness and customer-centered operations.

Next, the team introduced a performance follow-up model to lock in short-term profitability. The objective? To centralize the monitoring and control of all turnaround activities so profitability and cash-flow improvements could be closely observed and deviations from the plan quickly adjusted. For example, as raw material costs in one area increased and supplier negotiations began to get sticky, Alakoski's team poured more effort into other sourcing initiatives to keep the overall plan on track.

The short-term fixes took hold quickly. Inside 18 months, Martti had gone from a loss to a modest profit—a year ahead of plan.

However, the business was clearly not sustainable at that level, and Alakoski knew it. He was well aware, too, that business cycle downturns as well as currency and other business risks could easily bring Martti down below breakeven again. And, of course, from a financial standpoint, a breakeven position would do nothing to lower the cost of capital. Alakoski also knew that the short-term efforts could not create profitability in all regions for all products; there was a constant risk that market dynamics would force the product mix away from the plan and thus take Martti back into the red.

Global matrix

The first phases of the turnaround were about much more than cost cutting: Their success was largely due to astute management of the product mix through the entire distribution chain.

The new organization design was critical to centralizing decision making and moving from decentralized product areas to a matrix with global responsibilities for purchasing, R&D, marketing and manufacturing. It was also important to fill management positions in the company from within—at least initially. The rationale: This would boost morale, ensuring that people did not feel that they were being perceived as "part of the problem."

Meanwhile, the team working on creating long-term solutions was making good progress. And by early 2006, it was starting to become clear how Martti could ensure profitable growth beyond 2007.

The team's output comprised two major components: a deep understanding of the current market logic and future outlook for the industry, and a detailed strategic agenda for how to reach long-term profitability. In particular, the strategy focused on determining what capabilities—for example, product-mix management—were required for lasting success.

Today, the company is preparing to implement the long-term turnaround efforts. The members of Martti's top team are primed to handle this successfully, having met aggressive short-term targets so capably. "Finally, we understand how this business works and what to do with it," said one Martti executive.

Five lessons learned

So what can be learned from such value-based approaches to turnarounds? We have observed that companies like Martti stay true to five key principles.

1. **Stop the bleeding.** It is crucial that short-term and long-term activities are run in parallel. When perfor-

mance continues to decline, there is simply no time to go through the pre-study and feasibility stages typical of conventional change programs before taking the actions defined by such programs. (However, the scope of the initiative must be comprehensive enough to get the job done; this is not the time for a "quick fix" mentality.) To ensure that the short-term "action stations" initiatives get the attention they deserve, it is best to centralize control of the turnaround program.

The recent turnaround of a European services company provides a good example of such centralization. A major factor in the company's large losses was its limited understanding of the profitability of its big contracts. At the proposal stage, cost and price calculations were often based on a rosy picture of total overhead costs. This, combined with tough negotiations that led to further discounts, virtually guaranteed that almost all the company's big contracts would be unprofitable.

To help remedy the situation, the proposal and contractual process was centralized for all contracts over a certain price. The arrangement led to impressive results: Average margins on large projects went up by 11 percent over the first six months following implementation of the change.

2. **Dispense with steering groups.** Successful turnarounds cannot be delegated. They have to be at the top of senior management's agenda, and they must stay there until the turnaround—or at least the short-term stage—is complete.

   Why? Because what's ultimately at stake in any turnaround is the overall health of the bottom line, so everything under senior management's control is affected. It is true that a "normal" project can be run successfully even if other parts of the business begin to deteriorate. But nothing is normal about a complete turnaround.

   The corollary here is that turnaround activities must command the full attention of every senior manager. At Martti, a deadline was set for when all members of the management team were expected to give the CEO their formal commitment to the turnaround plan as well as to specific goals within their respective areas. There was no project steering group; it was Martti's directors who reviewed progress and made recommendations.

3. **Put up a cost firewall.** It is not uncommon during turnarounds for the cost picture to be muddied to the point that managers are unclear which expenditures relate to the turnaround activities themselves and which relate to ongoing operating costs. Effective turnaround teams make sure there is a clear distinction. For example, they account separately for salary payments for laid-off personnel. It is common for such payments to continue for several months after the layoff dates, but if the payments are "mixed" with those of active employees, there is no way to know the actual payroll run rate.

4. **Sound the alarm.** Another important turnaround discipline is to instill a consistent and very tangible sense of urgency throughout the organization. At another large European company, the turnaround team's big call-to-action message was, "This is the organization's last chance." The team used multiple communications channels: management meetings, department meetings, intranet, mail, bulletin boards, workers' unions and in-house media. The communications were tracked, and a team member made

sure that all meetings planned were actually held.

This discipline was essential when it came time for layoffs, because employees had to be informed in an order determined by national labor laws. The turnaround leaders made sure that the entire management team stayed on message; any deviation from the gospel of turnaround would weaken the overall effort.

5. **Take it to the top.** In any turnaround, it is vital to "manage up"—to manage the expectations of the company's owners or its parent company's executives, for example. At one leading European services provider, the management team consistently managed up throughout the course of a recent turnaround. Indeed, the CEO was constantly surprised by how much time he was spending on all forms of upward communication.

   Because financing was a core issue for Martti, a lot of time had to be spent on presentations to banks and other debt holders to demonstrate progress and to ensure the availability of additional short-term funding at reasonable rates. Toward the end of the turnaround program, potential new equity owners entered the picture, and their involvement required considerable extraordinary communication.

Falloffs in performance almost never self-correct—not unless we're talking about the rising tide of a cyclical economic upturn. On the contrary, they gradually grind down shareholder value. Business leaders who recognize the hallmarks of such a slide have few chances to act forcefully; when they do, they need to do so with an approach quite different from the usual change initiatives. The kind of value-based approach adopted by Martti Industrial provides a useful template.

Dealt with adroitly—as Martti's management team dealt with its situation—performance degradation can be arrested and reversed. Dealt with using the conventional change management tactics—or, worse still, ignored—the failing company might well be destined to provide a fine "how not to" case study for tomorrow's management texts.

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