



Addressing Performance Decline via Restructuring

*PLC Transformation Program
7 August 2023*

Rethinking
Balance Sheets

Sage 3

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Today's Presenters

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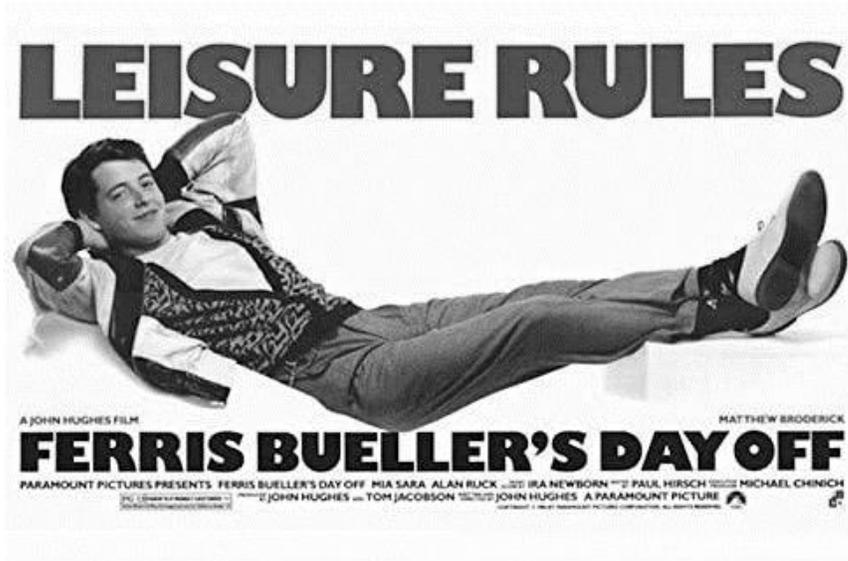
Who is attending today?



“Sometimes it's the people no one imagines anything of who do the things that no one can imagine.”

- Alan Turing

What are we doing today?



“Life moves pretty fast. If you don't stop and look around once in a while, you could miss it.”

- Ferris Bueller

What are we covering today?

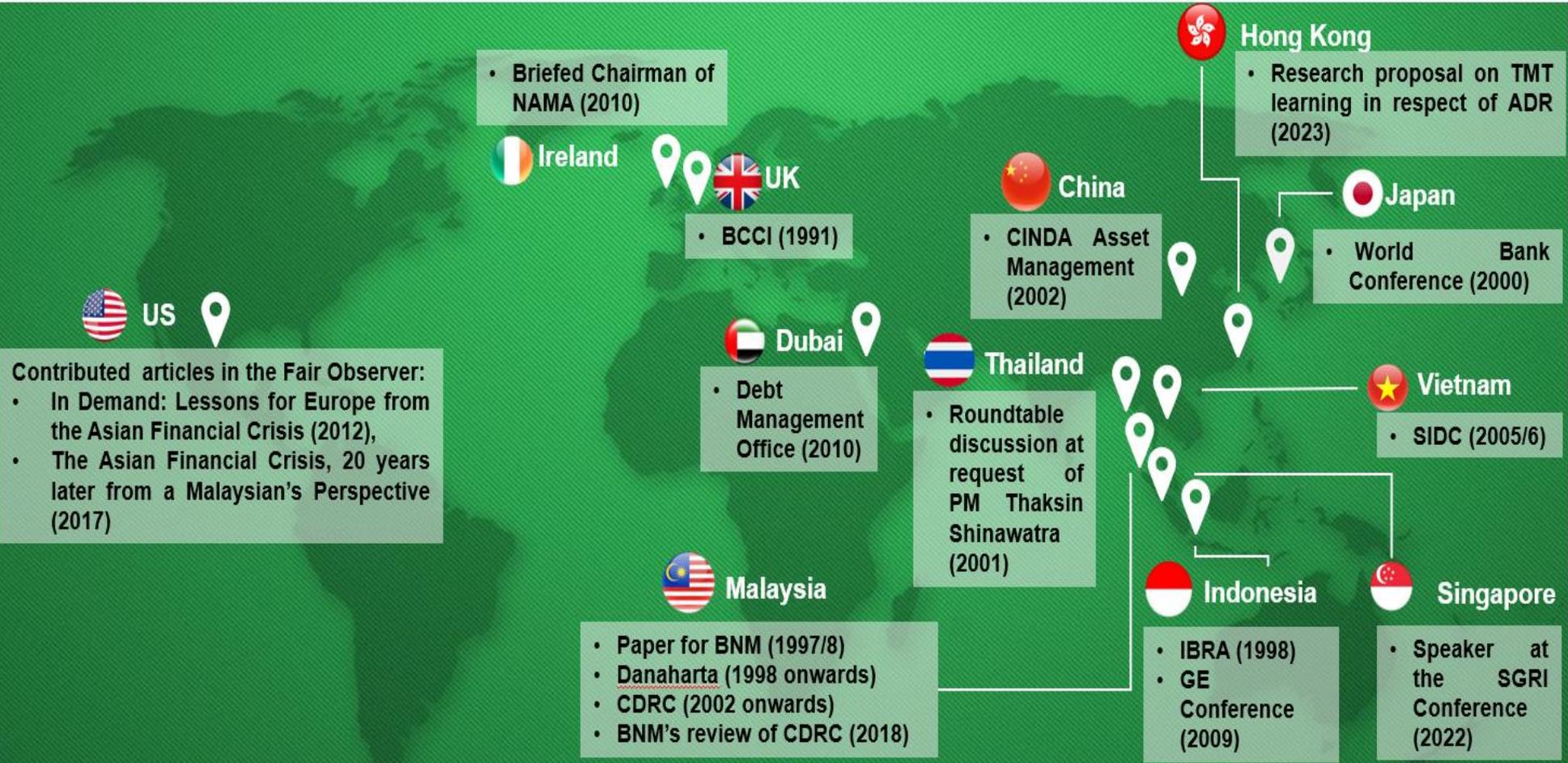
Program agenda

- Presentation by Sage 3 – Addressing Performance Decline vide Restructuring
- Coffee Break
- Presentation by Norton Rose
- Presentation by SC Lowy
- Case study by Sage 3
- Lunch



Ravindran Navaratnam

Executive Director of Sage 3



Since 2015, I have had discussions with several prominent thought leaders in banking crisis including Prof Altman, Prof Steve Keen, Andrew Kemp Collier, Lord Adair Turner and Yanis Varoufakis

Experience

Sage 3

Clientele

Publications

Edge Weekly

My Say: Revitalisation of the corporate sector is urgent but how can it be done fairly and quickly?



