Case Studies on

Corporate Turnarounds – Vol. I

Edited by

Rajendar Singh Rathore

ICFAI Business School Case Development Centre

ICFAI Books

71, Nagarjuna Hills, Punjagutta, Hyderabad – 500082

ICFAI Books
71, Nagarjuna Hills,
Punjagutta, Hyderabad – 500082
Andhra Pradesh, INDIA
Phone: 91 - 40 - 23435387/91, Fax: 91 - 40 - 23435386
e-mail: icfaibooks@icfai.org, ibscdc@icfai.org
Website: www.icfaipress.org/books, www.ibscdc.org

Case studies are intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation.

Copies of individual case studies are available for purchase from www.ibscdc.org

ISBN 81-314-0339-4

Editorial Team: Priyanka Ramgopal and R.V. Harnoor

Visualiser: Ch. Yugandhar Rao
Designer: Mrugasira A.

AN OVERVIEW

"When firms are doing so badly that failure seems imminent, only turnaround management can restore performance and profitability."[1]

With the increasing competition, rapid advances in technology and rising complexity of the business conditions accompanied by blend of customers and employees, the challenges for any corporate have been rising. Only a timely response to this situation can save organisations. However, due to management inefficiency, most of the corporates fail to identify the problems and therefore delay in taking precautionary measures affecting the owners, employees, customers, suppliers and the economy. To restore the organisation on its normal course, a corporate turnaround is essential.

A corporate turnaround is 'a substantial and sustained positive change in the performance of a business'. A business usually opts for a turnaround due to several years of declining profitability often leading to significant losses and in severe cases, destabilising the financial viability of the enterprise. The declining business impacts negatively on the market competitiveness, the employee morale and the customer confidence.

A business failure can be due to various reasons mainly categorised as social, economic, legal and managerial. An unsuccessful business is usually considered as a negative economic event by the society. Apart from a negative image, the suppliers, creditors and employees of the business have to bear the second-order effects. Due to the decreasing demand, the suppliers lose their business; the customers are also forced to shift to other alternatives.

Whether a firm disintegrates early or continues to flourish forever depends on the management's response to a particular crisis. The problem usually heightens when the organisation is in a transformation stage and fails to recognise in time, the significant crises occurring in the organisation's life cycle. Most organisations have difficulty in identifying the crises and act late. The financial crises being finite in terms are easily identifiable; on the other hand, the non-financial critical situations are left to subjective discretion of the management. Therefore, failure to cope with the non-financial situations like people and organisational problems, lead to future financial crises.

Apart from these internal factors, external factors like political, economic and stock price also play a decisive role in the decline of an organisation. It includes role of unions, governmental regulations, safety and health improvement measures, consumer organisation pressures, shortage of energy and raw materials, change in technology etc. However, research shows that external causes play minimal role compared to the internal causes in stifling the fortunes of an organisation (Table I).

[1] Slatter, Stuart "Corporate Turnaround – Managing Companies in Distress", http://books.global-investor.com/books/10638.htm?ginPtrCode=00000&identifier

Table I
The Principal Reasons for Corporate Decline

Reasons	Percent
Sheer Bad Luck	1
External factors beyond management's control	8
Real balance of external and internal factors	24
Internal problems triggered by external factors	15
Internally generated problems within management's control	52
Total	100

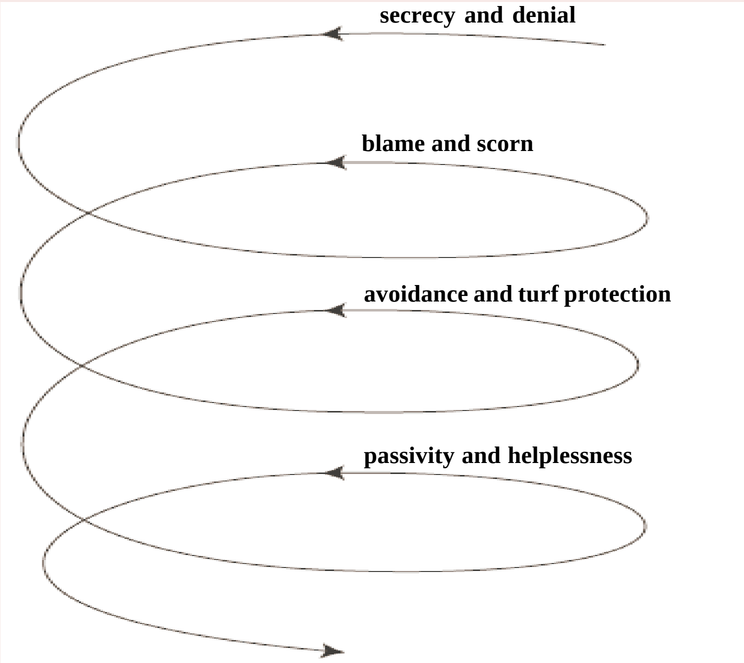
Source: Bibeault, B. Donald "Is Decline Externally or Internally Caused", *Corporate Turnaround – How Managers Turn Losers Into Winners!*, page 25

The internal reasons mostly depend on the management style. It can be due to incompetence, narrow vision, displacement activity (i.e. doing things which he likes rather than what he should do), lack of managerial depth, management change problems, inbred bureaucratic management, unbalanced top management team, weak finance function (i.e. inadequate financial and accounting control) and/or non-participative board director.

