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TURNAROUND OF THE YEAR:
HOW ONE FAMILY SAVED ITS BUSINESS FROM DESTRUCTION BY HIRING A TURNAROUND EXPERT

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ABSTRACT

This is the story of PML, Inc., a family-owned business in which the culture of the family — a culture of niceness and omission — became the culture of the company. When the market changed, the family's culture brought the family's company to the brink of disaster. The company's professional advisors — attorneys, accountants, and bankers — failed either to recognize the symptoms or to recommend appropriate solutions, so the problems escalated to a crisis. At that point, PML engaged a turnaround expert, Renee Fellman, to change the culture and save the company. The results were not only a change in the culture of the company to one of clear direction and absolute accountability but also the most profitable years in the history of PML. The author describes the situation and the turnaround techniques and provides a list of symptoms and a screening tool.

The following is a description of PML's situation at the crisis point, January 1995. What symptoms of problems do you see?

EXHIBIT 1: CASE STUDY, PML, INC.

The situation in January 1995

PML Microbiologicals, Inc. (PML), with headquarters in Portland, Oregon, was founded by Art Torland in 1969. The company is publicly held, FDA-regulated, and has operations in the US and Canada. The Torland family owns 80% of the stock. The members of the Board of Directors are

- Art's son, Ron Torland, who serves as CEO and Chairman of the Board (Ron has a degree in business administration and has served in the military, but he has never held a management position in any company other than PML.)
- The President, who was a hospital human resources (HR) administrator before coming to PML
- A cousin, who worked for the CIA in Africa before becoming PML's HR Director
- Art, a warm-hearted people-person, beloved by his customers and employees, is no longer active in the business, but he stays in close touch with the employees, most of whom have been at PML since the company was founded. All members of the Torland family place a very high value on being nice to everyone.
- Ron's wife, who works as an administrative assistant
- Ron's daughter, a high school student who works at PML during the summers
- Ron's sister, who works in production in Portland

As a practical matter, all employees are treated like family. Almost no one has ever been fired from the company.

PML manufactures and sells culture media, a commodity product, to hospitals, medical laboratories, and pharmaceutical companies. The company has annual revenues of $15 million and is the third largest company of its type in North America. Its largest competitor is Becton Dickinson (BD), a medical supplies behemoth; its second largest competitor, Remel, has annual revenues of $40 million. The company has manufacturing facilities in Portland, Oregon; Sacramento, California; Vancouver, British Columbia; and Toronto, Ontario. PML has distribution facilities at each of those locations as well as in Renton, Washington and Providence, Rhode Island.

PML has either lost money or been at break-even for the last four years. The company, for many years the only supplier of culture media in the Pacific Northwest, is facing increasing price pressure in its health care markets and incursions into its territory by its well-heeled competitors, BD and Remel.

During 1994, to combat PML's declining sales and lack of profitability, Ron decided to acquire a similar company, Adams Scientific, located in Rhode Island. Ron believed that the acquisition would restore profitability through increased revenues, cost efficiencies, and a broader national presence. Adams Scientific, like PML, was losing money.

PML is more than ninety days beyond terms with some of its largest suppliers and six months in arrears in its payments to its attorneys and auditors. In addition, many of PML's customers are more than ninety days late in their payments to PML.

The company recently hired a new CFO, a CPA with extensive experience in troubled companies. In spite of that, however, the company's financial statements are late and have frequent prior-period adjustments.

The company has had frequent overdrafts on its bank account. In addition, PML has made a series of commitments to its bank but has failed to meet those commitments. The family has pledged additional assets, but the company is still out of compliance with several loan covenants. The loan has been moved to the bank's "Special Assets Department," and the bank has recommended that PML hire a turnaround expert.

PML's fiscal year-end is May 31. The following table provides actual financial results for the years indicated.

	1995	1994	1993
Net sales	**15,295,572**	13,887,475	11,832,392
Gross margin	**5,033,241**	5,331,680	4,421,416
SG&A	**6,386,572**	5,073,888	4,343,357
Operating income	**(1,424,400)**	257,792	(54,441)
Net income	**(1,612,880)**	40,909	(180,745)
Net sales	**100%**	100%	100%
Gross margin	**33%**	38%	37%
SG&A	**42%**	37%	37%
Operating income	**-9%**	2%	0%
Net income	**-11%**	0%	-2%

Exhibit 1, PML Case Study:

In the case study above, the key symptoms of business distress were a lack of profit, a lack of cash, late financial statements, and a growing chorus of concerned vendors. The underlying problems, however, were those of virtually every distressed company: the wrong person in the CEO slot, lack of a sound business plan, and lack of a system for ensuring accountability throughout the organization. These problems were the direct result of the culture of the family becoming the culture of the company.

