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How companies recognise, exploit and overcome crises

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Crisis prevention and crisis management are primarily the responsibility of the business owner. The earlier the symptoms of a crisis are recognised and the required steps are implemented, the more likely this action will meet with success.

Corporate crises are commonplace ...

Practically every enterprise goes through at least one crisis in the course of its history. Over the last ten years, 15 to 23% of all SMEs in Germany have experienced a downward trend in return on sales for at least two consecutive years (Figure 1). This means roughly 400 to 600 thousand enterprises per year. A reduced return on sales over an extended period is a symptom of undesirable developments, either in the business model or with in-house processes. If the overall economic climate deteriorates, the number of enterprises with declining revenues increases. Financial distress deepens if revenues cannot be increased with appropriate measures, or costs cannot be adjusted quickly and adequately. Coupled with losses and liquidity bottlenecks, these difficulties can signal the end for the company concerned, as well as for associated workplaces and occupational livelihoods.

... but recognised too late

The root of the term "crisis" is the ancient Greek word "krinein", which means "judge", "decide". If symptoms of crisis are not recognised in due time or are ignored, or if there is a lack of judgement and decisions required to resolve the crisis, valuable time is lost. In many corporate crises this is unfortunately the case.

The amount of time before micro, small and medium-sized enterprises respond to a crisis is shown by the PwC evaluation of the KfW "Turn Around" advisory service.¹ This programme subsidises corporate advisory services and is explicitly directed at firms in difficulty.² According to the evaluation results, at the beginning of the advisory service one in every four enterprises had faced problems for more than two years. Nearly 42% of the companies decided to seek professional business advice only one to two years after the first problems occurred. Not even one in every ten enterprises sought advice within six months following the onset of crisis symptoms (Figure 2). Other studies on this issue also come to the conclusion that the majority of small and medium-sized businesses only initiate restructuring after facing acute profitability and liquidity problems.³ This is often too late.

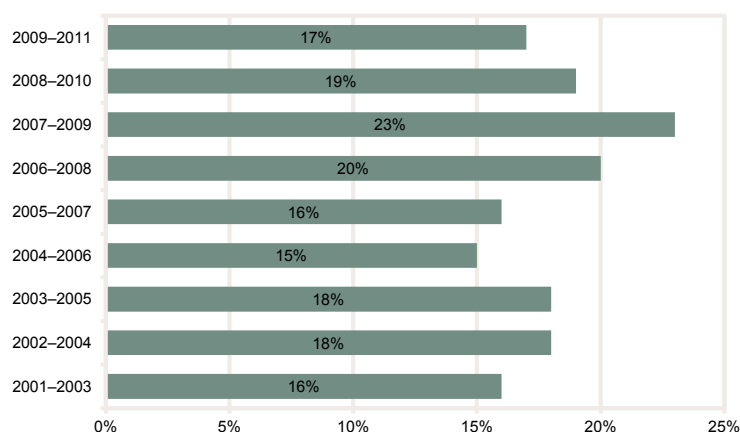
Ignorance and taboos amplify the crisis

There is a myriad of reasons why micro- and small enterprises especially are reluctant to make use of external support: from simple ignorance, through psychological hurdles such as fear of change or a lack of understanding, to the overburdening of management in the daily "struggle for survival".

In retrospect, it frequently looks as if the enterprises became entangled in the crisis "with their eyes open". But it is often not quite as simple as that. In many cases the development of the company is not properly observed, there is a lack of simple business monitoring instruments, or the developments observed are not interpreted correctly. Many companies simply do not know-how to recognise a crisis in time.

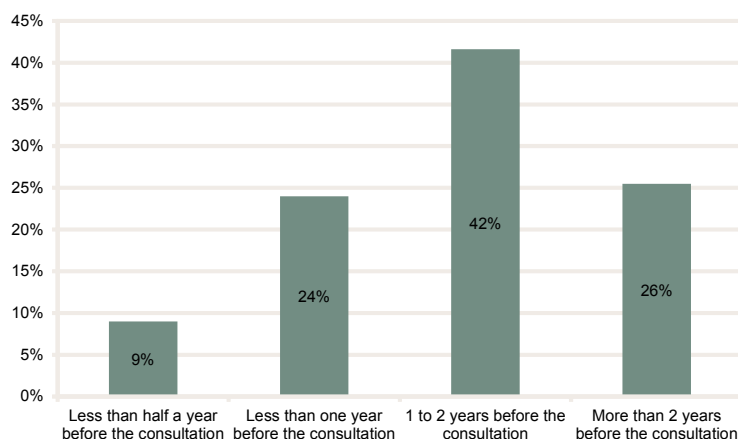
Recognising an undesirable development is made more difficult by the taboos surrounding the topic of corporate crises. This results in a real inhibition about admitting the (impending) failure to themselves or others, not to mention a reluctance to consult corporate advisors, especially in the case of smaller businesses. The management of small enterprises often cannot imagine how they could benefit from such services, which are also provided by somebody who is

