The ABCs of the CRO

Bob Rajan and colleagues explain why a Chief Restructuring Officer (CRO) is often such an important factor in achieving the goal of a successful restructuring

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Like all things in life, everything evolves. But whether one believes in the Theory of Evolution, Creationism or some other founding principle of human existence, one will agree that some constants remain throughout time.

Practically speaking, while restructurings may have evolved into more complex and special situations, the need for a strong hand to take charge and ensure a steady drumbeat to achieve the goal of a successful restructuring will always exist. Hence the need for a Chief Restructuring Officer ("**CRO**"), not a Chief Risk Officer as the acronym might suggest, is critical in our opinion to the success of any restructuring. The larger or more complex the restructuring, the greater the need for such an intervention. The CRO concept started in America, and has slowly moved to other parts of the world (primarily Western Europe), but has still not become a recurring theme in several other parts of the world.

The purpose of this article is to remind us why CROs are required, and to outline what they can and cannot do. The function of the CRO has taken a life of its own, and for reasons of perception, may not always be referred to as a CRO, but rather as a Chief Restructuring Advisor ("CRA"), Restructuring Officer ("RO") or Chief Transformation Officer ("CTO"), when the word 'Restructuring' instills too much fear in the enterprise, its incumbent management or certain stakeholders. Nevertheless, it is important to explicitly outline the scope and responsibilities of a CRO be they an individual or a firm, who will be looked upon to deliver the end goal – i.e. a successful turnaround.

Why the need for a CRO?

A CRO can be embodied by different persons, depending on the situation; however, what is important is that the relevant stakeholders in a restructuring obtain the comfort required to decide on the level of empowerment any type of independently appointed person or firm should have. Often, CROs are members of a larger restructuring boutique firm, or what appears to be the trend more recently, CROs are retired executives or individuals, now working as independent consultants, who must rely on the distressed company's workforce to deliver and implement the turnaround plan – easier said than done.

Of course, a CRO can be capable of doing almost anything, subject to the agreed-upon mandate. With the exception of extraneous external factors or fundamental problems inherent within an industry or sector, the number one reason for the failure of a business and the subsequent appointment of a CRO is the structural failure of management; or in other words, poor management.

1. Causes of Corporate Failure[1]

Poor management
Inadequate financial control
Poor working capital management
High costs
Lack of marketing effort
Overtrading
Big projects
Acquisitions
Financial policy
Organisational inertia and confusion
Changes in market demand
Competition
Adverse movements in commodity prices

[1] *Corporate Turnaround Managing Companies in Distress, Stuart Slatter & David Lovett (1999)*

2. Example Tasks[2]

Bringing credibility and objectivity to the engagement:

Set objectives, measures and timeline
Monitor action plan and realisation of objectives
Conduct management meetings
Manage cash and liquidity
Coordinate implementation teams
Negotiate with workers council/third parties on disposals or workforce reductions

Creating stability to the entire restructuring process

Identify and overcome implementation barriers
Define the future management of the organisation
Present / communicate restructuring results to the board, management, shareholders and banks
Determine basis for optimising exit strategy / recruitment of employees

[2] *Alvarez & Marsal Thought Leadership*

Table 1 (left), although somewhat dated, appears to have stood the test of time.

Whilst it is difficult to solely blame management for every business failure, it still remains the primary reason for keeping the turnaround profession alive.

Furthermore, the reasons in almost every case, as to why a CRO is appointed, is first of all due to the lack of trust between stakeholders, typically between the shareholder and/or management and its financing creditors, and secondly, a CRO is needed to implement actions, usually against an opposing force, be it the incumbent management or the workforce. In the majority of cases, some event has been triggered that causes a roadblock in the communication between stakeholders, therefore, an independent broker is required to re-start discussions and move the process forward. As a result, we see the CRO having three primary responsibilities throughout any restructuring:

1. *Bringing credibility and objectivity to the restructuring process;*
2. *Driving and creating stability to the entire restructuring process; and*
3. *Building a consensus amongst stakeholders about the direction of the restructuring.*

Today's CRO needs to possess a skill set that includes not only strategic, but also operational and financial know-how, if a business or its stakeholders want to properly medicate the troubled business, as opposed to simply applying a band-aid solution. In addition, a CRO needs to have strong constituency management skills to lead parties to sustainable solutions.

In a recent survey by Deloitte, the skills most required for a CRO ranked as shown in Table 3 (right).

As time has progressed, less reliance is given to a CRO for his/her financial advisory skills, but more so to his/her capacity to drive operational change and be all-encompassing.

The role and psychology of a CRO

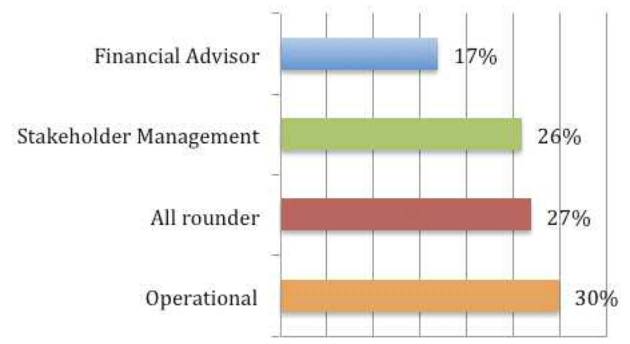
Stepping into any restructuring situation is difficult enough, let alone extremely political, hence the psychology of how a CRO or interim manager should approach a situation is extremely important. In most, but not all cases, the CRO has the three primary responsibilities listed above. Very often, the incumbent management team has never had to experience a distressed situation (by choice!), and therefore, is unaware of all the complexities and intricacies that accompany a restructuring.