The key steps to changing the culture and restoring profits were: changing leadership, preparing the company's first comprehensive business plan, implementing a management control system, controlling cash, reducing costs, controlling revenues, and restoring credibility with all stakeholders.

- The CEO, Ron Torland, effected a change in leadership by hiring the turnaround expert, Renee Fellman. Fellman, in turn, either eliminated positions of or replaced three-fourths of the management team.
- Fellman led, with participation by all key managers, preparation of PML's first comprehensive business plan which included strategy, tactics, and assignment of specific responsibilities.
- Using that plan as a basis, Fellman designed and implemented a management control system to ensure that personnel were held accountable and that targets were met.
- Fellman and Torland, working together, achieved control of cash by implementing an out-of-court Chapter 11, putting tight controls on purchasing, and using sound cash planning techniques.
- Far-reaching operational improvements coupled with renegotiation of vendor contracts resulted in dramatic cost reductions.
- PML was not able to increase revenues but was, in fact, able to stop the erosion of sales.
- Fellman and Torland, acting as a team, restored credibility by communicating fully with stakeholders — customers, creditors, employees, and family members — and by achieving the results projected during the planning process. They kept their commitments.

The turnaround would not have been successful without strong teamwork between Fellman and Torland. Fellman had full operating authority, including the authority to hire and fire. Torland managed cash, handled a flood of creditor calls, and provided advice about the company and industry to Fellman. Although he and Fellman did not discuss it at the time, Torland assumed an unofficial role; i.e., handling upset and disgruntled employees. Torland refrained absolutely from undercutting Fellman's authority. His ability to do that was essential to achieving a successful turnaround.

Fellman collaborated with a wide variety of professionals during the course of the engagement: an industrial engineer, two experts in finance, and experts in sales and marketing, facilities management, and recruiting. In addition, the company's attorneys played a vital role. Fellman also used a shadow consultant, a Ph.D. psychologist who provided advice about how to handle issues which arose with the family.

How did the family respond? Both Torland's father, Art, and brother-in-law, Doug, interfered with management of employees and were critical of Fellman. To solve those problems, Fellman and Torland met with the two, discussed the situation fully and openly and obtained agreement on a memo titled "Ground Rules for Family Members."

Overall, however, family members had a strong, positive impact on the success of the turnaround.

- Fellman appointed the former CIA agent as the new head of Customer Service. The resulting turnaround in that department was dramatic.

- Torland's aunt audited the phone bills after a new contract was implemented. The billing errors she uncovered saved the company money and provided badly needed cash at a critical time.

- Doug ultimately came to work as a PML employee and reported directly to Fellman. He made a remarkable difference in the bottom line by successfully tackling a series of cost-saving initiatives. Doug became an exceptionally strong contributor to the turnaround and, once actively involved in the effort, a strong supporter of Fellman.

In September of 1995, Torland and Fellman agreed that an outside, professional CEO should succeed Fellman and become the next CEO. The family balked. In fact, they objected vehemently for several months. Finally, at a family meeting, Torland persuaded them to acquiesce and to sign a document which was a part of their agreement with the new CEO. The agreement stipulated that family members would not interfere in management, that the new CEO would not be required to hire or retain any family members, and that the family would not replace him with a family member for a period of at least five years.

In addition, the family accepted Fellman's recommendation that they form an independent advisory board of experts in manufacturing, marketing, finance, and general management.

Fellman's results:

By the time Fellman left PML in early 1996, the company was more profitable than at any other time in its history. In recognition of her efforts, the International Turnaround Management Association gave Fellman the 1997 *Turnaround of the Year Award.*

In spite of the dramatic improvements, however, the new CEO still faced significant challenges. He implemented additional changes and has produced, year after year, improvements in the bottom line.

What are the lessons from the story of PML's turnaround?

