Transformation Practice

When do you need a chief restructuring officer?

When external shocks rock the business, a chief restructuring officer brings a specialized skill set to restructure the balance sheet.

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The CEO faced a difficult conversation; the company's leading secured lender was on the phone. Again. The company, one of Europe's leaders, had been buffeted by low margins and hard contract conditions in a challenging market. The cost base was expensive and too domestically oriented. Given that its balance sheet was overleveraged, covenants were at risk, and cash was rapidly depleting, the organization couldn't cope with the volatility inherent in its industry.

In less than a year, however, the ailing company's cash situation had stabilized, avoiding the possibility of an abrupt insolvency. The company had found new sources of liquidity, and millions of euros in working capital were freed up thanks to improved short-term cash management. Lenders and other key stakeholders got behind the balance-sheet restructuring.

What had the secured lender and CEO discussed? To paraphrase: that the company was on the edge of insolvency, and something needed to change to save it—now, before there was nothing left for stakeholders, including, for employees, their very jobs. That "something" was the balance sheet, specifically the overleveraged capital structure. But the particular skill set called for was not readily available. For the CEO and the board, there was only one solution that made sense: to bring in a chief restructuring officer (CRO).

In this article, we'll explore when and why companies need a CRO. We'll examine their special blend of analytical and functional expertise, which, when combined with an innate ability to communicate numbers, concepts, and solutions to people, can restructure a balance sheet. It's a blend of skills expected to be in increasing demand, as external shocks, such as the coronavirus pandemic, cause global economic uncertainty, hindering businesses' ability to manage their finances.

What—and who—is a CRO?

CROs have been active for a couple of decades, yet there are still only a finite number of people who specialize in the role. In the past, a CRO usually came out of an accounting firm as an insolvency practitioner or as an adviser to lenders doing independent reviews of companies. Today, a CRO might also come from the corporate world—a CEO who led a successful turnaround, for example, or a chief financial officer with financial-restructuring experience. In selecting a CRO, trust, chemistry, and the right situational experience is key.

The CRO's role is interim; if they can implement the restructuring programs quickly, their life span in any one job could be as short as a year or up to three years at the outside if it also encompasses an operational transformation. Once they've successfully completed the balance-sheet restructuring or subsequent transformation, they become free agents, ready to start a new assignment the next day.

CROs draw on an expansive financial tool kit but recognize that only certain tools will prove optimal in any given balance-sheet restructuring and that each situation is unique. CROs know how to stabilize the crisis and manage cash, when to raise equity, roll over debt, divest units, equitize debt, or work an insolvency process—and when not to.

Effective CROs are also exceptional people managers who strike a balance between challenging teams and offering support—leaders who both motivate people to change and hold them accountable, while rebuilding trust and consensus across multiple external stakeholder groups with differing views and objectives.

But CROs bring another trait that's crucial to their success, and it would be folly to shortchange its value: the ability to communicate the restructuring

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plan to the board, management, employees, secured lenders, shareholders, the pension regulator, the press, and any other key stakeholders.

In sum, a CRO is by nature rigorous, with a strong grip on numbers; a good negotiator; an empathetic leader; thick skinned—able to take the shots, deflect criticism, and reduce emotions; and gifted with the ability to connect with people. Of course, not all CROs are made the same—these success factors are markers of truly great CROs.

When a CRO is necessary

Ernest Hemingway once wrote that there are two ways to go bankrupt: gradually, and suddenly. Likewise, there are two typical situations where the skills and experience of a CRO may be a good fit for an organization:

— A balance-sheet event creeps up following a period of subpar performance and an erosion in balance-sheet resilience. Triggers can include a failure to respond to market changes, an inability to tackle new competitive behaviors, underdelivered integration programs, a failed major acquisition, or a situation in which the company might need new money and the equity owner has suddenly declined to fund it further.

— A significant external shock hits demand, prices, or the means and cost of doing business—all while the balance sheet lacks the resilience to withstand the exogenous event. These events could include, for example, the coronavirus pandemic, a broad financial crisis, a commodity-price drop, an economic recession, fraud, or litigation.