Davin Kenneth Fernandez
Executive Director of Sage 3

Sage 3

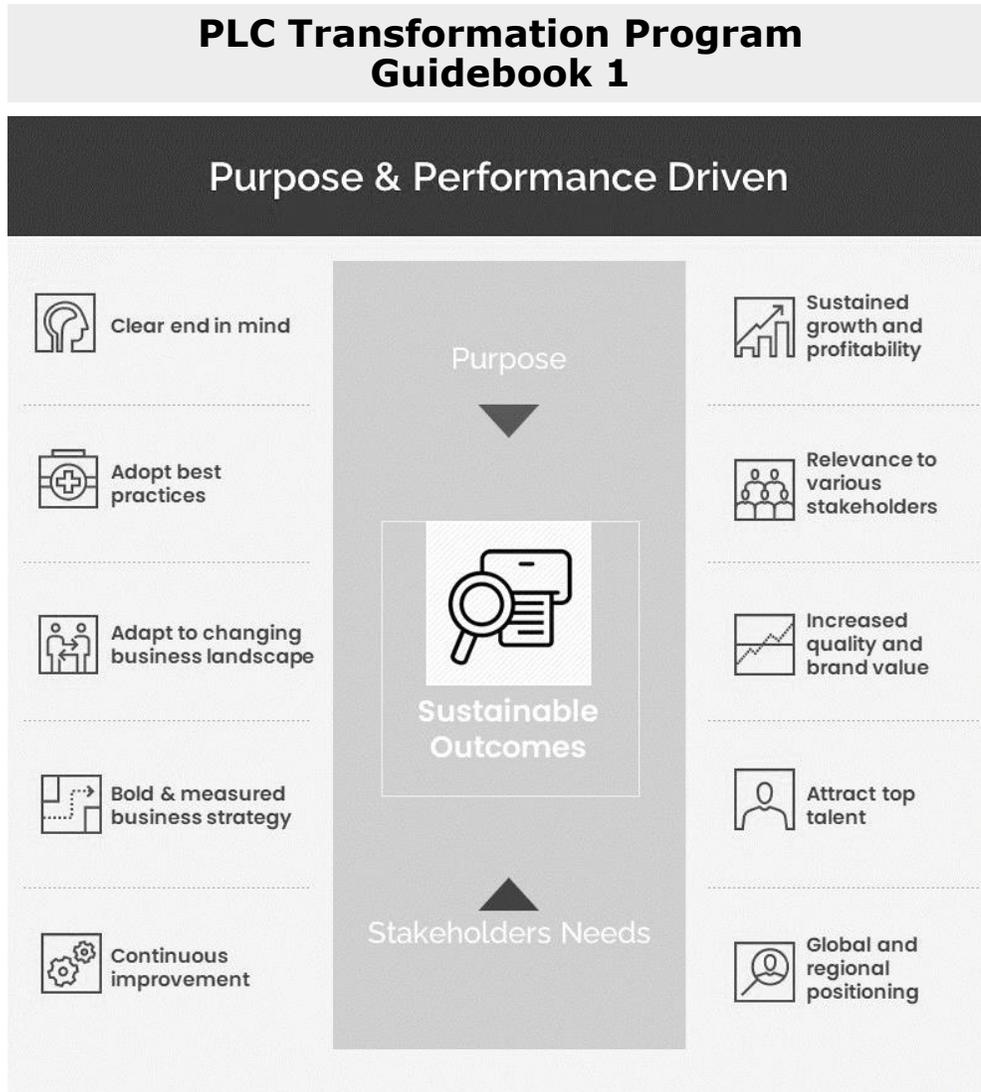


*Rethinking
Balance Sheets*



- ❑ Overseen numerous substantial corporate transactions, includes debt restructuring, financing and M&A.
- ❑ Successful implementation of the RM5 billion corporate restructuring of Megasteel Sdn Bhd. ***"We would like to thank Sage 3 for the exceptional work and expert guidance" - Megasteel***
- ❑ Successfully completed the restructuring and lifting of PN 17 designation. ***"Your ability to build consensus as well as escalate issues for resolution, all factors that contributed ultimately to success" - Client***
- ❑ M&A success stories include Acquisition of Malakoff (RM9.3 billion) and Johor Port (RM426 million) for the MMC Group, and acquisition of stakes in Bank Muamalat (RM1.01 billion) and EON (RM1.3 billion) for DRB-HICOM

What are Bursa's objectives & how will today's workshop support it?



01

How this program assists Purpose and Performance driven PLCs

02

Identifying the downcycle and undertaking appropriate action

During times of growing economic uncertainty, our main priority is to restructure firms experiencing a decline in performance. Sage 3 achieves this through the application of **management science**, backed by **25 years** of experience and expertise, as well as our extensive experience in working on restructuring debt assets worth **RM30 billion**.

What are the topics covered in the first session?

1 Performance Decline & Top Management Team ("TMT") Characteristics Influencing their Response



2 Implication for Listed Companies in Severe Distress & Debtor in Possession Restructuring



3 Fair & Equitable Restructuring and the outcome in Restructuring



4 Type of restructuring and workstreams to deliver the restructuring



5 Organization Issue & Behavioral Issues in a restructuring



6 Framework for restructuring and how do PLCs build capacity



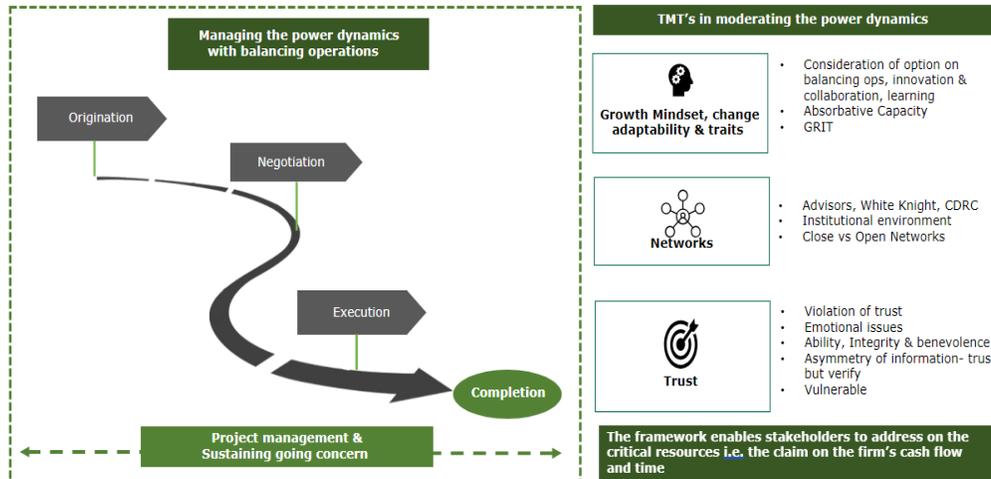
Learning Outcomes:

- Understanding performance decline & its outcome
- Learning the action items required by TMT to mitigate & improve situations of performance decline
- Understanding types of restructuring, the critical work streams and phases
- Understanding the power dynamics during restructuring, the TMT mindset and behavioural issues

How does the 1st session connect with the case study session?

1st Session

An applicable framework:



Boundary conditions TMT's acceptance of the problem & belief it can be resolved, business viability and stakeholders committed to consensus-based approach

2nd Session

Reinforcing the application of the framework through a case study:

A Sage 3 Case Study

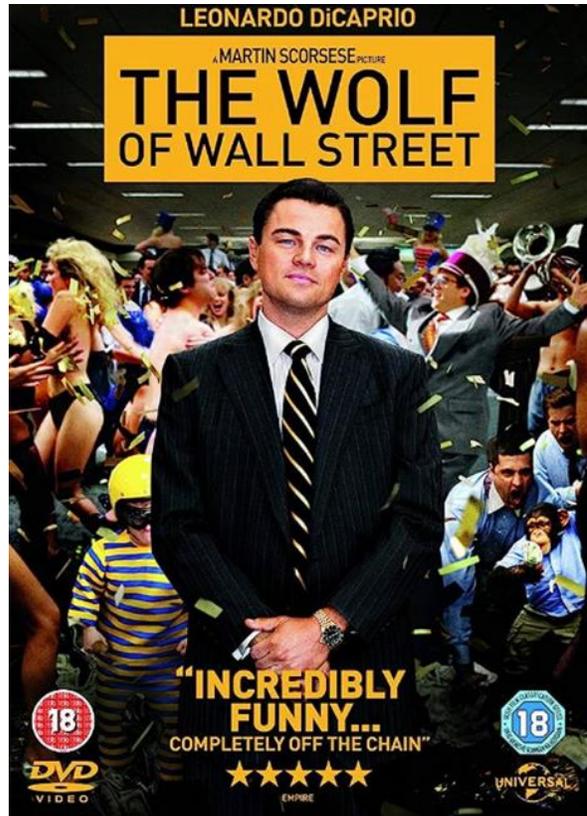
"If this company can restructure, anyone can restructure."

- Former Head of Operations, CDRC

Rethinking Balance Sheets

Sage 3

How do we define performance decline and how should the Top Management Team (TMT) respond ?



“The only thing standing between you and your goal is the story you keep telling yourself as to why you can't achieve it.”

- Jordan Belfort

How is performance decline evaluated?

Performance Measure	Description
Profitability	<ul style="list-style-type: none">Decreasing & increasing profitability for a set time period (e.g. 3 years)
Profitability relative to an objective financial benchmark	<ul style="list-style-type: none">Firm's profitability falls short of an objective financial benchmark (e.g. 5% return on investment or the risk-free rate)
Proximity to bankruptcy	<ul style="list-style-type: none">Firms facing increased & decreased bankruptcy risk
Slack resources	<ul style="list-style-type: none">Firm's increasing & decreasing level of financial cushion (i.e. slack)
Expert panel/ business press	<ul style="list-style-type: none">Defined by experts outside a firm (e.g. stock analyst, consultants, academicians)Firms receiving increasing & decreasing performance ratings
Stakeholder opinion	<ul style="list-style-type: none">Defined by stakeholder perspective (e.g. employees, stockholders or local community)Firms facing withdrawn & renewed stakeholder support

What happens in near bankruptcy / performance decline situations?



