



## What Is Turnaround?

Dealing with problems is a part of doing business. There are various problems that can beset a business. When business problems are allowed to progress unchecked, they can cause a business to falter badly or even fail. Turnaround is the process of determining the problems of a faltering business and rescuing the business by implementing a strategy to stop negative cash flow and return the business to profitability.

## Assessing Business Problems

Most business owners do not suddenly discover that the business is in trouble. It is normally a gradual process that occurs over several months or even a year. Business owners must continually assess their business operations to determine if the business is trending in the right direction. If the business is not, there are some common warning signs that can predict danger for the business. Warning signs are serious business concerns that require immediate attention to resolve. Those warning signs include:

- The business cannot pay its expenses (e.g., payroll, vendors, utilities)
- Net profit is shrinking and business expenses are increasing
- Sales are flat or decreasing even in a prospering economy
- A significant number of regular customers are not returning to the store
- Employees are showing unhappiness in their attitudes
- The owner or manager no longer has the confidence of the employees

### Main Idea

This unit explores the topic of business turnaround. We will discuss the meaning of the term turnaround. We will also learn how to assess and diagnose business problems, develop action plans to correct the problems, update the business plan, and address the burn rate for cash. Lastly, we will review some of the mathematical calculations associated with business turnaround.

### After completing this lesson you will be able to:

- Identify warning signs that a business is in immediate danger
- Diagnose problems within a business by assessing financial statements, customer behavior, and employee feedback
- Develop an action plan to restore a struggling business to profitability
- Explain the importance of updating your business plan
- Compute cash flow based on total cash generated and total cash spent
- Calculate burn rate and explain its importance in turning a business around

### Key Terms

- Turnaround
- Warning Signs
- Honest Assessment
- Cash Flow
- Variable Expenses
- Fixed Expenses
- Burn Rate

Use these warning signs as a guide. Remember, it is important to make an honest assessment – one that is objective and includes a review of all the normal warning signs.

## **Diagnosing the Problems**

After the problem assessment comes the diagnosis of the source of business problems. While not strictly necessary, it is advisable to obtain an objective and professional outside point of view of your current business operation. It is important to be as objective as possible when identifying the source of business problems.

### **Start with the Financials**

Your first step should be to determine how to stop or slow the financial bleeding. If you are struggling to make payroll and to pay the business expenses, the financial statements will help you further diagnose the problem. Your accountant is an excellent source for assistance with an objective assessment of the financial statements. Schedule a meeting to analyze your current and prior financial statements of the business. This should provide the financial diagnosis you need to launch the development of a turnaround action plan for the financials.

### **Take a Candid Look at Your Customers**

Customers are the lifeblood of your business. If they start shopping less or stop shopping altogether, you will need a transfusion of new customers. It is much, much easier to retain existing customers than to attract new ones. If you have not been on the sales floor with your customers, then get out there. Get firsthand feedback from your regular customers. Put yourself in the place of the customer and evaluate your service and product offerings. Next, visit your competitors. Ask one of your best employees to join you. Together, diagnose what the competitors are doing better from the consumer's perspective, such as service, value, merchandising, or store appearance.

### **Talk with Employees**

Employees project their attitudes about their work environment. Make a careful observation of employee attitudes, attendance, and appearance along with their customer interaction skills and turnover rate. Then ask your employees for feedback on their impressions of the business. To do this effectively, you must set your personal pride aside and ask employees to evaluate you as a leader. You must set up a safe environment to encourage honest feedback. Be friendly, nonconfrontational, and open to employee input. Probe, but do not argue, and be sure to thank employees for their feedback. These meetings can provide some invaluable input on the business and your management skills. Together, your observations and employee feedback should give you a clear diagnosis of employee status.

## **Creating an Action Plan**

Once the business problems have been determined and confirmed by a professional business advisor, you need to develop an aggressive action plan to address these problems.

## **Financials**

Carefully examine all aspects of the business's financial transactions and records. In most turnaround situations, the business expenses are creating a negative cash flow. Cash flow is the amount of cash a business is taking in at a particular time. A negative cash flow means that there is less cash coming into the business than is needed to pay for expenses. To remedy this situation, you must identify variable and fixed expenses.

Variable expenses are those that change according to the level of sales. Fixed expenses are those that remain the same regardless of sales. Now turn to what you can control—variable costs. Stop the negative cash flow. Be tough-minded and make some hard choices. Once you have eased the cash flow concern, you will have the time to think more logically. Then you can address other challenges.

It is important to keep creditors and vendors informed about your situation and the corrective action you are implementing to restore your business to profitability. Be proactive regarding your communications with vendors and creditors. Face-to-face meetings will enable you to demonstrate your confidence and personal commitment. Once creditors and vendors understand you are on top of the situation and have an action plan to bring about a turnaround, they are much more likely to be willing to work with you.

## **Customers**

Customers need to see you, so be visible and accessible in the store. Appearances of personnel and of the store speak volumes. Outside appearances can signal a failing business or one that is open and ready to fill customer needs. Friendly, well-groomed employees project confidence and high business standards. A well-maintained and adequately stocked retail facility further promotes customer confidence.

