

Was it really only a scant few years ago that Silicon Valley was booming, dot.coms were the next big things and Nortel shares were trading at more than \$100?

David Menzies

Alas, there's nothing like a pinch of reality to pop an over-inflated hype bubble. These days, so many of those whiz-bang dot.coms are dot.goners; Nortel shares are penny stocks; and the busiest folks in Silicon Valley aren't new age high-tech gurus, but rather a legion of repo men towing BMW and Mercedes sports coupes back to the impound lot.

Since the turn of the new millennium, the business casualty list – especially in the IT sector – has become increasingly bloated. A *McKinsey Quarterly* report released last year determined that out of 492 software companies defined as “struggling,” only 13% were subsequently able to revive themselves. McKinsey noted that executing a turnaround in the software sector is an especially difficult task because at the first signs of trouble forces specific to the industry combine to create a deadly downward spiral.

Indeed, according to McKinsey, during boom times, the “land grab” mentality of most software companies drives them headlong into new geographies, products, channels and customer segments. Given the overriding importance of scale within the industry, this approach is not only sensible but also frequently imperative. When changing market conditions, strategic mistakes, new technologies or shifts in customer demand abruptly end the boom, companies that have grown unselectively or that have

neglected their core business find themselves saddled with bloated costs and with poorly defined products and services.

Yet, not all software vendors that have fallen on hard times in recent years have succumbed to bankruptcy. In fact, McKinsey notes that a software firm can indeed engineer a turnaround if the following challenges are addressed:

- It revitalizes its core business.
- It invests in new category killers.
- It ruthlessly cuts everywhere else.

As well, a would-be turnaround champion in the software realm must also regain the trust of financial markets by achieving liquidity, profitability and growth. Finally, to attract and retain talent and to create a commitment-based culture and organization, the company must staff a core turnaround team – and then empower it to act quickly.

While the *McKinsey Quarterly* notes that embracing these strategies is easier said than done, they are nevertheless achievable, pointing to such examples as PeopleSoft and Intuit. There are other examples as well, including two firms in the medical industry – Ormed Information Systems Ltd. and MediSolution. *Electronic Healthcare* recently spoke to the principals of these two Canadian-based software companies to see how they were able to emerge triumphantly from the jaws of defeat. Here are their stories.

ORMED INFORMATION SYSTEMS LTD.

Usually around Christmas-time, most people are thinking about flying south or going on a shopping safari or simply looking forward to spending some quiet quality time with the family. But just a week and a half prior to Christmas Day 2000, Chris Sherback, chairman and CEO of Edmonton-based Ormed Information Systems Ltd., received a surprise phone call from his bank, HSBC. It might as well have been the Grinch on the other end of the line calling long-distance from Whoville.

Concerned that Ormed was going to emerge as yet another bankruptcy statistic like so many of the dot.gones that were littering the business landscape at the time, the HSBC decided to call in its loan of \$350,000. Once the darling of the investing and banking scene, high tech was starting to look more like high-risk, and the bank had compiled a hit list of companies that it deemed as being a tad too risky for its liking.

For Ormed, the timing of the bank's new strategy could not have been worse. "The banks entice you to join them by telling you they understand your business and your industry, and then, at the first sign of trouble, they don't even have the expertise on staff to look a little closer," says Sherback. "The problem is we got caught in an expansion mode as the market suddenly contracted."

But Ormed and its products, he maintains, were always fundamentally sound. Ormed's dilemma partly stemmed from its desire to go public via a reverse takeover in August of that year. A target of \$5 million was set, with a \$3 million minimum. However, Ormed was only able to raise \$2.35 million, "which is frankly excellent considering the fact that everyone else got nothing because the markets were collapsing," notes Sherback. "But we had a shortfall of \$650,000, which our bank was very uncomfortable with."

By way of background, Ormed, established in 1989, designs products that allow healthcare facilities to become more efficient. Specifically, Ormed products are designed for supply chain management, inventory control and operating room management – essentially, all the areas affecting the consumption, supply, finances and

efficiency of a healthcare operation.