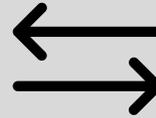
**Termination
or Reduction
of Current
Banking
Facilities**



**Reduced
Access to
Financing**



**Resignation
of key
personnel**



**Credit Term
Changes with
Trade
Creditors**

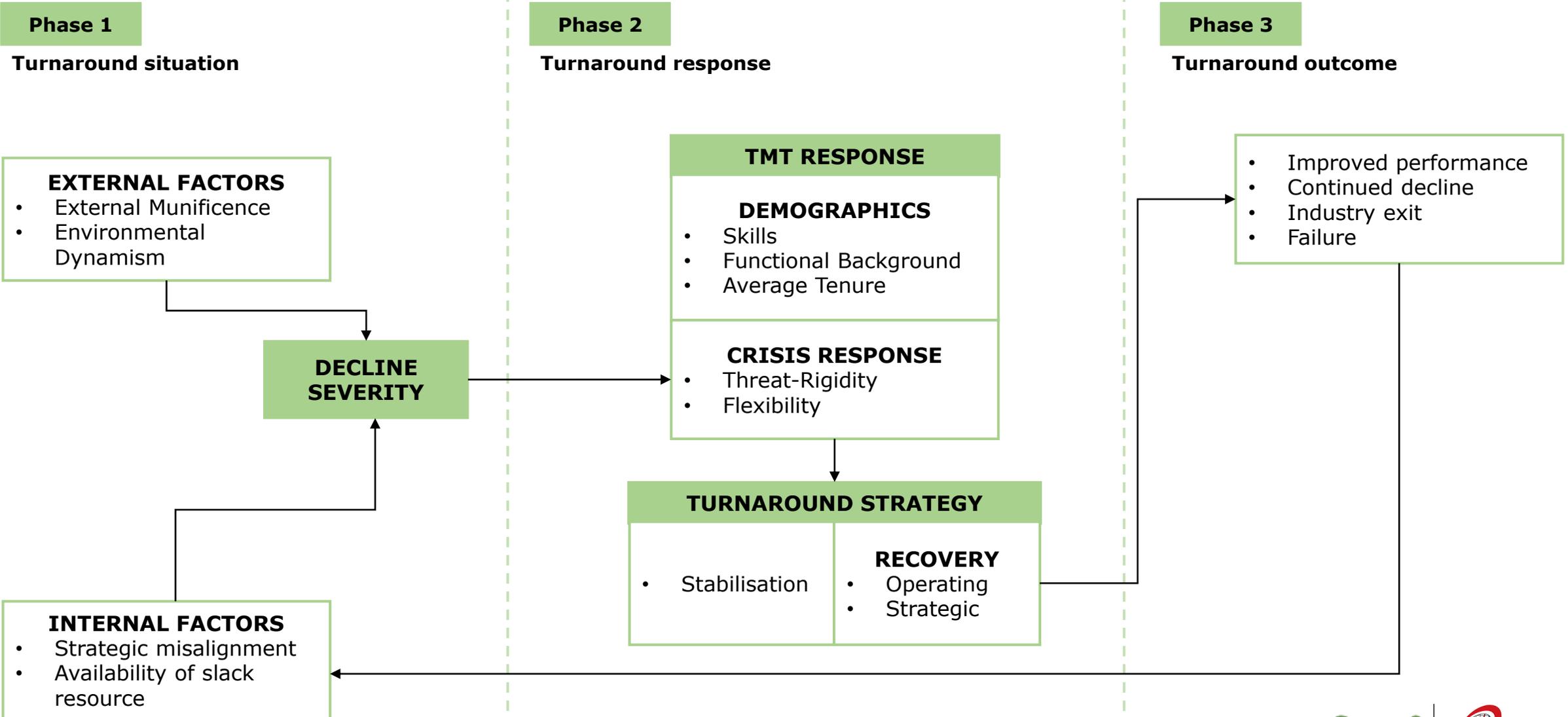


**Supply
Disruption**



Legal Action

How do we logically think about decline to understand actions and outcomes?



What are the critical considerations in “Phase 1”?

Causes of Decline

External

1. External factors impact firms differently, but **responsiveness** plays a **key role**.
2. Industry decline can result from **reduced environmental support** for growth.
3. **Heightened variability in competitive intensity** and customer demands can also contribute to industry-based decline.
4. Certain industries may experience both **reduced environmental support** and **increased dynamism** due to deregulation

Internal

1. **Faulty TMT decisions** can misalign a **firm's strategy** with its **task environment**, ignoring environmental changes.
2. Strategic misalignment arises when TMT **neglects to update** products, address weaknesses, cut costs, or avoid unwise expansions.
3. **Insufficient slack resources** can further worsen a firm's decline.

What are critical considerations in Phase 2 ?

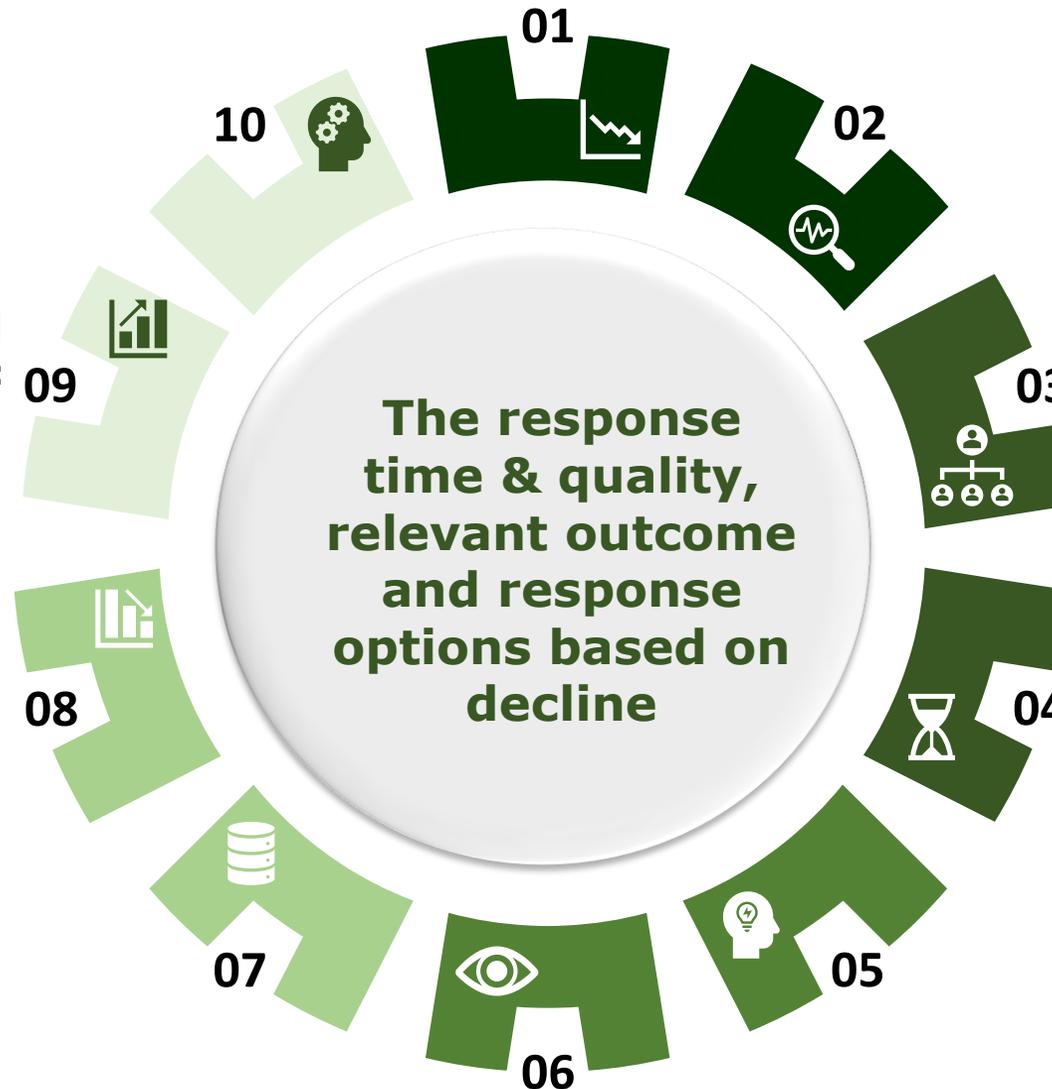
High-severity decline and limited resources require **quick** decisions to **prevent** immediate failure

Firms with low-severity decline and resources have more **strategic** options

Severity of decline affects **viable** decisions for the TMT

Success involves **efficiency, stabilization,** and stakeholder **support**

TMT demographics and **crisis response** impact turnaround strategies



A decline **prompts** action from the TMT for recovery

TMT's inability to **respond effectively** can lead to continued decline and failure

Inappropriate TMT responses make it **harder**, causing loss of support and resources

TMT's must make **informed** and **quick** decisions during decline to facilitate recovery

Even in challenging situations, **well-informed** strategies by TMTs can turn around firms

What are critical considerations in Phase 2 after stabilization?

TMT

Identify the cause of a firm's decline to initiate recovery

Make decisions to facilitate recovery through two strategies

Decline due to a cyclical downswing in munificence.