Figure 1: Share of SMEs with falling returns on sales in two consecutive years



Source: KfW SME Panel

Figure 2: Onset of corporate problems before consulting



Source: Evaluation of KfW "Turn Around" advisory service, PwC.

not familiar with the company. This is compounded by mistrust and a very common tendency to let no one look into the books "from the outside". In practice, these factors are often far more serious than the costs of such advisory services. The "Turn Around" evaluation confirms the problem by using case studies.

Exploiting the crisis as a productive state

When the management is willing to confront the crisis, to analyse the causes and the need for action, new prospects and opportunities for action arise. Max Frisch once said, "A crisis is a productive state. You simply have to get rid of its aftertaste of catastrophe." In order to address the crisis productively, however, the company needs an honest assessment of its actual strengths and weaknesses. The best practice is to look at the problems – which can emerge in various business sectors – from a certain distance. With or without consulting, a systematic, distanced weakness analysis is the first step towards overcoming a crisis. Companies should definitely invest time into this, which is why KfW's Turn Around advisory service requires an analysis of weak points.

Based on such an analysis, the business owner and / or the competent consultant can make a cost-effective contribution to helping the enterprise navigate calmer waters again. About 30% of companies that carried out weakness analyses were able to return to black figures within the first two years. This is shown by the evaluation results of the KfW advisory programme "Runder Tisch".⁴

In this context it can make sense to look for external help, especially in the case of SMEs. The scarce personnel capacities of these enterprises make it increasingly difficult to focus on the general state of the company. One particular bottleneck is the lack of know-how in reorganisation.

Back on track with "Turn Around" advisory service

The afore-mentioned hindrances to looking for advisory help are as explicit as the companies' opinions about the benefits of this step afterwards: more than half of those who sought advice from the "Turn Around" programme (57%) believe, in retrospect, that the advice should have come earlier. Most of the advisers were clearly able to convince customers of their competence, which plays a key role in this regard. This competence is assessed by the companies receiving the advice on a scale of 1 to

10, with an average of 8.3.

These estimates are also reflected in the results and effects of the consultations: after the "Turn Around" advisory service, 56% of the companies have a better liquidity position and 43% a better financial position for instance. More than nine out of ten companies (95%) find that their conditions do not deteriorate further and the crisis has not led to the worst scenario (Figure 3).

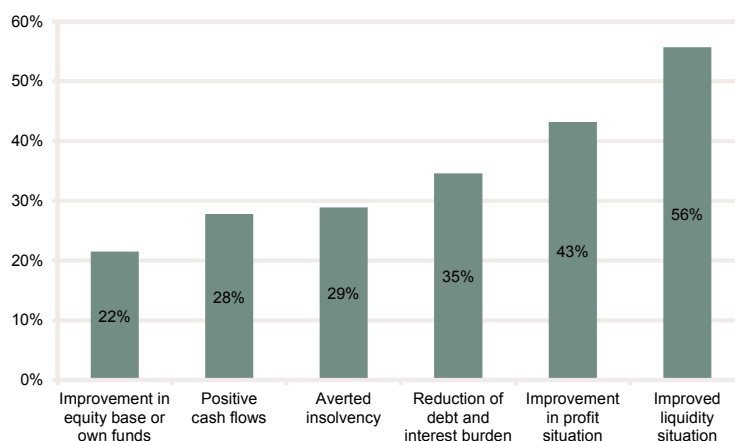
These results should encourage companies in crisis to address their problems as long as they still have the freedom to make changes.⁵

Early detection and handling of crisis symptoms

The prospects for a corporate turnaround depend heavily on the date the management responds to the crisis. This means that signs of a possibly negative development should be clearly detected. The symptoms can be very different, and there is no universal signal of the onset of a corporate crisis either. Nevertheless, the development of key business figures is a good indicator for businesses of every size. If

- sales or market shares decrease and debt or inventories increase,
- this often indicates difficulties. We do not necessarily have to be talking about a serious crisis. If, however, developments like
- increasing losses or interest expense and decreasing cash flow are experienced,

Figure 3: Impacts of reorganisation measures on companies



Source: Evaluation of KfW "Turn Around" advisory service, PwC.

the business is at risk of a liquidity squeeze.