In either case, a CRO is signaled for when an outside event is expected to cause a breach of covenant or missed repayment on a loan, or a liquidity crisis and overleveraged balance sheet. The company's board of directors will typically appoint the CRO. This usually occurs on advice from legal counsel or other financial advisers, or when lenders encourage a balance-sheet restructuring due to heightened concerns about a company's ability to meet its covenants or service its liabilities as they fall due. The key is to be proactive to retain control, giving time to explore all options and to implement the preferred solution, rather than leaving too late when the company is about to run out of cash.

Why hire a CRO?

In our experience, there are six reasons to hire a CRO:

The company has insufficient management bandwidth. Restructuring situations are complex, time consuming, and high pressured. Full-time leadership is necessary to manage multiple moving parts, workstreams, and stakeholders and to successfully navigate the process to a conclusion. Unlike management, CROs can dedicate themselves totally to the successful completion of a restructuring (taking a huge amount of pressure off the shoulders of senior leaders). This frees up the management team to focus on the day-to-day company operations and execute the business plan without distraction. In that regard, the CRO acts as a buffer while "missiles" come from multiple directions.

Stakeholders want a trusted, independent view. An externally appointed CRO with a strong market reputation can quickly provide lenders and directors with an independent perspective on a company's situation, business plan, and restructuring options. Typically, a CRO reports directly to the CEO or the board (or chairman of the board); even when the CRO reports to the CEO, they act with full objectivity and have authority to raise issues to the board that are sometimes unresolved within the existing management team. The CRO acts solely in the interest of the company and its stakeholders, serving as an honest broker to quickly instill trust and confidence. CROs can be a sounding board when emotions run high or restructuring solutions need to be debated without bias. CROs have no history with the company, so they are willing to accept changes without getting defensive and do not tolerate any sacred cows.

CROs invest time with stakeholders to rebuild trust. A CRO at a care-home business had placed most of its properties in a large, complex, commercial mortgage-backed securities structure, which would face catastrophe if the business should fail and the company were unable to keep up with its obligations to bondholders. When the private-equity owners of the business said they were not going to provide additional funding, the management team was caught unaware, without a contingency plan, and faced default within a few weeks. They planned to file for insolvency. The CRO, however, had the necessary situational experience to see the company through the crisis. The business sought a standstill agreement, which allowed it time to negotiate with the secured lenders and implement a robust restructuring that reduced its debt burden by nearly 50 percent.

The CRO serves as an honest broker to quickly instill trust and confidence among all stakeholders.

Crisis requires a different mindset. In times of crisis, a company needs to shift to a "war footing." As an experienced practitioner who has been involved in many other restructuring situations, a CRO has the survival mindset needed to bring a relentless focus on cash. CROs know how to dislodge deeply entrenched processes in order to stabilize a company and provide the time to secure a restructuring deal, as well as how to reorient the business plan to underpin the restructuring and engender a bias to action that will help complete the process swiftly.

One European private-equity-owned company had spent more than a decade acquiring businesses but failed to integrate them properly. Expected synergies had become inflated costs. Serious operational problems surfaced after a major acquisition doubled the size of a large part of the business. Equity owners were able to buy time by injecting equity once. That kept restless lenders clamoring for lasting change at bay, recalls the CRO who was eventually brought in to right the ship after the private-equity firm declined to inject equity for a second time a year later. The CRO quickly and successfully stabilized the company's cash situation—achieving a standstill with secured lenders that bought time for new management to table a fresh business plan—and negotiated a consensual restructuring with key lenders that saw 80 percent of debt exchanged for new equity capital from the secured lenders.

Instability demands a decisive firefighter. Restructuring situations are breeding grounds for instability in supply-chain continuity, customer retention, and preservation of key staff. CROs' "been there, done that" experience allows them to counsel management to act decisively when navigating these risks while still keeping the business going as robustly as possible.

One CRO we spoke to emphasized the importance of focus. "You try to keep the business stable and moving forward while all of this noise goes on with regards to your capital structure," the CRO says. "If management isn't engaged in the business, and the business performance is not beginning to improve, that eats into the trust that you're trying to build back up with not only the secured lenders but also suppliers, employees, and customers."

Debt restructuring requires a specialist tool kit. A balance-sheet restructuring often means consideration of a wide range of very specific and highly technical tools, from "amend and extend" changes to loans to debt-for-equity swaps, debt or equity injections, M&A, and insolvency tools. These are almost impossible to find in a typical C-suite, leaving the executive team short when it most needs to be observant, anticipatory, and nimble. A CRO is on a first-name basis with these tools and can quickly prepare, propose, and implement an optimal solution. In addition, a CRO will always be on top of changes in the germane legal environment. A CEO at the helm of a London-based company, for example, may not know that the United Kingdom just introduced an alternative to schemes with ability to "cram down," or compromise, particular lenders in certain circumstances.[1] But a CRO most definitely would.

Interpersonal skills are important. CROs have done restructurings before, and that situational experience allows them to be calm, undistracted, and effective under immense pressure. Using a wide interpersonal skill set to "win the hearts and minds" of all involved, especially management, which sometimes resist the introduction of the CRO to its team. The CRO leads negotiations with lenders and needs to be a strong influencer who can secure commitment to the restructuring plan from all stakeholders. Lenders can be frustrated, and fairly so, the former CRO at the European private-equity company notes. When emotions run high, the CRO interprets the actions of secured lenders for the board to avoid the wrong reaction. Different stakeholder groups worry about parochial issues, so communications can't be one-size-fits-all.

[1] Corporate Insolvency and Governance Act 2020, legislation.gov.uk.

How CROs fix problems

Typically, CROs have four key objectives to ensure a successful restructuring: stabilize the balance sheet, plan the path forward, negotiate the restructuring plan, and expeditiously execute against the plan.

Stabilize. The immediate focus of the CRO is to stabilize the business and restore lenders' and shareholders' trust and confidence in the company. How?

First, the CRO will evaluate the current liquidity position and business plan to quantify the size of the problem and determine the runway available to complete a restructuring. Short-term cash management is a top priority; another is often some form of forbearance or standstill. The CRO will then talk with all stakeholders to understand the facts, issues, potential deal blockers, and emotions involved before communicating clear and concise messages that will reassure secured lenders, customers, suppliers, employees, and other key stakeholders as solutions are pursued.

Plan. In conjunction with financial advisers, the CRO then pressure-tests the business plan to find optimal restructuring options, such as a recapitalization, as well as contingency options, such as going through an insolvency process. In addition to debt and equity solutions, the CRO will also consider optimizing the balance sheet to release cash and reduce liabilities, for example, by divesting noncore businesses combined with a leaseback.

Negotiate. Developing proposals and negotiations is often the longest phase of the restructuring, and the most harrowing as the clock ticks and the risk of a liquidity shortfall rises. The talks can involve a complex group of stakeholders with competing objectives and opposing views as to the end state. CROs must act like the conductor of a symphonic orchestra—while they are not playing every instrument, they are coordinating the process and pulling strings whenever required to unite all parties in support of a final restructuring plan.

Execute. An effective CRO excels in project management, staying disciplined, and installing a steady restructuring cadence while working closely with financial advisers and lawyers to navigate any potential deal blockers and implement the agreed restructuring plan.

Finally, it is important to note that the CRO does not conduct alone—for what is an orchestra without its first chairs? The CRO will work with and rely on a supportive management team, an agile finance team, and strong financial advisers, public-relations professionals, and lawyers to successfully restructure the organization.

Amid ongoing global disruption, executives and board directors may increasingly face restructuring situations. A CRO brings a specialist mindset and tool kit that enhances an existing team and helps see the organization through a period of extreme crisis. The CRO shoulders the restructuring by working with a small, experienced team, allowing other executive leaders to focus on customers, suppliers, employees, and the daily running of the business. When trouble strikes, organizations should not be afraid to appoint a CRO, but rather, should embrace the opportunity to change the company's trajectory with their help and ensure long-term survival.

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