Operating Turnaround

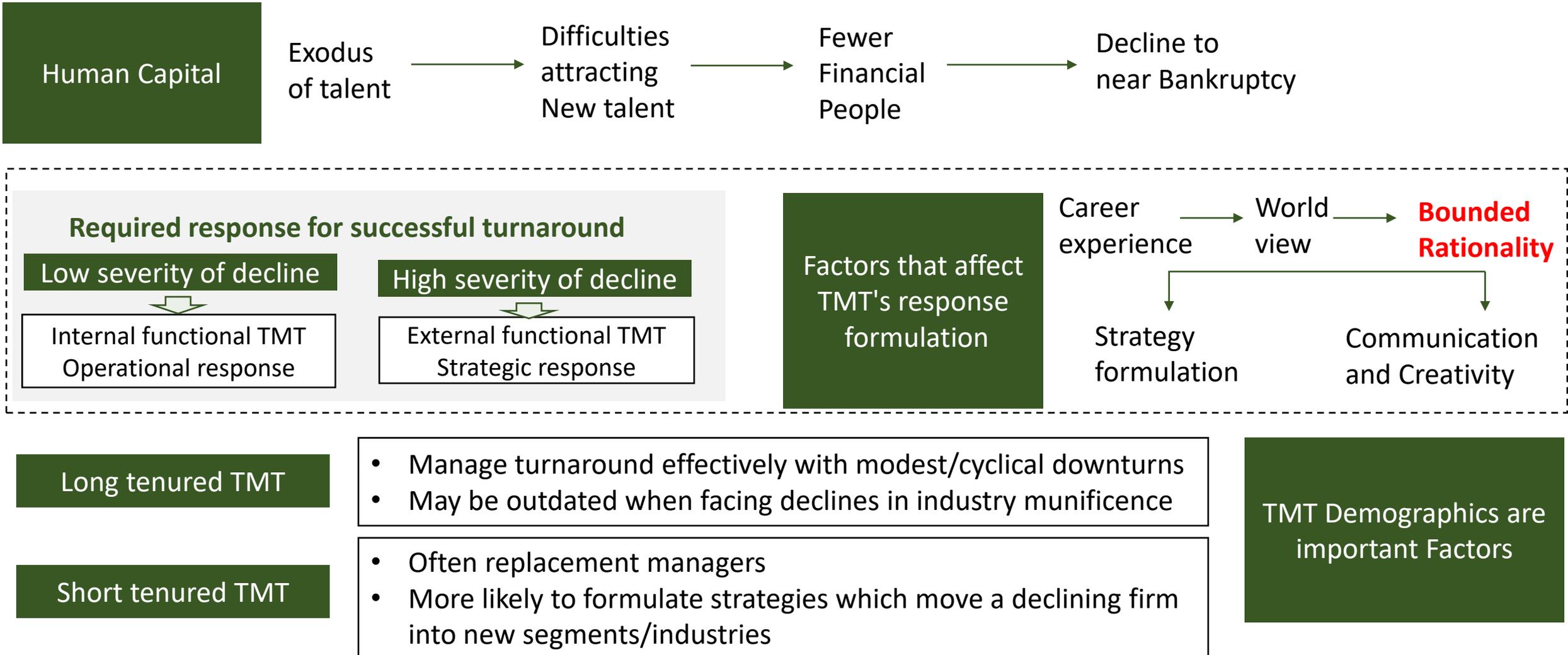
Strategy: Focuses on increasing long-term efficiency.

Decline if its strategy becomes misaligned with its changing task environment.

Strategic Turnaround

Strategy: Involves changing the firm's strategic position in the marketplace.

What research tells us about TMT demographics?



What does research from psychology and sociology tell us regarding crisis response of TMT?

Crisis as the 'Mother of Rigidity' and 'Crisis as the Mother of Innovation'

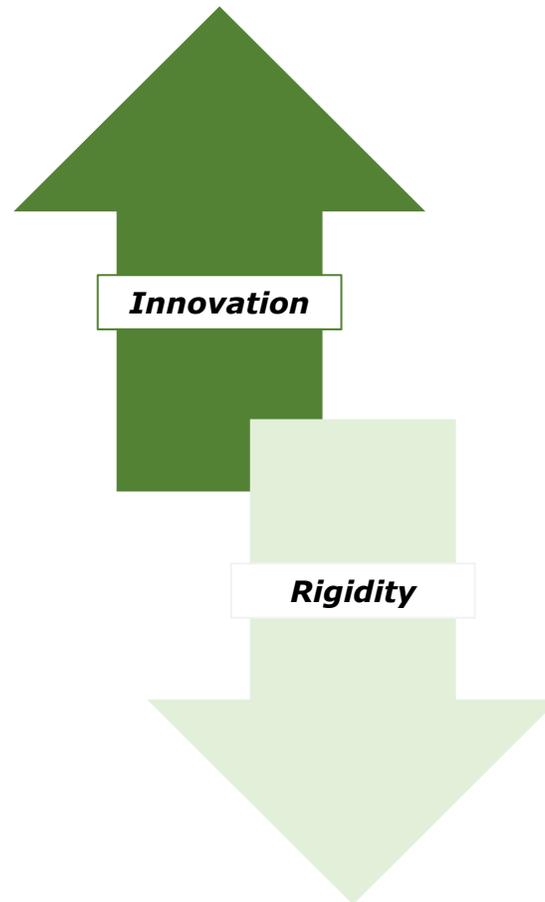
Innovative decision-making routines and strategies

i.e., imposing high risk strategies to turn around a declining performance.

BTOF proposes that a firm's decline prompts TMTs to formulate strategies to improve performance.

Prospect theory:

- When faced with a loss, TMTs will pursue riskier strategies as a mean of loss avoidance.
- TMTs in declining firms may formulate hyperactive strategy changes that exacerbate a downward spiral to bankruptcy.



Conservative decision-making routines and strategies

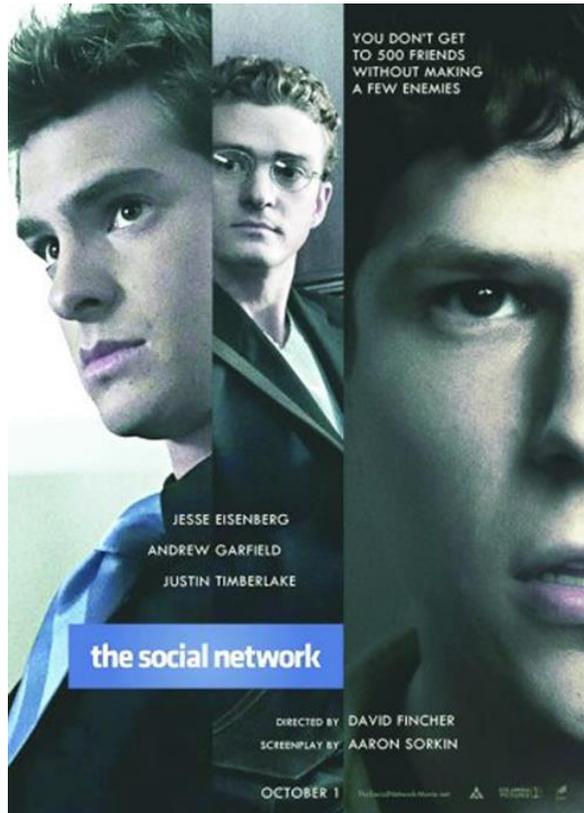
Centralised authority and decisions on past routines contributes to decline due to external forces.

Decreased TMT participation in decision-making, adherence to existing procedures and cutting down workforce may arise due to lack of fundings.

Financially distressed firms face a decline of their competitive advantage.

TMTs exhibited rigidity response when facing increasing environmental instability.

What happens to a listed company in severe distress?



“A million dollars isn't cool. You know what's cool? A billion dollars”

- Sean Parker

What are important characteristics of TMT essential for formulating and implementing strategic response?

Awareness

Scanning behaviors:

TMTs will have somewhat accurate interpretations of environmental trends depending on amount of scanning.

Cognitive complexity:

TMTs process information differently based on their level of cognitive complexity.

Motivational

Causal attributions:

TMTs that attribute decline to internal and external causes will be somewhat likely, respectively, to take actions necessary to promote a firm's turn around.

Self-interests:

Absence of sufficient controls, managerial self-interest rather than stockholder wealth maximization may guide TMT decision-making.

Capabilities

Power:

TMT members have varying degrees of power with which to influence strategic decision-making.

Resources:

TMT skills and abilities based on human capital, social capital, and managerial cognition represent potential strategic assets that may provide a firm with a competitive advantage.

How can enforcement action be triggered & what are the steps necessary for PLC to take?

Prescribed Criteria

1. Low consolidated share capital (<25%)
2. Appointment of receivers/managers/judicial managers
3. Subsidiary/ associated company winding up
4. Adverse/disclaimer opinion by auditors
5. Going concern uncertainty (<50% equity)
6. Payment default, solvency declaration inability



Compulsory Actions

Appointment of Principal Advisor



Formation of Due Diligence Working Group



Announcements to be made monthly



Details required in Regularisation Plan

Should TMT believe PN 17 enforcement action can be easily resolved?

