The Company in the Decline Stage: Diagnosis, Alternative Scenarios and Reorganization

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Abstract

The crisis and the restructuring of companies are very important and current issues. The life of a company is characterized by different phases that have different characteristics and peculiarities. The company in the process of decline, after a careful diagnosis, must choose whether to restructure or continue to work without hoping to obtain economically satisfactory results. Until now, scientific studies have not investigated the issues of the diagnosis of companies in the phase of decline while the methods of business evaluation have been extensively studied in order to identify the indicators of the crisis. The objective of this paper is to focus attention on the preliminary business diagnosis activities in companies in crisis and on the study of alternative scenarios in order to trace the guidelines for a restructuring plan. After reviewing the literature, an analysis was carried out on the phases of corporate diagnosis; in addition, the second level of analysis was carried out to examine the possible alternative scenarios and finally the issue of the recovery plan was examined in depth.

Keyword: Business diagnosis, decline, alternative scenarios, reorganization

Introduction

The company, like any other organism, has a life cycle that is divided into several sequential phases: the embryonic phase; the Constitution; Development; the decline and the hypothetical failure. These phases, even if they would seem to be distinct from each other, are linked since the decisions and actions were taken at one stage naturally have repercussions on the future of the company, that is, in the later stages. The establishment of the company is preceded by a phase of careful study and analysis in which the company does not yet exist and future entrepreneurs define:

- the basic idea;
- technical and economic resources;
- the launch and distribution of the product / service;
- the costs to be incurred and the prices to be implemented;
- the financial structure;
- the location of the company

Then there is the real birth of the company that takes shape in the establishment of the company. The first years of life are the most critical because:

- a new structure is more fragile;
- the market in which the company operates may not be profitable;
- evaluation and analysis errors are greater.

After the establishment of the company and the first years of operation, it follows the phase of stabilization and normal functioning that in theory should last forever. Naturally, this is the longest phase through which the company carries out all its typical activities and develops knowledge and skills. It may happen that, at a certain point in his life, the company goes into crisis (phase of decline) and this crisis, if not carefully diagnosed and managed, could lead to the cessation of the business of the company (bankruptcy).

In the phase of decline in order to understand the gravity of the crisis and the possibility of reorganization, the company must carry out a delicate and punctual diagnostic activity. The present paper deals with the issue of corporate diagnosis in companies in crisis, the subsequent study of alternative scenarios and finally the restructuring plan aimed at rebirth.

Literature review

First, we proceeded with the analysis of the reference literature and, in particular, I sweated the scientific contributions related to the issues of corporate diagnosis, business crisis and restructuring. From this first analysis, I discovered the
lack of organic documents on business diagnosis in the decline phase and on alternative scenarios. The texts analyzed are:

- Lazonick W., *Corporate restructuring*, The Oxford handbook of work and organization, 2004

The other texts studied and used for the realization of this work are reported in the references section.

**Idea**

Diagnosis in the phase of corporate decline carries out the function of analyzing and understanding the gravity of the situation in which the company is located. This activity, depending on the situation, may involve different company areas and in particular for example: purchasing and sales area, marketing area, research and development area, planning and production area, administrative and financial area, etc. More precisely, the corporate diagnostic activity is generally structured following a precise path that provides for several consecutive study points that consider:

- the market and the reference sector;
- the business strategies are undertaken;
- the organizational and financial structure.

Considering the subject of this paper, we proceed first with the analysis of the criticalities that could emerge considering the phase of decline already begun. The study of the market and of the sector is necessary to understand, not the internal events of the company, but the external dynamics that concern the context in which the company operates. The major criticalities that can emerge during diagnosis at market and sector level are:

- the entire sector is in crisis;
- the offer is excessive compared to the demand;
- change in consumer tastes;
- the competitiveness of the sector is growing rapidly;
- new government policies.

After analyzing the market and the reference sector, it is necessary to proceed with a precise diagnosis of the business logic adopted by the company in order to understand the adequacy of the model used. In this phase the variables that must be taken into consideration, for example are: the proposed value offer; customer segments; all types of relationships undertaken; the various channels used; internal key resources; the various relationships with strategic suppliers and finally the revenue model and the cost structure. The critical points that could emerge in this level of analysis are:

- the offer may be standardized and undifferentiated;
- the high quality of the products offered is not supported by the right information;
- the sales channels are essentially the traditional ones;
- investments in marketing, research & development and technological innovation were too small;
- turnover is concentrated on a few small customers;
- the cost structure is too heavy compared to the company size.
The study of the organizational and industrial structure is aimed at understanding the sustainability and consistency of the corporate structure with respect to the business model. To carry out this phase correctly, it is advisable to collect and analyze information relating to the organizational structure and the industrial configuration.

Some examples of critical issues at the level of the industrial-organizational structure are:

- a high turnover of commercial functions;
- a staff that is decidedly excessive compared to the current production volumes;
- dated and non-innovative production plants;
- wide variety of products.

The analysis of historical financial performance is aimed at understanding the sustainability of the company's financial situation. In order to carry out this phase correctly, it is advisable to collect and analyze information relating to the final economic, financial and equity performances, and relations with the banks.

The examples of the criticality of financial balances are:

- the decrease in turnover;
- the sharp decline in characteristic margins that are now insufficient to cover the high incidence of depreciation and finance charges;
- strong economic losses in recent years;
- the gradual erosion of net equity;
- high medium-term financial debt, and important financial commitments for the repayment of existing loans;
- the significant absorption of liquidity in recent years;
- the high level of stock in relation to company size.

Following this analysis, the potentials, that is the positive elements, must also be considered, to then be able to undertake the road to recovery. Without the analysis of strengths for each level of study, it would be impossible to implement a recovery strategy.