If such a trend continues for more than two years, the chance of a severe crisis will become ever more likely. In this case, the aforementioned signs can crop up in combinations or even separately. In all cases, companies should not hesitate to look for the causes of and solutions to such developments.

A case study from Turn Around practice

Just how important it is in such a situation to act decisively and have experience in coping with corporate crises is demonstrated by the example of a logistics firm surveyed by PwC as part of the "Turn Around" advisory service evaluation. The company was in financial diffi-

culty owing to a reduction in freight orders because of the economic crisis, rising costs and a low number of clients. The relationship with its main bank was already strained and it was facing an imminent liquidity squeeze.

Quite by chance the managing director learned of KfW's "Turn Around" programme. After an initial meeting with the Chamber of Commerce and Industry, which is a regional partner of KfW, everything proceeded rather quickly. First of all a weakness analysis was compiled as part of KfW's "Runder Tisch" programme, while the advisers took immediate action (such as restructuring loans) to ward off insolvency. Thereafter the company was put in order as part of the "Turn Around" advisory service, and given a more professional approach both

internally as well as externally. When the support of the advisors resulted in a large logistics company being won as a new client, what initially seemed like an unconquerable crisis was resolved.

It is possible to find a way out of the crisis

Crisis prevention and crisis management are primarily the responsibility of the business owner. Yet in emergencies, small and medium-sized businesses can rely on active support that is tried and tested in practice. Chambers of commerce and industry as well as craft trade chambers are important partners in this respect. Overcoming the inhibition about admitting, to oneself and others, that there is a need for help, often represents the first step on the road to regaining a company's competitiveness. ■

¹ Evaluation of the "Turn Around" advisory service programme. A study by the Federal Ministry of Economics and Technology, June 2013, Berlin.

² As part of the TAB programme, grants are awarded for advisory expenses to the self-employed and enterprises that are in difficult economic situations but have positive development forecasts. The scheme applies exclusively to professional external advisory services of any management consultant registered at KfW, and to all economic, financial or organisational issues designed with a view to restoring productivity. The maximum eligible net daily rate for the consultants is EUR 800. The maximum amount of eligible costs adds up to EUR 8,000, for which grants covering the advisory fees are awarded on a percentage basis. Such amount to 50% of the advisory expenses in the old federal states of Germany and in Berlin, and a maximum of 75% in the new federal states of Germany, including the "phasing-out" region of Lüneburg. The support scheme is financed by subsidies from the European Social Fund (ESF).

³ According to the study entitled "Ursachen und Erfolgsfaktoren von Restrukturierungen" by Roland Berger Strategy Consultants (2002), this holds true for no less than 80% of all restructuring in small and medium-sized enterprises. A recent study confirms this result, cf. Roland Berger (2013), Restrukturierungsstudie 2013, Düsseldorf. See also Lehnert, N. and M. Tchouvakhina: "Der "DtA-Runde Tisch" als Instrument des Krisenmanagements." In: Bindewald, A. and J. Struck. "Was erfolgreiche Unternehmen ausmacht", Physica Publishers, Heidelberg 2004. Tchouvakhina, M. "Turn-around durch Krisenmanagement? Ergebnisse der Evaluation DtA-Runde Tische." In "DtA-Studie", Bonn 2003

⁴ Cf. Tchouvakhina, M. "Turn-around durch Krisenmanagement? Ergebnisse der Evaluation DtA-Runde Tische." In "DtA-Studie", Bonn 2003

⁵ KfW's "Turn Around" advisory service makes it easier for small and medium-sized enterprises to take this step by subsidising half or 75% of the consultancy fee (for SMEs headquartered in the new federal states of Germany).