**The submission of the regularisation plan is
within 12 months**

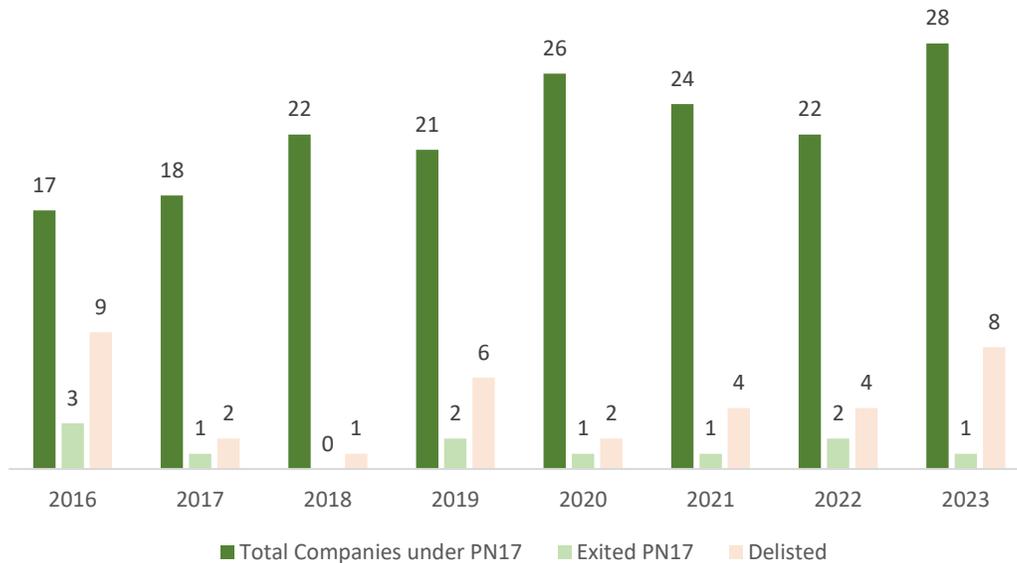
**Chances of emerging from
PN 17**

Cost and Opportunity

“There is moral obligation to resolve and above all be fair and equitable ”

What are the chances & opportunity costs ?

Chances of emerging from PN17 classification



The average number of companies being delisted is higher than the ones which exited

Opportunity cost of PN 17



Z' score provides earlier identification of companies with potential for distress in comparison to Z score which is purely accounting based.

How does Debtor-in-Possession compare to alternatives?

Liquidation

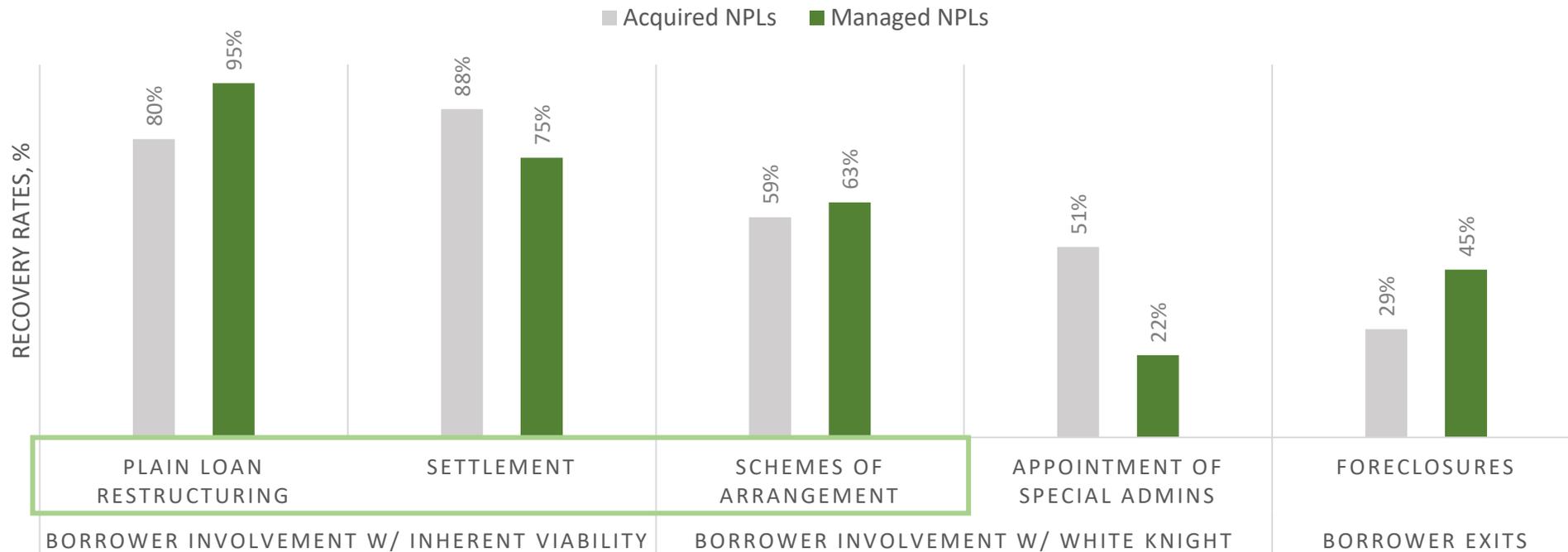
Borrower	What Happened in Liquidation?
 <p>Paper Mill</p>	<ul style="list-style-type: none"> Recycled paper supply not secured. Electricity never reconnected. Working plant could not be demonstrated to prospective buyers. Tenders failed to achieve even lower reserve price. Borrower reported recovery against capital of only 4.5%.
 <p>O&G Service Provider</p>	<ul style="list-style-type: none"> Recovery of rigs in Singapore yard is problematic because of amounts due to authorities and rigs being dismantled into parts. Difficulty to recover on Gen sets for Bangladesh project which were specific for the purpose (not easy to find new PPA). Nominal recovery around 1-2% & ONGC contract lost
 <p>Scrap Merchant Dealer</p>	<ul style="list-style-type: none"> Copper in bonded warehouse at substantially lower value. Original valuation on land for borrowing purpose, optimistic. Best estimate 10% recovery
 <p>Optical Disc Manufacturer</p>	<ul style="list-style-type: none"> No material recovery other than building but far less than valuation. Long drawn-out legal action against auditors.

Managed Disposal & Investor

Scenario	Example
<p>Only effective for large scale prime/strategic assets</p>	<ul style="list-style-type: none"> Geely-Proton (M&A) Reliance-Hualon (vide R&M) GSH Corp-Sutera Harbour (Scheme) E.g. 1MDB (hold co) – CGN Group-Edra IWH-CREC-Bandar Malaysia Projects
<p>Unresolved issues for years</p>	<ul style="list-style-type: none"> Asia Petroleum Hub InnoBio Vivobio SKVE Pewaja Steel
<p>Mid-sized businesses difficulty to attract investors</p>	<ul style="list-style-type: none"> SAAG CHH SPM Metals Sectors - O&G & iron and steel Perisai Drilling

What is evidence of Debtor-in-Possession effectiveness during AFC?

RECOVERY FROM VARIOUS RECOVERY METHODS



Options available to TMT:

1. trade out

2. managed disposal or

3. restructuring



relate to the 1st 3 methods vide debtor-in possession debt resolution

Why is it so difficult to execute a comprehensive restructuring of the balance sheet ?



Many moving parts



Trust



Skills



Characteristics and traits of TMT



Turnaround is comprehensive



Viability



Funding



Adaptability & absorptive capacity



Power imbalance



Sustaining going concern



Psychology i.e., escalation, loss aversion , etc.



Auditors are exceptionally cautious

Where may the solution be to improve the chances of a comprehensive restructuring?

Companies Admitted to CDRC since GFC	Advisor	On-going	Completed/ Discharged	Uncompleted/ Terminated
Megasteel Sdn Bhd	S3		✓(Managed Disposal)	
Perwaja Steel Sdn. Bhd.	S3 (resigned)			✓(Liquidated)
Perisai Petroleum	S3/EY		✓ (Manage Disposal)	
Jasa Merin ^{1,2}	S3		✓ (challenges)	
Perdana (extended to Dayang) ²	S3		✓	
Alam Maritim Resources Berhad (2018)	EY		✓ (Defaulted)	
Icon Offshore Berhad ²	S3/EY		✓	
Sarawak Cable Berhad	EY		✓	
Daya Materials Berhad	S3		✓	
Sentoria Group Berhad	EY		✓	
Nam Cheong Dockyard Sdn Bhd	S3	✓ (AIP obtained)		
Alam Maritim Resources Berhad (2021)	S3		(AIP obtained, WK pulled out)	✓(Ongoing ³)
Sapura Energy Berhad	S3/PWC	✓		

Special Case: Dayang– Not admitted but assisted by CDRC due to Danajamin guarantee provided to Dayang

Note:

¹ Jasa Merin TMT proposed restructuring replaced Sage 3 proposal

² Avoided PN17 even though loan defaulted given special dispensation for CDRC cases

³ Ongoing debtor in possession effort but sage 3 no longer involved

How do we achieve fair and equitable restructuring?



**“It's not easy to stand alone against the
ridicule of others. You've got to be
courageous”**

- 12 Angry Men

Do traditional approaches deliver fair and equitable settlement?

Business falls into distress and liquidation scenario

The table below shows the balance sheets as a business moves from a going concern towards liquidation.

Items (RM)	(A)	(B)	(C)
Asset	100	70	20
Total assets	100	70	20
Borrowings	80	80	80
Retained profits/(loss)	10	(20)	(70)
Shareholding	10	10	10
Total liabilities & equity	100	70	20

Approaches

Approach 1 – Liquidation Plus Offer

Approach 2 - Concessionary waiver of unsecured portion

Approach 3 - Debt sustained in full (roll over)

Do traditional approaches deliver fair and equitable settlement... con't ?