Demand for Ormed's products grew quickly over the years, with revenues jumping from \$1 million to \$5 million in just five years, despite healthcare being "a double-edged sword," in the words of Sherback. "On the one hand, if you get the business, it's a stable business – healthcare will always be there. But on the other hand, it's not about to jump on the latest fad."

Ormed, however, did a good selling job and began to expand geographically. Beyond Alberta, the company made forays into British Columbia, followed by Saskatchewan, the Northwest Territories and Nova Scotia. By 1998, Ormed was starting to make inroads into the United States. (While minuscule in size compared to the likes of Oracle or SAP, Sherback says Ormed offers products that are typically five to 10 times less expensive and, as an added bonus, are written specifically for the needs of the healthcare market.) In 1996, Ormed staffers orchestrated an employee buy-out. A major benefit of the buy-out, says Sherback, was that Ormed was left with a stable labour force.

Fast-forward to December 2000 and things were looking grim, especially since "we [Ormed executives] had personal guarantees with the banks as well ... the banks were coming after our homes." However, Sherback notes that a notice of intention to restructure Ormed kept the wolves at bay. "Also, we offered our creditors 100 cents on the dollar so we couldn't imagine any creditor voting against that." As well, to demonstrate their faith in the company, Sherback and a couple of shareholders withdrew approximately \$50,000 from their RRSPs to reinvest into the company.

Ormed filed its restructuring notice in December 2001, and by March 2002 the company had received unanimous creditor approval. Little wonder: as Sherback notes, "The trustees valued our bankruptcy at zero. Our assets [i.e., brainpower] are riding the elevators up and down every day."

Sherback was also able to prune Ormed's expenses down to \$1.2 million from more than \$4 million previously. The payroll, meanwhile, was slashed from 75 to 25 employees. "We had always been a company of about 25 people, but

we tripled to 75 in order to build this new technology. So when it was done, we didn't need all the labour."

Expenses were dramatically cut as well. As Sherback notes, Ormed now sells and installs its products via the Internet. "We've avoided travel costs, which are enormous, and we have the ability of having one trainer train 20 people at once rather than just one person at a time."

Ironically, Sherback attests that the "new" Ormed is better positioned than its previous incarnation thanks to HSBC's surprise phone call more than two years ago. "Although we are in a restructuring state, we are probably better off than the companies that aren't restructuring because they are facing the exact same market slowdown we're facing but they have obsolete product," says Sherback, pointing out that Ormed has not lost a contract in more than a year.

"This product we have built is so efficient and we can install it so quickly, we can make up the difference in volume in recurring maintenance fees," he adds, noting that Ormed used to ring up about 10 new sales per year but has generated more than 50 qualified sales leads since the beginning of 2002. "We're now in a situation where we can book enough work to last us the next couple of years," says Sherback. "And most important, it will allow us to deploy our product into the market when our competitors are extremely weak, thereby shifting the balance of that penetration so we'll have larger market share. Even those very few who can compete with the technology cannot compete with the price."

From many perspectives, the forced restructuring process has actually resulted in Ormed changing for the better. For example, 2002 revenue was more than \$4 million – which represents double the industry norm of \$100,000 of revenue per employee. "We're still a ship at sea, while many other ships have sunk and some are burning where they sit," says Sherback. "We're operating under our own steam and doing very well from that perspective. Many of our competitors are facing the market slowdown with obsolete product and lots of debt on their balance sheets. Not us."

MEDISOLUTION

Throughout its 25-year history, MediSolution's blueprint for rapid growth has always been via rapid and timely acquisition. Over the years it gobbled up a payroll services business based in London, Ontario; a retail pharmacy business in Calgary; a patient administration software company based out of Edmonton; and a U.S. company orientated on financial and administrative solutions for healthcare. Slowly but surely, MediSolution ballooned into the largest Canadian IT vendor for healthcare – not a shabby achievement for a small Quebec company that started off in the payroll services business 25 years ago.

Alas, the irony cannot go unnoticed that it was an acquisition that very nearly proved to be MediSolution's death knell. In early 2001, MediSolution acquired Markcare, a PACS vendor, for \$8 million. Based in the United Kingdom with an office in New Jersey, the acquisition was problematic from the beginning given that other PACS vendors represented a Who's Who list of deep-pocketed technological titans, including the likes of GE, Siemens, Agfa and Fuji.

"MediSolution bought this tiny little company that thought it had the capability of competing with these large companies with hundreds of millions of dollars to spend," says Allan Lin, who took over as president, CEO and all-around saviour in April 2002. "Overnight, we found that it [Markcare] required almost \$1 million in cash to keep it alive – that was a very, very unexpected surprise. What it really said was our due diligence processes were not as tight as they should've been. [The acquisition] put a burden on the company that it could not support."

While there were other "bad investments" prior to the Markcare deal, Lin says this particular deal "was the straw that broke the camel's back."

Also prior to Lin's arrival, MediSolution was making significant investments in e-commerce. Soon, the payroll ballooned from 350 to 500 employees – yet there was almost no incremental revenue to show for the staffing-up tick. Worse yet was the fact that the Markcare deal had been financed with borrowed money.

Indeed, Brascan Financial Corporation, which had made loans to MediSolution in early 2001, was being asked to put more money into the now ailing company. Instead, Brascan examined the business thoroughly. The consensus: if it hadn't been for so many dubious deals and ill-thought-out acquisitions (the Markcare deal by far being the worst) MediSolution would never have found itself in such a hole. "They [Brascan] decided they wouldn't invest anymore in the company unless it was cleaned up, and they wanted to make changes on the senior management team," says Lin, a former Xerox veteran of 27 years.

For starters, the top five members of the senior management team were asked to leave. As well, all but one of the members of the board of directors were asked to step down. The mission statement was clear: restore the company to financial health in the Canadian marketplace and re-establish a growth pattern – before it was too late. "A large part of the work was to determine what is our core business and then to be kind of ruthless about getting out of the [businesses] we shouldn't be in," recalls Lin.

Not surprisingly, the albatross-like Markcare business was jettisoned, along with the company's e-commerce division and practice management division. "A number of these divisions, such as practice management, were low margin businesses and our value-add was not significant," says Lin.

As for Markcare, "We didn't have the wherewithal to compete with the big guys," he says. "I don't know what the [previous executive team] was thinking. I can't imagine that you could think of taking a company that was close to bankruptcy [Markcare] and then turn it into something that could compete against GE Medical. [Acquiring] Markcare was due to a lack of due diligence and just not having a product that could keep pace with the market."

Lin notes that in 2001 MediSolution had revenue of \$39 million and a \$50 million loss. About \$10 million of the loss was "what I would call the ongoing operation part of our business, and that was very disturbing because that's the part you have to make a business with." The other \$40 million, meanwhile, represented one-time write-downs of various assets.

Brascan wanted Lin to eliminate the \$10 million operating loss and turn it into a small positive. For the first two quarters of 2002, the company was slightly better than breakeven, says Lin. Lin also went about trimming the company's payroll. "We used to have 550 people – now we're down to 340. We've shed about \$1 million in annual savings of facility space. We have been very quick to resize our business model."

Lin's other major initiative involved replacing half the senior management team by the first half of 2002. "We needed a lot of energy and the right leadership from the senior management team," he says. "Most [former employees] had been sourced from healthcare – meaning bureaucrats – but you need the odd businessman too. Often in healthcare, there's a feeling that 'profit' is a dirty word. I needed to strengthen the business component. At the end of the day, we are not a government-run, non-profit organization – we're here to make a profit."

The ongoing turnaround doesn't have just MediSolution breathing a sigh of relief – so too are the hospitals and healthcare institutions that use MediSolution products. "The customers are delighted," notes Lin, "because hospitals don't invest in systems for one or two years – they invest in systems for 10 or 15 years. They are delighted that we've gone from the edge of the precipice staring down to being the best-financed healthcare company in IT." **E**

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