## **Employees**

The diagnosis of employees outlined earlier should lead your action plan in this area. After meeting with employees individually, it is important to meet as a group and share the input gathered. Employees need to understand what you plan to do and how they will be affected. You may be forced to lay off some employees if the business is over-staffed. Communicating with employees will help set expectations based on their understanding of the business situation that is driving this effort. One of the most important steps of your action plan should be to recruit the support of your employees and their critical role in the turnaround. Working harder, longer, and smarter will be required by the entire workforce to successfully deliver a turnaround.

## **Modifying Your Business Plan**

The key role of the business plan was explained in the Business Plan Analysis unit. Businesses that keep their plans updated are less likely to fall victim to a turnaround situation. Modification of your business plan must include updating the major sections with the assessments, diagnoses, and action plans resulting from the turnaround strategy. You need to record and document the ongoing business issues, both positive and negative, and set a direction for the future. The revised business plan will then serve as the warehouse of your findings and the implementation guide for the turnaround.

## Burn Rate – How Much Time Do You Have Left?

In order to effectively execute a turnaround strategy, you need to answer a key question. Based on the cash flow status, what is the burn rate of your business for a specific period of time? Burn rate is the amount of cash a business spends, usually projected on a monthly basis. For example, the total cash spent during six months is \$36,000. To compute the monthly burn rate, divide \$36,000 by 6 to get a \$6,000 monthly burn rate. The higher the burn rate, the sooner the business will deplete cash reserves and will need an additional cash infusion. Compare your projected burn rate with your cash reserves and the timeline you have established in your business plan to return your operation to profitability. If they do not match, then consider how to obtain additional cash to stay in business during the short term with an outside loan or further reduction of expenses.

### Summary

In this unit we have explored returning a business to profitability by implementing a turnaround. We have discussed how to assess and diagnose the problems at hand, create an action plan, update the business plan, and compute the burn rate for cash. Lastly, we reviewed some of the mathematics used in determining a successful turnaround.

## Key Math Concepts

### COMPUTE CASH FLOW

To compute cash flow, use this formula:

$$\text{Cash Flow} = \text{Total Cash Generated} - \text{Total Cash Spent}$$

### COMPUTE BURN RATE

To compute burn rate, use this formula:

$$\text{Burn rate} = \text{Total Cash Spent} \div \text{Specific Period of Time}$$

## Key Terms

### Turnaround

The process of determining the problems of a faltering business and rescuing the business by implementing a strategy to stop negative cash flow and return the business to profitability.

### Warning Signs

Serious business concerns that require immediate attention to resolve.

### Honest Assessment

One that is objective and includes a review of all the normal warning signs.

### Cash Flow

The amount of cash a business is taking in at a particular time.

### Variable Expenses

Those that change according to the level of sales.

### Fixed Expenses

Those that remain the same regardless of sales.

### Burn Rate

The amount of cash a business spends, usually projected on a monthly basis.

**Turnaround**

1. Last month your financial statements indicated that your total revenue from the business was \$48,000 and you distributed \$48,500 to pay monthly expenses and vendors. How would you express your current cash flow? Should this be a cause of concern?
  
2. Your business is in a turnaround situation. During the last six months, your total expenses were \$275,000. Your fixed expenses make up 65% of the total and variable expenses make up the other 35%. What is the dollar amount of the fixed and variable expenses? You need to trim 25% from the variable expenses to maintain a positive cash flow. How much money do you need to trim?
  
3. During the last year, your total expenses and vendor payments for your new business required a total cash payout of \$600,000. What was your average burn rate over the last 12 months?
  
4. Your business has a cash reserve of \$20,000. During the last four months, your total expenses and vendor payments required a total cash payout of \$20,000. Your total sales during this same period were \$16,000. What was your average monthly burn rate, monthly sales, and cash flow status during this time, and if this pattern continues, how much longer can you sustain the business before you will need additional cash?

**Turnaround**

1. You opened your business a year and a half ago. Since then, sales have leveled off and expenses are going up. You are struggling to keep enough cash in the checking account to pay expenses. How would you assess if your business needs a turnaround and, if it does, what is the key component of the assessment?
  
  
  
  
  
  
  
  
  
  
2. You've confirmed that your business is indeed in need of a turnaround. List and discuss the three key areas you should examine to diagnose the problems. What will give this diagnosis credibility?
  
  
  
  
  
  
  
  
  
  
3. In developing an action plan to execute a successful turnaround, where should you start and why? List examples of some of the actions you might take immediately.
  
  
  
  
  
  
  
  
  
  
4. How would you use a business plan in a turnaround situation and what steps should you take regarding the business plan you developed when you started your business?

## Turnaround

**GOAL:** Your goal is to fix several key things that are wrong with your store and raise the store's weekly profit from a loss to \$5,000 per week.

**YOUR SITUATION:** You control all aspects of your store.

1. Run all sections of the **Tutorial** under the **Reports** and **Actions** headings.
2. Open the **Turnaround** Lesson.
3. Try to identify the problems with Nikki's and solve them.

**QUESTION 1:** What problems do you see with Nikki's?

4. Try to restore the profitability of the store and raise the store's weekly profit from a loss to \$5,000 per week. Unless otherwise notified by your instructor, you have 30 minutes.

**QUESTION 2:** Were you able to get Nikki's store to make \$5,000 in weekly profit? How did you solve the problems you identified with Nikki's store?