When Risk Becomes Reality…
The ***C***risis ***C***ure – Disaster Strikes

...Applying a Framework of ***C'***s to Help Manage During a Crisis

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Your Worst Dream has come to life, the levee has broken and previously flooded portions of New Orleans remain uninhabitable. Nobody knows for sure when and how over 450,000 residents who fled New Orleans in the wake of hurricane Katrina will return.

While the hurricane devastation may feel like a nightmare, it's the aftermath that threatens a business' viability. As noted in our pre-Katrina article, business crises come in all shapes and sizes -- from a simple everyday customer crisis, to an employee's personal crisis, to a complete market collapse. In the case of New Orleans and the Katrina disaster all forms of these individual crises arrived on the same day. Risk management becomes a reality and a call to immediate action.

Katrina proves bad things do happen to good organizations, but – let's be honest – when disasters do strike, they do more damage to organizations that are not prepared and aren't willing to change. A crisis may not always be curable, but many factors impact the arrival, duration, and recovery requirements of a crisis.

Here's the checklist of C's that deal with spotting, avoiding, and managing crises published <u>before</u> Katrina (shown in Figure 1). In this article we use the Environment, Action, Results Framework to communicate how to put into perspective some of the issues that confront a hypothetical organization after a disaster like Katrina has occurred.

These issues might include some of the decisions a business owner may face such as:

- Deciding how and when to communicate your situation.
- Helping key employees get relocated.
- Helping negotiate new loans and grants.
- Helping evaluate the viability of a business in crisis.
- Evaluating cash flow needs.
- Finding new business partners.
- and more ...

Figure 2 contains a few of the more obvious issues for a hypothetical food distributor that was not flooded but is now left with a smaller customer base and a loss of employees

Katrina Proves Communication is Critical in a Crisis

Poor communication between government agencies and denial aggravated the pain and suffering from the disasters resulting from hurricane Katrina. Now its up to business owners and their suppliers, lenders and government aid workers to communicate clearly – and realistically" on how they can work together to restore businesses in New Orleans and along the Gulf Coast.

As of the writing of this article, a bill to improve communications between police, fire and disaster relief workers was still stalled in Congress. ***The Turnaround Management Association is offering TMAssist, a new public service program including a series of free workshops in the disaster area to help local businesses get access to educational material and an on-line resource center. Go to www.turnaround.org for registration and details.***

FIGURE 1

The *C*risis *C*ure –

A Framework for "C-ing" a crisis coming, and for dealing with it

Environment

- Change
- Competition
- Customer change
- Constituent change
- Continuous change
- Courts

Actions

- Change!
- Contingency planning
- **Communication**
- Control the cash budget
- Cost control
- Combining & consolidating
- Cross-functional teams
- Cutting waste
- Cycle times
- Commitment to goals
- Core competency & innovation
- Culture
- Critical success factors
- Compensation Confidence
- Consultant's view
- Chapter 11

Results

- Contented customers
- Cash flow
- Chaos
- Chapter 7

System

- Continuous relative improvement
- Complexity requires a simple framework
- Causes aren't unique

FIGURE 2

The *C*risis *C*ure – After Disaster Strikes – A Few Critical Concerns for a Hypothetical Food Distributor

Environment

- Change in New Orleans population from 500,000 to 50,000 now means change.
- Competition from Distributors in Baton Rouge may increase.
- Will business interruption insurance be enough?
- How will customers concerned with your service change?
- How will Suppliers and Lenders change?

Actions

- Change… Downsizing or resizing is critical to control costs but maintain great service to customers.
- Contingency planning to evaluate how the population and your customers will return.(Fast or Slow?)
- **Communication of the realistic situation to all stakeholders is critical.**
- Control the cash budget and carefully use credit that may be extended to you.
- Cross-functional teams
- Cycle times
- Commitment to goals
- Core competency & innovation
- Creativity
- Critical success factors
- Confidence
- Chapter 11

Results

- Contented customers may remain with you and are critical to your viability.
- Cash Flow must be positive over the planning horizon, remember credit that must be repaid.
- Chaos can be avoided if plans are realistic and carefully communicated.
- Chapter 7 liquidation may be the best way to start over.

System

- Continuous relative improvement
- Complexity requires a simple framework
- Companies that learn

Environment

Crises often result from an unexpected change in the environment in which an organization operates. For a typical food distributor in New Orleans, Katrina has produced actual and potential future loss of major customers, loss of key employees, uncertainty with investors, and changing interest rates. Whatever causes the change, the failure to adapt to the new environment may result in a continuous state of crisis, which may lead to business failure.

Change is the only constant. Change can happen rapidly *or* slowly. The Hurricane came quickly and recovery and rebuilding will be slow. Crisis often results from denying dramatic change is happening, or taking action only in response to change. Successful businesses expect that their circumstances will change, and avoid crisis by anticipating change.

Competition often catches companies off guard. New competitors untouched by the hurricane may be better able to serve your customers. You may have been the best supplier in town, until the day the environment changed, giving an immediate advantage to a differently situated competitor.

Customers can defect. The loss of key customers, and broader changes in customer preferences, have put many companies into bankruptcy. But such changes usually don't happen overnight. If changes in relative quality (relative, that is, to the competition) and relative cost are not monitored, it's hard to tell how your customers perceive your service. How was your service relative to competition before the disaster? Could the disaster be an excuse for customers to abandon you?

Constituents change attitudes. Creditors get concerned when a covenant is broken or after a crisis becomes obvious. Stockholders or owners rebel when told that dividends must be eliminated. Employees leave for greater pay or living conditions and occasionally take major customers (not to mention intellectual property, such as customer lists) with them. Vendors shut off shipments or change alliance partners. Once-loyal customers sue for damages. Those once friends can become foes. Previous foes can become your friends.

Actions

How the organization responds to the changing environment, and the actions it chooses are important to recovering from a crisis. Lessons learned from prior actions may help any organization get through a disaster.

Change is needed to respond to the devastating events that have occurred and will affect the recovery efforts in the future. How each business chooses to deal with these changes will mean the difference between long term success and barely surviving.

Contingency planning extends a safety net. Like business interruption insurance, contingency planning may appear to be a waste of time – until it is needed. Some companies have a passion for contingency planning. They typically stay invigorated and vital, with reserves and multiple locations to weather a normal storm. Such a company is like a person who puts a high priority on his or her personal health through daily workouts. In a changing environment, there's often no time to think, so having contingency plans in advance of potential changes in the market can put you in a position to take advantage of opportunities that may arise.

Communication is Critical to build Consensus. Leaders must communicate effectively to build a consensus about what actions to take. Direct communication with customers, suppliers and lenders are essential to orchestrate a turnaround. Developing sources of factual information about the current environment, customer demand, and cash flow can help to avoid a future crisis. Clear, honest **communication** is central to overcome any crisis. (*We show it in bold for emphasis.)*

Cash flow is crucial in a crisis. Earnings don't always reflect current cash flow, business owners must look beyond earnings to *cash.* Cash flow is probably the best indicator of both short- and long-term health for any business. Healthy cash flow lowers the odds of falling into crisis, and helps a company to weather the storm if one hits. Companies get into serious trouble when their business model is marginal and a crisis strikes. In a disaster, cash truly becomes king – because gaining (or re-gaining) control of the cash budget is essential to maintaining and building the confidence and credibility with creditors and other constituents.

Cross-functional teams enable collaboration and change. In a stable economy, organizations often tend to function better when segregated into specialized functions such as sales, marketing, R&D, human relations, finance, and customer service. In a rapidly changing environment, these 'functional silos' can be barriers to change. Cross-functional teams, when set up on a project or crisis basis, can remove excess layers of management, improve communications, and sharpen a company's ability to adapt to a changing environment. Crisis and recovery teams *absolutely* need to be cross-functional.

Cycle times will shorten. As distressed companies review their value chains and apply lean management techniques, everything begins to move faster. Distributors serve as the critical link between end customers and suppliers. Cycle times for product delivery are being cut as customers get their product "Just-in-time (JIT)". Companies that fail to focus on better, faster, cheaper will lose out to "better, faster, cheaper" competitors.

Core strengths need to be balanced with innovation. The concept of *Core Competencies*: focusing on original strengths and outsourcing the rest is often a method of improving returns. Disaster often promotes innovation in the effort to survive.

Creativity is a child of necessity too. After a disaster, think of ways to adapt quickly and uniquely to the two or three major drivers of current business success.

Critical success factors are powerful lodestones. Every organization needs a bone deep understanding of just what factors of its business beyond serving the customer are critical to its success. Critical success factors change in a disaster as the competitive environment changes and they especially change when a company is in crisis mode. Business owners must know them and communicate them constantly.

Confidence is vital to overcoming a crisis. Once in crisis, all constituents – including employees, customers, suppliers, shareholders, and bankers – must have the confidence that a turnaround is achievable. It's the leader's job to instill that confidence, while taking care to communicate the message with reality.