- When the culture of the family becomes the culture of the business, a crisis can ensue which threatens the viability of the company.
- The causes of business distress are usually the wrong person in the CEO slot, the lack of a sound business plan, and the lack of a system for ensuring accountability throughout the organization.
- When a business is in distress, a change in leadership is almost always necessary, and a turnaround expert can provide critical, interim leadership.
- Professional advisors must be aware of the symptoms of trouble. Had PML's professional advisors recognized the symptoms and referred help earlier, the process of changing the culture and restoring profits could have been achieved with less pain and at a lower financial and emotional cost.

The following is a list of symptoms often found in troubled companies. (PML had some, but not all, of these):

EXHIBIT 2: KEY SYMPTOMS OF SERIOUS BUSINESS PROBLEMS

- Profits are declining, and/or the company is losing money.
- The company needs more cash but is having trouble finding it.
- Bank accounts are sometimes overdrawn.
- Company checks bounce.
- The company is out-of-compliance with its bank covenants.
- The current lender has asked the company to find a new lender.
- Vendors are calling for payment or have placed company on credit hold or COD.
- CEO feels like the business is out-of-control.
- Management does not meet its commitments to customers, vendors, lenders, and employees.
- There are persistent internal conflicts.
- The management team is always fighting fires instead of being able to solve underlying causes of problems.
- Internal financial statements are issued more than 15 days after month-end.
- There are frequent prior-period adjustments to company financial statements.

- The company is losing customers and is unable to reverse the trend.
- The company has trouble getting its customers to pay.
- Products and services are often late or not provided according to customer specifications.
- The company has no "real" board of directors.
- The company has no business plan or has a plan which is unmet.
- Your invoice is unpaid.

Times of special risk

- Management transitions
- Rapid growth/expansion/acquisition
- Consolidation
- Change to new information systems
- Sudden change in market place

Exhibit 2, Symptoms:

The following is a screening tool which can be used by family business advisors to establish whether there are significant problems which need to be addressed.

EXHIBIT 3: TOOL FOR UNCOVERING SYMPTOMS OF SERIOUS BUSINESS PROBLEMS

Each sentence with a box to its left is a symptom of underlying business problems. Each question is a tool to use to evaluate whether those symptoms are present and to determine what other kinds of problems the company is facing. Any unfavorable answer may indicate that the company is either headed for or in the midst of serious business problems.

- ■ **Profits are declining or the company is losing money, but management seems unable to reverse the trend.**
- Is the company operating at break-even? If so, for how long? One month? A year? More?
- Is the company making money or losing money? If losing, how long has that been the case?
- What actions have you taken to reverse the trend, and have those actions achieved the desired result?
- Is the company out-of-compliance with its bank covenants?
- ■ **The company needs more cash but is having trouble finding it.**
- Does the company have plenty of cash for its needs?
- Are the bank accounts ever overdrawn?
- Has any company check bounced?
- Are vendors giving the company their best payment terms?
- Do you ever get calls from vendors asking for payment?
- Has any vendor put your company on credit hold or COD?
- Has your bank moved the company's account to its troubled loan department and/or asked you to find other financing?
- If so, has the company been able to find substitute financing? Is this financing at a higher rate than its original loans?
- When was the company last able to afford employee salary increases?
- ■ **Financial statements are late, and there are frequent prior-period adjustments.**
- How soon after month-end do you get your financial statements? (Two days is excellent. Anything more than

thirty days is a sign of serious problems.)

- Do the results usually match what you expected?
- Do profits tend to swing dramatically from month to month?
- Does the CFO/VP Finance ever have to make prior-period adjustments? If so, how often?
- Did the company's accountants discover any major adjustments at year-end?

■ **CEO feels like the business is out-of-control.**

- Do you feel that you are running your business, or is your business running you?
- Is the management team constantly fighting fires instead of solving underlying problems?
- Are products or services ever late or not provided according to customer specifications?
- Are you facing persistent internal conflicts?
- Is the company losing any customers? Any major customers? If so, why? Have you been able to get them back?
- Does the company ever have trouble getting customers to pay? If so, why? (Poor credit risk? Wrong product? Other operational/product problem?)

■ **The company is unable to meet its commitments to vendors, customers, employees, lenders, and governmental entities.**

- When you make commitments to customers, vendors, lenders, and employees, are you always able to meet them?
- You haven't paid my bill for six months. Are you behind in payments to your other professional advisors, too? If so, what is the reason?
- Have you promised to pay a creditor or do something for a customer but been unable to keep that promise?

Exhibit 3, Screening Tool: