SUSTAINABLE RESTRUCTURING

If the restructuring of your company
should really be successful in the long term

EIP
EXECUTIVE
INTERIM PARTNERS

WHEN FAILURE IS NOT AN OPTION

INTRODUCTION - A LOOK AHEAD TO THE YEAR 2025

The German economy is in a severe crisis, marked by rising insolvencies, stagnant economic growth, and increased transformation pressure in key industries. According to leading economic research institutes, Germany will once again end 2024 with stagnant economic performance, similar to 2023.

The credit rating agency Creditreform reports that the number of corporate insolvencies in 2024 reached 22,400 cases, the highest level since 2015, with structural issues such as high energy and labor costs, as well as declining innovation capacity, severely impacting competitiveness.

The latest Roland Berger restructuring study concludes that 98% of experts anticipate further increases in restructuring pressure, particularly in the automotive industry, construction, and retail sectors. Bureaucracy and labor shortages are cited as the biggest growth inhibitors, while limited financing options for restructurings add to the challenges.

LBBW Research forecasts a slight decline in Germany's GDP by 0.2% in 2025, as declines in exports and investments hinder recovery. In contrast, GDP growth is projected for 2025 in the Eurozone (0.4%), the United States (2.9%), and China (5.2%), with global growth expected at 2.9%. Hopes rest on stabilized private consumption; however, political and economic uncertainty remains a key risk factor.

In addition to the companies that will be confronted with a liquidity crisis for the first time in 2023 and 2024, numerous "old" restructuring cases from the past will also arise again. In addition to many of these so-called zombie companies, which will continue to be restructuring cases in the forecast recessionary environment due to their high level of debt and rising interest rates at the same time, new companies will also be added that thought they had already successfully left the restructuring path. The reason for this is the fact that many restructuring processes of recent years have not been implemented sustainably and are therefore only temporarily effective.

A survey of the leading restructuring experts by the consulting firm Deloitte concludes that less than a third of the restructuring projects were able to remedy the strategic causes of the crisis. At the same time, the study assumes that restructuring is completed too early and that a comprehensive and therefore sustainable restructuring has not taken place. As a result, many restructuring cases will find themselves in a crisis again in the short or medium term.

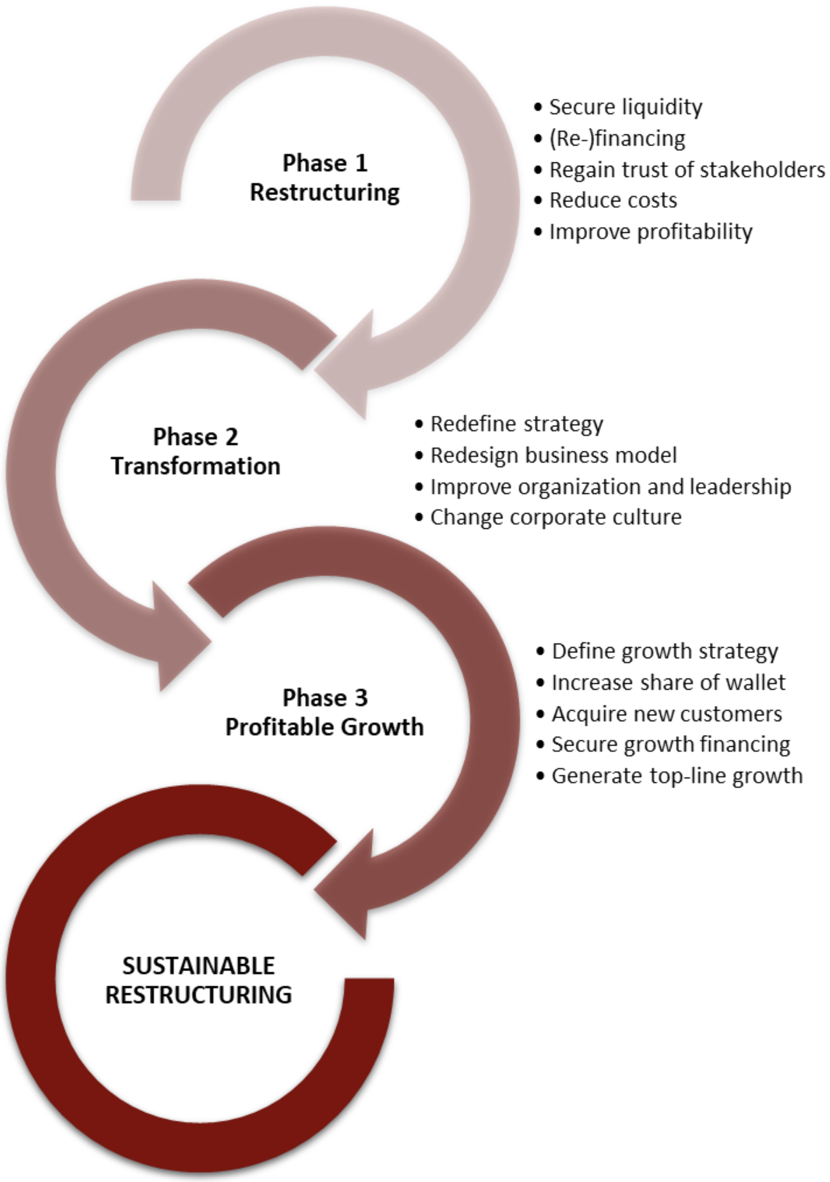
Our interim managers at EXECUTIVE INTERIM PARTNERS (EIP), who have been and are active as Chief Restructuring Officer (CRO) or Chief Transformation Officer (CTO) in various companies and in numerous restructuring situations from different industries, come to the same conclusion:

"The restructuring process is only sustainable
if it includes the fundamental transformation
of the underlying business model and leadership structure,
followed by the implementation of a strategy for profitable growth."

One of our EIP clients, an international automotive supplier, needed seven years and three IDW S6 reports from three different restructuring consultants, before the new management team was able to successfully shape the company's restructuring, including the transformation of the business model and realignment and implementation of the growth strategy, in the long term.

In order for a restructuring to be really successful in the long term, the following three phases in the restructuring process should be carried out and implemented consistently:

The process of "Sustainable Restructuring"



PHASE 1: RESTRUCTURING

In the first phase of “sustainable restructuring”, which takes six to a maximum of nine months, **measures to secure liquidity are implemented immediately in the event of a liquidity crisis** . This includes communicating policies and implementing an immediate spending freeze for non-essential operational expenses, for investments (capex Freeze), a hiring freeze for new employees and the implementation of short-term measures to reduce working capital.

In an EIP mandate at the subsidiary of a leading European aerospace group, we, as CRO, also deliberately implemented some symbolic measures to secure liquidity, such as the sale of the designer furniture in the boardroom and the subletting of floors of the representative company headquarters. The scrapping of old inventories, materials and systems that were no longer required and the termination of externally rented warehouses that were then no longer required also had a positive effect on liquidity and the internal awareness of management and employees for the crisis situation.

"In practice, unfortunately, restructuring processes are often initiated much too late because the management, the shareholders and other stakeholders act too late or (want to) perceive how existential the crisis is for them and their company."

Regaining trust through **active stakeholder management** is also one of the core tasks of a CRO. This includes the creation of transparency, internal and external communication of the company's acute crisis, which is also the basis for demanding restructuring contributions from all stakeholders. A successful restructuring cannot be realized without complete transparency, regaining trust and receiving appropriate restructuring contributions from all stakeholders.

For example, in one of our CRO mandates at a German automotive supplier, restructuring contributions included the **refinancing** through the prolongation of the existing debt financing for another four years by the banks, fresh equity funds from the shareholders, price concessions by customers, support of the works councils in the implementation of restructuring measures such as a plant closure and staff reductions in the administrative areas of the company headquarters.

In addition, further liquidity-saving measures must be implemented for **cost reductions,** that are effective in the short term. The lack of consistency and the ability to implement restructuring measures are often the reason why an earnings crisis grows into a liquidity crisis or why companies are unable to get out of it. The CRO/CEO of a medium-sized cable manufacturer achieved these savings by renegotiating purchasing conditions for prices and payment terms with its suppliers and by implementing measures for operational excellence, such as eliminating bottlenecks in production, reducing scrap and increasing throughput times.

In addition, measures to **secure and increase profitability** must be implemented. In the case of an international automotive supplier, this included terminating a customer with chronically negative margins or standardisation of product solutions and streamlining of the product portfolio.

PHASE 2: TRANSFORMATION

However, the implementation of short-term measures to secure liquidity and optimize costs after a successful restructuring process is not enough to put the company back for sustainable success.

"The entire existing business model must be critically examined and adapted to the current challenges and made fit for the future. Immediately following the successful restructuring, a fundamental transformation is therefore necessary to sustainably turn around a company that has fallen into crisis."

In the transformation phase, which can last at least twelve months, but often up to two years, the realignment of the **corporate strategy** takes place with the definition of a clear unique selling proposition (USP). If the business environment of an industry has changed permanently, the corporate strategy of the company must also be questioned and adapted or redeveloped. Top management and employees need a convincing vision of the future with clearly defined strategic goals in order to be motivated to work on sustainable restructuring and transformation.

At the same time, the existing **business model** must be readjusted or renewed on the basis of the new corporate strategy. In one of our EIP mandates in the media and publishing sector, the interim CEO and Chief Transformation Officer (CTO) had to convert the more print-oriented business model to new digital services and processes. Although the COVID pandemic increased the pressure to digitize in addition to the already advanced digitization of the competitors, there was great resistance in the management team, in the editorial department and the sales team to adapting the existing analogue business model. Only through the replacement of leadership positions in management, sales and editorial teams, the success of proactive sales of digital services and acquisition of new key account customers, the targeted reallocation of investments to digital products and services and the support of the works council throughout the transformation process, the digitization of the existing business model could be implemented.

These examples make it clear that with the existing **corporate culture** and **organizational and management structure,** a sustainable recovery of the company in crisis is not possible. At an international machinery and plant manufacturer for an EIP client, the resistance of the old management team to change was so great that a total of more than 30 managers had to leave the company and the structural and process organization had to be restructured (including the introduction of a project organization), before a successful and sustainable transformation was possible.

" You can't create a "high-performance company" with change-resistant low performers, but only with many high performers".

This also made it possible to create and establish a completely new corporate culture at both the media company and the international machinery and plant manufacturer.

As an important internal change there is also a need to switch from short-term measures for reducing cash outflows for investments, personnel costs, other operating costs and working capital to a permanent, structured and quantified management of these expenses. For this purpose, it makes sense to **implement practicable KPI systems**, where the responsible managers are forced to take a deeper look at the processes of the operative business through the regular exchange of deviations between target and actual. This can also lead to fundamental measures, the approach of which is elementary for the long-term competitiveness of the company. This includes, in particular, **digitization through the introduction of new IT systems** with their effects on internal company resources and processes, the necessity of which is already known but the implementation of ehich has been postponed. Ideally, the restructuring with its interventions has also increased the willingness to change in the organization for such far-reaching projects.

STAGE 3: SALES GROWTH

In the third and final phase of sustainable restructuring, the company must return to the growth path in phase 2 after the sales decline usually suffered before and during phase 1 restructuring and subsequent consolidation of the business model.usually suffered before and during phase 1 and the subsequent consolidation of the business model.

> *"Profitable top line revenue growth is an important part of sustainable restructuring to keep the company from being stuck in a loop of ongoing restructuring programs to only optimize the bottom line."*

The active management of **existing customers** with the aim of increasing the share of wallet, e.g.,. the proportion of a company as a supplier in the total purchasing volume of the customer supplied, was an important component for an interim CRO/CTO from EIP at a German Tier One automotive supplier company to increase sales and thereby sustainably restructure the company.

The interim CEO of the international plant manufacturer was able to sustainably increase sales and diversify and broaden the customer base through proactive **new customer acquisition** in other European countries and outside the existing customer portfolio (e.g. the construction of test stands for diesel vehicles of a Czech car manufacturer). The company developed a high level of resilience even during the subsequent COVID Pandemic, unlike its competitors.

At the same time, the interim CEO had to ensure sufficient **growth financing**. This was possible by regaining the trust of the financing banks through open communication and transparency as well as the rapid recovery of the company, visible through the significant increase in profitability and the generation of positive cash flows.

This economic recovery was also supported by **cost degression effects**, since despite the significant growth in sales after the restructuring and transformation, the realized sales growth of more than 30% had significant effects on earnings and liquidity. At the cable manufacturer was able to better utilize the existing production capacities. Due to the positive pressure caused by sales, the number of internal improvement suggestions from productive employees in production also increased, which led to a further increase in productivity.

Often, a **fourth phase** is necessary for sustainable restructuring, during which the company's long-term refinancing and growth must be implemented. This long-term refinancing is often achieved through a change in ownership as part of an M&A sales process, ensuring that the restructuring, business model transformation, and strategic realignment remain sustainably successful.

CONCLUSION

In the new year 2023, the ongoing, but also new geopolitical, economic and market-related or industry-specific disruptions will again plunge numerous companies into a liquidity crisis for the first – or even repeated - time.

The restructuring process is usually recognized and initiated too late, but is often completed far too early after the most acute liquidity and, in some cases, earnings crisis has been resolved, but a full and thus sustainable restructuring of the company has not yet been implemented.

If the restructuring of a company is to be really successful in the long term, profitable top-line sales growth must also be achieved after consistent restructuring and fundamental transformation of the business model.

The use of an interim manager as Chief Restructuring Officer or Chief Transformation Officer, who has extensive experience and proven success in sustainable restructurings and transformations in restructuring situations in the position as a board member or managing director, has proven to be critical to success in many cases in practice.

ABOUT EXECUTIVE INTERIM PARTNERS

Founded in Munich in 2005, **EXECUTIVE INTERIM PARTNERS** (EIP) is a leading organization and owner-managed partnership of experienced interim managers at the C-level, specializing in special situations that require immediate entrepreneurial action.

EXECUTIVE INTERIM PARTNERS consists of seasoned top-level managers at the executive and board level, who guide companies back on track, successfully manage special situations, and capitalize on opportunities. Unlike management consultants and intermediaries (providers/recruitment consultants), EIP partners personally take on temporary responsibility as interim executives or board members in your company to successfully implement restructurings, turnarounds, complex transformations, corporate sales, or M&A transactions.

The partners of **EXECUTIVE INTERIM PARTNERS** support you and your company as an interim manager, especially in special situations that require immediate entrepreneurial action, such as

- Restructurings
- Liquidity crises
- Refinancing/Recapitalizations
- Exit preparations and company sales
- Value enhancements/ Exit readiness
- Company acquisitions and integrations (PMI)
- Complex transformations
- Strategic corporate crises/Revenue and growth crises
- Operational turnarounds
- Leadership crises or leadership vacuums
- Digitalizations

All partners of **EXECUTIVE INTERIM PARTNERS** have a proven track record as managing directors and board members - as interim managers or in permanent positions. Approximately 80% of our mandates result from executive functions as interim managing directors or board members (e.g. as CEO, CRO, CFO, COO, CDO, or CSO).

Clients of **EXECUTIVE INTERIM PARTNERS** are medium-sized family businesses, corporations and portfolio companies of private equity firms.

ABOUT THE AUTHOR

Michael Hengstmann is the founder of and Managing Partner at Executive Interim Partners.

He is also a co-founding partner and Co-CEO at Management Capital Holding AG, a private equity firm investing in medium-sized companies.

Prior to joining Executive Interim Partners, Michael was a Partner and Managing Director at AlixPartners, the leading consulting firm for restructuring and turnarounds.

Before that, he was a Partner and Managing Director at One Equity Partners, previously the captive private equity fund of J.P. Morgan.

Michael started his professional career at a family-owned company. He later was Project Manager at Arthur Andersen and Partner and Managing Director at LEK Consulting.

Michael has more than 20 years of experience in executive management roles and complex restructuring mandates, specializing in interim management for operational and financial restructuring.

Michael served as interim Chief Restructuring Officer (CRO), Chief Executive Officer (CEO) and Chief Operating Officer (COO) in several German and international companies with a track record in successfully restructuring, refinancing and turning around companies in special situations.

He is serves and has served as Chairman or Member of the Supervisory Board at several companies in Germany and abroad.

Michael earned his Master of Science in Management with Excellence at Hult International Business School in Cambridge/USA (formerly Arthur D. Little School of Management) studied Business and Administration at the Universität of Duisburg/ Germany.

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