	Approach 1	Approach 2	Approach 3
Distribution			
Creditors (Borrowings)	25	50	60
Shareholders	35	10	Nil
Gain or Loss			
Creditors	(45) ^a	(20) ^b	(10) ^c
Shareholders	23	(2)	(20)
Effect on New Money			
On Rm 10	9 ^d	nil ^e	(10) ^f
Legacy share capital			
On post restructuring capital	2 ^g	(2) ^h	(10) ⁱ
Recovery to creditors			
On the original RM 80	44%	75%	88%

Observations with new money of RM10 post-restructuring disposal of RM60

- All have higher recovery to creditors compared to liquidation of 25%;
- Approach 1 is undesirable; breaches first loss principle;
- Approach 2 is undesirable because new money is disadvantaged;
- Approach 3 is wholly unacceptable because new money suffers immediate losses.

What is the solution?

Understanding the enterprise going concern value with new money:

- EV of RM 52 pre money
- New Money of RM 8 i.e. investment at discount of RM 2
- Followed by a disposal at RM 60

	Equitable approach
Distribution	
Creditors (Borrowings)	30
Shareholders	30
Effect on New Money	
RM 10	2
Legacy share capital	
On the original RM 20	Fully written off
Recovery to creditors	
On original RM 80	62.5%

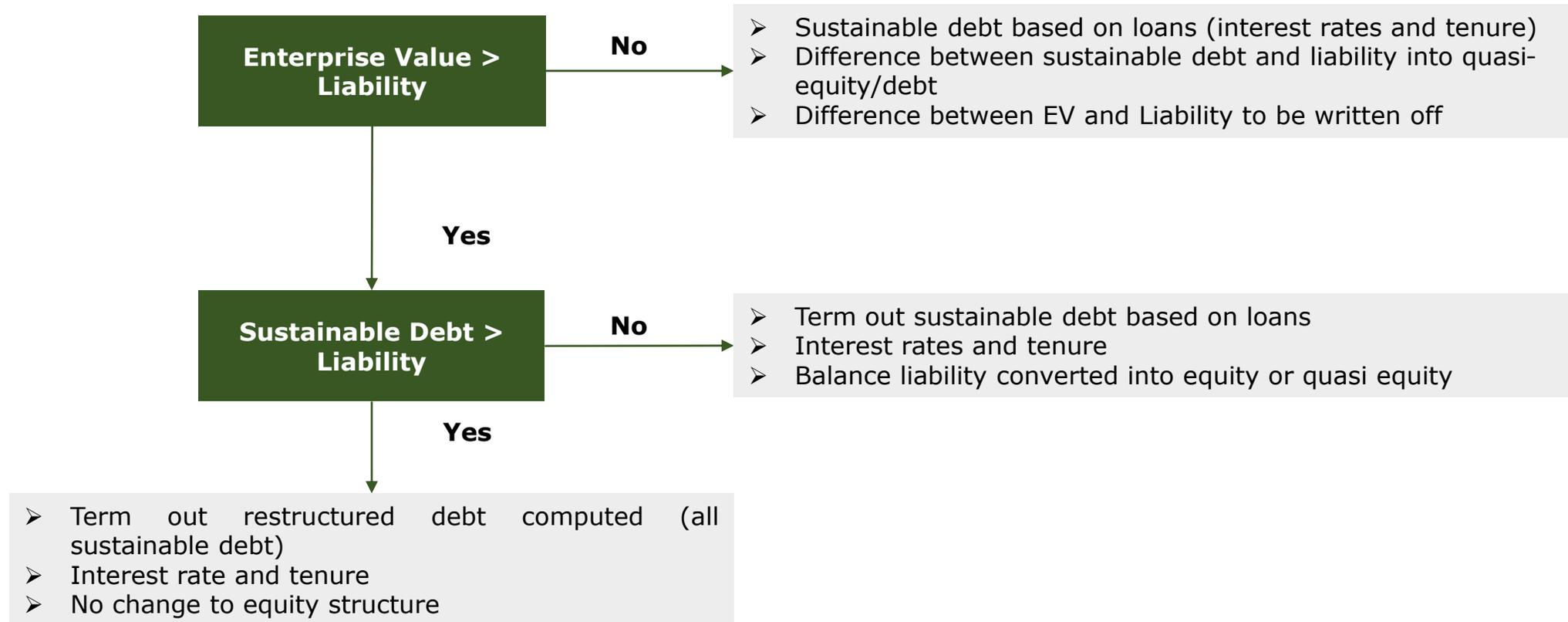
Comparison with 3 earlier approaches:

There is fairness achieved in terms of the debt restructuring exercise as the following are achieved:

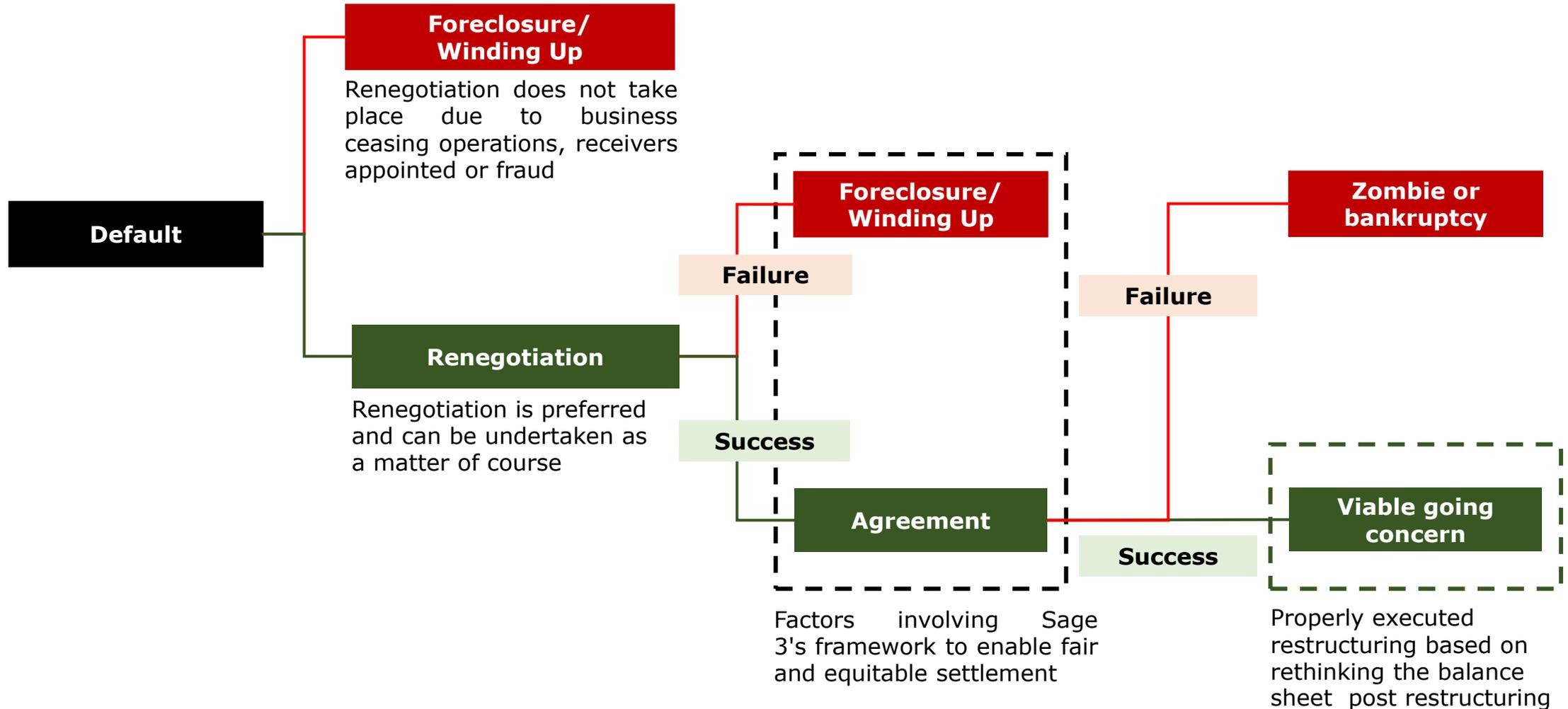
- New Money enjoys a return of 25% commensurate with expectation of the upper end returns in distress investment, i.e. RM 8 invested and RM 10 returned; and
- Creditors accept a waiver of 37.5% but existing shareholders are fully written down.

How to apply this EV & sustainable debt to the restructuring process?

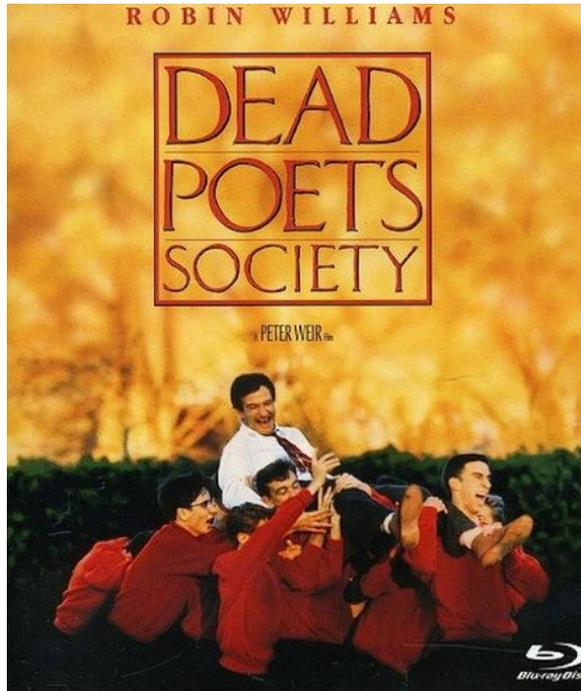
Allocation of Enterprise Value



Why is it important to apply the process correctly?



What action does the TMT need to take?



“Carpe Diem”

What are the critical work streams and phases?



Origination Phase

- Sets the foundation & establishes the objectives, strategy, and framework for restructuring.
- Viability, cause of decline has been addressed and contribution to solution, enterprise value and sustainable debt, derive settlement terms and comparator normally liquidation scenario



Negotiation Phase

- Company, their advisors and creditors seek to reach agreements on key aspects of the restructuring scheme.
- Involves discussion on needs and wants of all parties.
- Navigating negotiations require effective communication, compromise, and finding mutually beneficial solutions to address the concerns of all parties involved.



Execution Phase

- Requires careful planning, coordination, and effective implementation.
- Key is to work closely with relevant stakeholders, adapting to changing circumstances to successfully achieve the desired outcome of the restructuring.
- Ensure compliance with relevant guidelines/regulations to ensure upliftment from PN17 designation



Project Management & Sustaining Going Concern

Top management to:

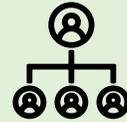
- Sustain going concern has two important facets – addressing legal threats and liquidity
- Provide effective leadership guides the company through the restructuring process via transparent communication, making tough decisions, and ensure fairness.

What does restructuring in distress encompass?



Asset Restructuring

- The disposal of high-valued/ underperforming/ non-core assets;
- Unlocking value of assets to align seamlessly with the Company's business plan going forward.



Operational Restructuring

- Restructuring of the ground operations and procedures (bidding process, workflows etc);
- Initiates cost reduction and value creation activities;
- Streamlining to reduce or remove redundancies in organizational structure.



Financial Restructuring

- Restructuring the balance sheet of the Company;
- Develop an optimal capital structure based on business plan and projections



What does a TMT need to be aware of?



**“Your focus determines
your reality.”**

- Qui-Gon Jinn



On immediate demand of facilities to be settled what are the critical considerations regarding heterogenous creditors?

Resources

- Claim on cash flow and time.

Secured creditors

- Level of security cover affects the preference and power of creditors.
- Can take possession of assets, sell the assets to recover loan.
- Typically favor liquidation, while unsecured creditors support firm reorganization.
- Secured creditors with more collateral are more likely to sell assets, while under-secured creditors may not.
- Secured creditors' approval is necessary for a reorganization plan to be accepted.

Impact of demand from secured creditors

- A disparity & conflict can exist between creditors in addressing financial distress situations.

Impact of partial sales of assets

- Negatively impact the business' economies of scale.

Creditor density

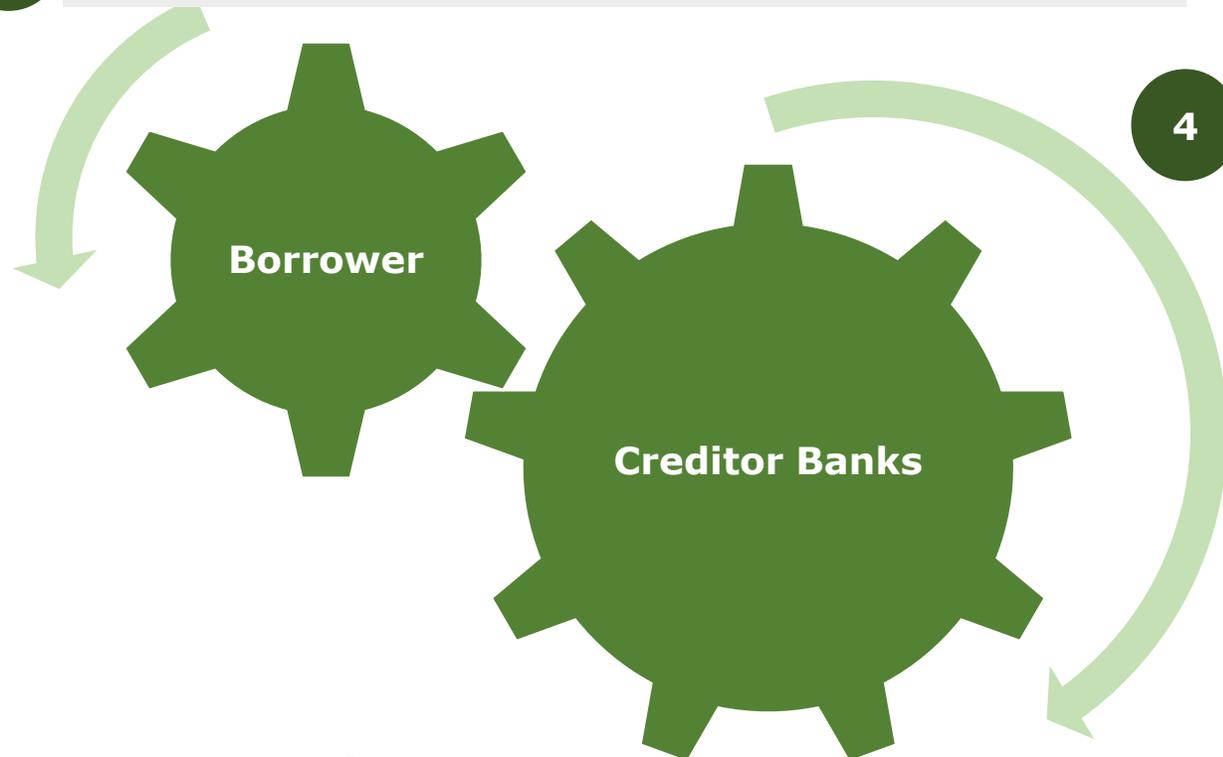
- Creditor density as well as bargaining or cooptative mode plays a role.

Borrowers try to minimize the power differential with creditor banks during restructuring

What are the power dynamics at play?

2 Borrower can employ various approaches to resist immediate payment demands by the creditor banks.

3 Borrower presents a restructuring proposal that serves as a motivational factor for creditor banks to move away.



1 Creditor banks have the power to demand immediate payment or liquidate as an alternative.

4

The banks' ability to overcome this resistance is determined by the power set out in the loan and security documentation, with the option of liquidation (legitimate power).



The extent of this power depends on the characteristics of the borrower's business and assets, including the alienable and inalienable assets and their value.

What can the borrower do to minimize/reduce the power differential?

Balancing operations

Withdrawal

- Borrowers initiate "motivational withdrawal" by ending the restructuring process.
- The focal firm may hand over the business to creditors through voluntary liquidation.

Extension of Power Network

- The focal firm relies on creditor banks for operating cash flow and repayment leniency.
- By including a white knight in the firm's network, dependence on bank cash flow is reduced.

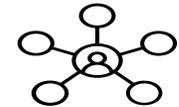
Moderates by facilitating or reducing the need for balancing



Growth Mindset,
change adaptability
& traits



Growth Mindset,
change adaptability
& traits



Network

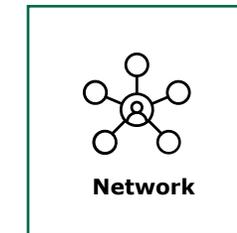
What does the borrower do to minimize the power differential?... Cont'd

Balancing operations

Emergence of Status

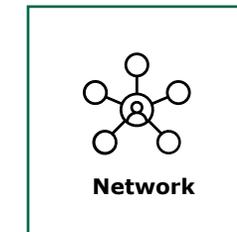
- Creditors are motivated to sustain operations if claims on cash flows increases or accelerated.
- E.g. Focal firms increase upfront payments and facilitate managed disposal to generate cash for creditors.

Moderates by enabling or Reducing the need for balancing



Coalition forming

- Borrowers admitted to CDRC mediation with creditor banks in restructuring parties functioning as a group.
1. Role-Prescriptions - Specifications of behavior which all group members expect (demand) of one or more but not all members.
 2. Group Norms - Specifications of behavior which all group members expect of all group members.



How is the balancing operation delivered?

9 Dimensions of influence

Influence Tactic	Description
Pressure	The actor uses demands, threats, or intimidation to increase the target's compliance.
Legitimation	The actor attempts to legitimize a request for compliance or claim the right to request it by referencing existing policy or tradition.
Exchange	The actor uses implicit or explicit promises to reciprocate if the target complies.
Coalition	The actor obtains the aid of others to help persuade or pressure the target to comply.
Ingratiation	The actor attempts to make a favorable impression and improve the target's mood before requesting compliance.
Rational persuasor	The actor uses logical arguments and factual information to support the viability of complying with the request.
Inspirational appeal	The actor makes an emotional appeal for compliance by appealing to the target's values and ideals.
Consultation	The actor seeks the target's participation in the decision-making process and the implementation of the request.
Personal appeal	The actor appeals to the target's sense of loyalty or friendship before requesting compliance.