The encouraging signs at the market and sector level could be:

- the sector is recovering slightly
- the world market is growing
- the birth of new markets
- the development of emerging markets

Examples of business strengths are:

- direct relationships and long-term relationships with the main key customers;
- industrial infrastructure adequate to sustain a strong recovery in volumes without having to make further investments;
- the current supply of products suitable for the target markets;
- The presence of foreign markets increased compared to the past and being strengthened.

As regards the organizational structure, the examples of potential are:

- recovery actions that can be made with little or no investment;
- more massive activation of social safety nets;
- significant recoveries obtainable on commercial margins through appropriate commercial focus work on the best performing "product-market" combinations.

Finally, with regard to financial balances, the following situations could exist:

- the Net Equity is of an important entity;
- payables to suppliers are carefully monitored;
- receivables from customers are constantly examined.

Following this long and complex study, we proceed with the construction of alternative scenarios if there were signs of probable recovery. In this situation, the alternative scenarios are:
The inertial continuity scenario is not sustainable at all: If the company does not carry out a reorganization, it will be more difficult to restructure its debts and therefore the likelihood of collapse will be greater and therefore certain bankruptcy. This scenario is not sustainable either economically or financially, also because the critical points in any case would be greater than the strengths. The evaluations underlying the plan must not be formulated from a liquidation standpoint, but from the point of view of a management policy that envisages overcoming the crisis and safeguarding the business continuity.

With regard to the requirements of the plan, specific indications are provided concerning the diagnosis activity:

- the collection of data and information concerning the company, the market, the sector;
- precise analysis of the causes of the crisis;
- study of the updated initial balance sheet;
- preparation of the industrial, economic and financial plan;
- the statement of total cash flows;
- the corporate governing body;
- the disclosure on hypothetical assumptions and forecast data.

With regard to the collection of data and information regarding the company (company and group), the market, and the sector in current and prospective function, particular attention must be paid to external factors and internal factors, as also mentioned for the preliminary study.

In the first case, external facts are meant:

- products;
- the competitive environment;
- competitive markets, outlet and supply markets;
- positioning in technological evolution;
- the political-technological and political-social situation in the territory.

In the second case when we talk about internal factors we refer to:

- economic, equity, financial and industrial indicators;
- the structure of customers and suppliers;
- the major components of cost and revenue;
- margins by product / customer / market;
- investments in research and development;
- intercompany relationships: industrial, commercial, economic, equity, financial.

The analysis of the "state of progress" of the crisis and its origins is aimed at framing the choice of recovery and motivation of the individual actions envisaged by the plan, this analysis must necessarily be connected with the preliminary study described above. Regarding the updated balance sheet, it refers to recent data, to the reliability and completeness of the "opening balance" (accounting control), to the homogeneity of the accounting principles and to the fair value on the elements subject to deeds.

The preparation of the industrial plan involves the analysis:

- the range of products;
- production and logistics;
- distribution and reference markets.

In the case of the preparation of the economic plan, the following are considered:

- margins for the product / market;
- prices and business volumes;
- reducing costs and increasing efficiency.

Finally, in preparing the financial plan we examine:

- maximizing cash flow;
- debt restructuring or consolidation;
• the new finance or new risk capital.

The plan must absolutely contain the statement of total cash flows. A summary of the flows deriving from: the executive documents provided for in the plan are inserted; the management envisaged by the plan and the execution of scheduled financial interventions.

The section dedicated to corporate governance contains the (possible) shareholders’ agreements and incentives and / or stock options to management. Finally, a summary of the main assumptions is included in the disclosure on hypothetical assumptions and forecast data (for example: good outcome of the “banking agreement”); the parameters used for the development of forecast data (for example: rates / exchange rates, volumes, etc.) and any exogenous interference factors.

The objectives of the plan are distinguished by internal objectives and external objectives. The internal objectives are represented by the monitoring by the management of the plan during its duration, while the external objectives enhance the “consents” of the management, of the creditors, of the new lenders, of the new shareholders.

The forecasts of the plan can be variously articulated according to the state of corporate crisis and the overall objective to be achieved. Certainly greater consideration must be given to urgent interventions, both short and medium-term, which are closely linked to the phase the company is going through. These interventions concern the emergency phase, the stabilization phase and the relaunch phase.

Urgent interventions in the emergency phase are:

• elimination of the most proximate causes of the crisis;
• cuts in costs and the sale of non-core assets;
• debt consolidation and restructuring;
• the collision of the liquidity crisis;
• the increase in cash flow.

The short-term interventions in the stabilization phase are instead represented by:

• the start of the turnaround;
• economic stabilization;
• financial development, through obtaining new finance or obtaining new risk capital.

Finally, the medium-term interventions for the relaunch phase are:

• the development of the turnaround;
• restoring competitive advantages;
• new investments and related financial plans.

The time horizon of the plan is generally 3-5 years, a period for which it is possible and / or reasonable to formulate hypotheses and specific forecasts, and within which the stabilization phase and the start of the phase are expected to be completed of the relaunch.

Conclusions

Considering that the company is going through several consequential phases, when imbalances emerge in economic and financial terms, it is necessary to proceed with the diagnosis.

The diagnosis of the company in a crisis allows on the one hand, to study the critical issues affecting the company and from the other the potential to be developed. Subsequently, given the results of the diagnostic activity, it is necessary to consider rehabilitation as an optimal scenario if we want to continue the business activity. For the preparation of the recovery plan, precise instructions must be followed in order to obtain the results sought in a timely and timely manner. Finally, it should be noted that inertial continuity considers as an alternative scenario, for companies in crisis, it is the optimal choice for the failure of the company.

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