Chapter 11 Debtor-in-Possession Bankruptcy Reorganization is almost the tool of last resort. When the business is viable, but the creditors' demands cannot be satisfied in a timely manner, Chapter 11 maybe the action that buys the time necessary to work out of a crisis. Unlike a broken levee, crises rarely develop overnight; they typically fester and grow over time. Likewise, the ability to work out of the crisis sometimes requires more time than creditors will allow. Chapter 11 provides the time, a legal forum and the process to solve a variety of complicated problems and issues of a viable business. A Chapter 7 Bankruptcy Liquidation usually results when the core business is not viable.

Results

In a crisis situation the obvious result an organization desires is for the pain to go away. In many cases, the source of the pain will remain (such as potential levee failure), so the best results reflect actions that truly have been adapted to the environment.

Contented, profitable customers are the ideal consequence of a business' many actions. A business that is not retaining and attracting satisfied customers will not be able to survive a disaster and, eventually, will find itself in a crisis. Keep monitoring whether customers are being served to their satisfaction, at a profit.

Cash flow that is positive is a result of profitable customers. Business owners must understand when their cash flow will become positive and debts will be repaid.

Chaos may erupt from too-frequent changes. There is a growing sentiment that since change cannot be predicted, it should be ignored. Although no one can predict the future with absolute certainty, results are generally more predictable than many people like to believe. Frequent changes, however, can produce chaos – so it's necessary to balance change with the *need* to change.

Chapter 7 bankruptcy is the end result most feared. Failure to solve the problems that arise from a crisis can, sadly, lead to complete liquidation of a business. In many cases, early and adequate adjustments or changes can help avoid a Chapter 7. In reality, however, more crisis situations are eventually solved by small business sales or mergers and acquisitions, rather than court proceedings. In many cases a business owner will rarely give up but find a way to try again.

System

Knowledge of the continuous interplay between actions, results, and the competitive environment should be thought of as unfolding within a system of continuous learning. *Even in a disaster situation, an organization's actions and results feed back on each other, and both actions and results continually respond to changes in the environment.*

Causes of crisis are not unique. Many companies can learn from hearing or reading about the crisis and renewal experiences of others. Learning the lessons from previous disasters can benefit businesses in all industries. In many cases, businesses fail to learn because they just don't take the time to think through and really understand the cause and effect dynamic that's operating in other situations, similar or different.

Complexity requires simplifying assumptions. Even in a short article such as this, we've seen that there are many factors that can produce help, correct or avoid a crisis. The only way to understand the interactions between so many multiple factors operating dynamically is to adopt a simplifying framework and set of assumptions to better understand the world. Tools exist that help break down the confusion that exists in a distressed situation such as the basic action plan, the 5 stages of a typical turnaround, credit scores, and the 13 week and annual cash flow forecasts. These basic tools can help communicate and motivate the changes needed for survival.

A Banker's Perspective: The 3 C's of Lending: Cash Flow, Collateral and Character

Bank credit becomes critical, and sometimes scarce during a crisis. Borrowers need to think like a banker and enhance their ability to weather a downturn or survive a sudden crisis.

Bankers believe in intent and capability to repay. Thus they look for "Cash flow, Collateral and Character" when making loan decisions. They judge capability by a company's cash flow, with collateral providing an all-important "secondary source of repayment." Character of management, judged by a history of success, a good payment record, managerial readiness, honest communication and sound planning can convince the bank that the company is worth betting on even after disaster strikes.

Before problems appear, companies that build a strong relationship with their credit sources are in the best position. When a crisis does occur, they will stand first in line because they have already established credibility with the lenders.

After a crisis is upon the company, credit is like air to a trapped miner. If the pipes have not been set up to deliver fresh air, in advance of a crisis it may be too late. But, with enough fresh air (credit), things may work out. If a company has been damaged by circumstances, such as a hurricane disaster, there are still steps it can take to maximize its chances for recovery.

Understanding how the banker thinks, the company should immediately begin effective communications with its lenders: first provide a factual update and set a date for a formal update and request. The next step is a serious review of the situation and formulation of a short term forecast (e.g. a 13-week cash flow projection.) As the forecast is built, management should think about the cash flow that it will generate and the collateral support that they can provide to the bank.

When disaster strikes, it may be far wiser to limit growth and control the operation in the short run, so that cash flow can be more accurately planned.

Clear communication with the bank is a critical link in building credibility. Remember, the banker is judging the intent and credibility of its borrowers at every meeting. Show them you care and are realistic. Demonstrate how you can pay back the loan, and that you can trust them to help.

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