Rational persuasion

Negotiator A	Negotiator B
Settlement from $U_{a(b)}$ Creditor portion of EV or Managed Disposal	Settlement from $U_{b(a)}$ Shareholder portion of EV or Managed Disposal
Expected recovery from $U_{a(alt)}$ Liquidation scenario for Creditor	Expected recovery from $U_{b(alt)}$ Liquidation scenario for shareholder

Negotiator A is Creditor Banks and Negotiator B is borrower

$$U_{a(b)} = Q_{a(b)} \times P_{a(b)} \times W_{b(a)}$$

Where Q=quantity = amount of resources; P = probability =likelihood of obtaining resources; W= weight = importance of resources

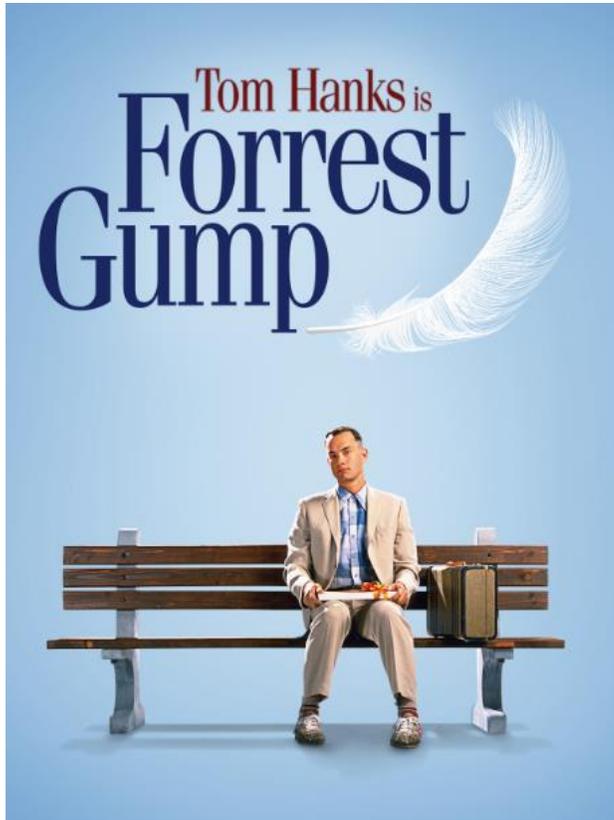
Reaching agreement

$$Total\ Utility = U_{a(b)} + U_{b(a)} - U_{a(alt)} - U_{b(alt)}$$

$$Surplus\ Utility = U_{(Total)} - U_{a(alt)} - U_{b(alt)}$$

- In a restructuring, dividing surplus value between a borrower and creditor banks is challenging
- Quantifying contributions, maintaining the going concern value, is difficult
- A rule of thumb approach is often used, allocating more surplus to creditors and less to the focal firm
- This allocation reflects the difference between debt and equity positions in a liquidation
- Measurable contributions like New Money from shareholders can significantly impact the surplus utility to favor them

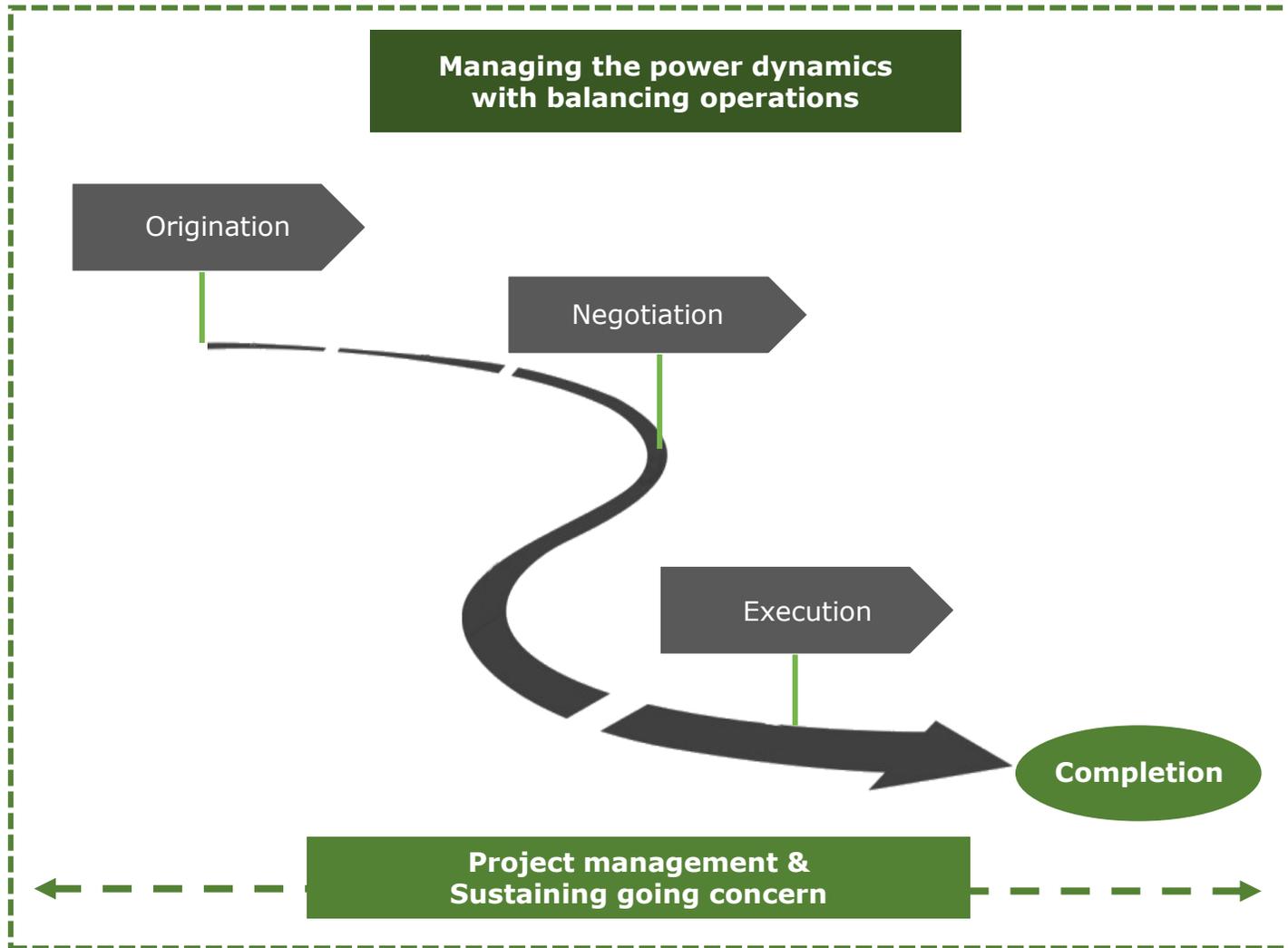
Is there a simpler way to understand all this?



“Life is like a box of chocolates; you never know what you're gonna get”

- Forrest Gump

What is the framework Sage 3 is evolving & testing using qualitative research with Asia's leading business research university, HKUST?



TMT's in moderating the power dynamics


Growth Mindset, change adaptability & traits

- Consideration of option on balancing ops, innovation & collaboration, learning
- Absorbent Capacity
- GRIT


Networks

- Advisors, White Knight, CDRC
- Institutional environment
- Close vs Open Networks


Trust

- Violation of trust
- Emotional issues
- Ability, Integrity & benevolence
- Asymmetry of information- trust but verify
- Vulnerable

The framework enables stakeholders to address the critical resources i.e. the claim on the firm's cash flow and time

Boundary conditions TMT's acceptance of the problem & belief it can be resolved, business viability and stakeholders committed to consensus-based approach

Is there something TMT can do today ?



“Do or do not. There is no try.”

What are things TMT can do today ?

TMT traits

- Evolve teams with GRIT and growth mindset being
 - a) Belief one can develop relevant skills & skills beyond corporate finance, law or banking
 - b) Ability to see options and innovation

Understanding the TMT psychology

- Acceptance of problems and belief solution can be found
- Realistic (avoid escalation to failing course of action, change the team if necessary) & Optimistic outlook

Appreciate the challenge

- Awareness of the power dynamics

Develop open network

- People: Boards, Advisors enabling new strategies, ideas & innovation
- Connectivity to funders (credit funds), White Knights, Equity subscribers, CDRC

Absorbative capacity

- Reading
- Participation in conferences not just not in Malaysia (e.g. SGRI)

Enhancing trust

- Reduce asymmetry of information
- Consider Chief Restructuring Officers

Understand power dynamics and how to deal with it

- Clarity restructuring outcome desired

Work on motivational issues

- Understand fatigue
- Reconfigure teams
- Narrative
- Programs



Parting Thought

“The true measure of success isn't just overcoming obstacles; it's about finding innovative solutions and transforming challenges into opportunities.”

End of Session