Studies have shown that turnarounds can be successfully implemented without changing any senior manager, or perhaps only the Chief Executive Officer ("CEO"). So that leads to the question of how a CRO integrates himself/herself into an existing management team that is under severe distress and pressure? Not very easily…

As mentioned earlier, the initial appointment of a CRO is primarily due to a lack of trust between the shareholders and/or management and the financial creditors. A second level of distrust comes up with the eventual appointment of a CRO. Typically, the incumbent management is concerned whether or not the CRO may replace it, or will be just a 'spy' for the financial creditors. The CRO's duty of care is to the respective Board of Directors of the enterprise, and that should never

> **"LESS RELIANCE IS NOW GIVEN TO A CRO FOR THEIR FINANCIAL ADVISORY SKILLS, BUT MORE TO THEIR CAPACITY TO DRIVE OPERATIONAL CHANGE[3]"**

Table 3: Skills most required for a CRO[3]



[3] Deloitte European Restructuring Outlook 2014 – The industry shifts

> THE CRO'S DUTY OF CARE IS TO THE RESPECTIVE BOARD OF DIRECTORS OF THE ENTERPRISE, AND THAT SHOULD NEVER BE LOST

be lost. Although the appointment might be a direct result of a standstill agreement involving certain financing creditors, for example, not advancing funds to solve the problem at hand unless the company in question hires a CRO, his first and foremost duty of care is to the distressed enterprise and its Directors.

Should CROs have executive powers?

The CRO can be whatever the CRO needs to be, however, in our experience, granting the CRO the executive power it needs (i.e. officially joining the management Board) not only provides accountability and enhanced governance, but on the flip side, puts the CRO on the same playing field as the other management Board members, with respect to personal liability. This can be very important in certain jurisdictions, where personal liability exists with regard to (or the perception of) insolvent trading. Placing oneself in the same position as the other members of the management can actually be considered as a vote of confidence to the management team to stay the course of the overall restructuring and take pragmatic solutions when exercising business judgment, while simultaneously hovering the thin red line, known as the Zone of Insolvency.

Although this does not happen in reality, stakeholders should understand the implications of executive vs. non-executive powers when it comes to implementing a turnaround. Executive power and authority is not necessary in every situation, however, if the incumbent management team has failed time and time again to deliver results, the idea of a non-executive restructuring individual, in most cases, will not be able to influence the management team to take appropriate action and thus, time is lost. Stakeholders must understand and appreciate the circumstances surrounding such an appointment.

Is a CRO effective?

The aforementioned question always arises in the context of any restructuring, with the follow-up question being – how does one measure success? To our knowledge, there are next to no studies dealing with measuring the actual impact regarding the appointment of a CRO. One study performed by Deloitte Touche Tohmatsu involved 71 distressed entities and analysed the success of the restructuring with respect to the time that was required for the share price to recover back to a healthy level again.

Not surprisingly, results supported the appointment of a CRO. The share price recovered after approximately 11 months of restructuring where a CRO was appointed compared to a recovery time of 26 months where no CRO was involved.

In a more recent survey, also by Deloitte, only 26% of reported cases in 2013 (within their sample) used a CRO, to help support both the financial and operational restructuring whilst allowing the incumbent management to focus on the day-to-day management of the business. This survey also reported, that while the CRO appointment was influenced by the lender community, the

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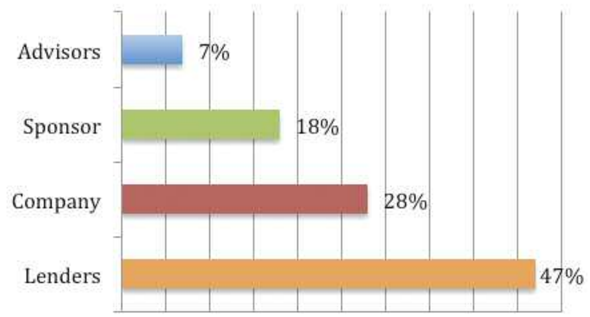
distressed enterprise was the first responsibility and care of the CRO (as previously stated). CROs are also more effective when they are involved with the business for a longer period of time in order to restructure the company properly. Contrary to what was stated earlier, respondents in this survey indicated a preference for a restructuring firm to be appointed as CRO, rather than an individual consultant, so that the CRO could leverage additional manpower as and when required during the restructuring. Our experience substantiates these findings also. Additionally, more dedicated resources accelerate the implementation of the restructuring and as a result, shortens the time to recover back to the status quo.

The figures in Table 4 (right) from the Deloitte survey confirm that lenders typically influence (directly or indirectly) the appointment of a CRO.

Conclusion

At the beginning of the article, we stated the contrasting theories between evolution and creationism, but also came to the conclusion, that certain constants remain as time move forwards. This also applies to the evolution of a CRO, and based on our experience and results of a third-party survey, the presence of a CRO will also form part of the DNA for future restructurings. The mandate of a CRO can be whatever one wishes and is subject to how much empowerment the respective stakeholders wish to give that individual or firm. Although there is no extensive empirical data supporting the success of a CRO, there appears to be no major obstacle in abolishing the role of the CRO in the medium-term. All the turnaround profession needs is to encourage more stakeholders to avoid band-aid solutions and opt for intensive care!

Table 4: Who influences the appointment of a CRO?[4]



[4] Deloitte European Restructuring Outlook 2014 – The industry shifts