The most common errors of bad management are the failure to keep pace with changes in the marketplace and lack of operating control (i.e. budgetary control problems, product costing, responsibility accounting, asset accounting/valuation and cash flow forecasting). Despite the indications of business decline like falling profits and market share, the management pretends to ignore it and fall into the death spiral of secrecy, blame and passivity, leading to delay in corrective measures. Therefore, an effective manager should identify problems at right time and also foresee the future challenges. Before carrying out a corporate turnaround, he should go for a psychological turnaround to restore people's confidence in themselves and others. He should replace the secrecy, blame and passivity with dialogue, respect and initiative (Box I).

There are various warning signals like mathematical forecasting method used to red-flag potential bankruptcies, the adverse trend signals and adverse behavioural signals. Mathematical forecasting signals include the z-score method, Gambler's Ruin prediction of bankruptcy and auditors "going concern" opinions. Adverse trend signals are more subjective in nature and include parameters like declining margins, declining market share, rapidly increasing debt, rapid employee turnover rate and rate of reinvestment. In the adverse behaviour signals, poor communication and low employee morale are some of the important signals. Therefore, after identifying the critical situation of the business, its the management's responsibility to ramp up the business by means of various turnaround strategies.

Box I
The Death Spiral



Contd...

Avoidance and turf protection – avoiding meetings and other peer interactions	**Collaboration** – promoting collective commitments to new courses of action	Kitts formed cross-matri committees with representati functions on which a business The new view across the revealed opportunities hard fo to see by itself. A result? powered toothbrush – born o between a US and German divi
Passivity and helplessness – feeling powerless to make a difference in the company's fortunes	**Initiative** – making people believe they can change things	Dyke forced managers to think and fostered idea generation down and bottom up throug Making it Happen" brainstorı Ten thousand of the BBC's participated. They submitted 2, of which were implemented. D responded to many of the inspiring managers to act fast up special funds to pay for pro by staff.

Source: Kanter, Moss Rosabeth "Leadership and Psychology of Turnarounds (HBR OnPoint Enhanced Edition)", http://harvardbusinessonline.hbsp.harvard.edu, June 1st 2003

TYPES OF TURNAROUNDS

The principal types of turnarounds include management process turnaround, economic or business cycle turnaround, competitive environment turnaround, product breakthrough turnaround and government-related turnaround.

The management process turnaround means a major change in the management processes to accomplish a turnaround. If the principal reason for decline in business was due to management problem, the correction of these management problems that caused the decline would be the focus of the turnaround.

If the failure of the business is due to various economic reasons, then the turnaround is called an economic or business cycle turnaround. These economic reasons are mostly common for cyclical industries like real estates. A sudden boom in the market will profiteer the business while turn it bankrupt in the other case. An effective economic turnaround tries to keep the business running until there is a boom in the economy. It also includes strategies related to reconsideration and redirection of company's product lines, tight control over economies of scale and intensive focus on the development of right products and market niche. Sustaining the business in these types of turnarounds are usually considered to be a difficult task and hence the requirement of a leadership style that maintains entrepreneurial drive and commitment among its key managers.

The economic and competitive factors also assist the business in turnarounds and hence called competitive environment turnarounds. Various factors like increased industry volume and competitive price increase, acts as main enhancements in the competitive turnarounds.

The product breakthrough turnarounds are very rare, but can cause a significant reversal in the organisation's fortunes. These turnarounds can be due to a breakthrough in consumer tastes and technical or scientific breakthroughs. However, in case of these turnarounds, the right timings and right products play a critical role. Selection of a wrong product could lead to huge losses both in terms of financials and customers.

The government-related turnarounds, on the other hand, directly or indirectly depend on the governmental role in turning a company around. It can be either direct government intervention/assistance or can be due to major governmental procurement and policy changes.

THE STAGES OF A TURNAROUND

The turnarounds are divided into five stages – the management change stage, the evaluation stage, the emergency stage, the stabilisation stage and the return-to-normal growth stage.

1. **The Management Change Stage:** When a company encounters a major problem and has to do something to solve it, a major question arises – can the present management take necessary action to address the situation? In majority of the cases, the managerial replacement is sought as a good option since they were inefficient in solving the problem or were themselves a problem for the business that caused the organisational decline. A change in the top management is required because they failed in identifying the problem at an early stage and take precautionary measures to contain it. Top management change means a change in the leadership, providing a new thrust to the business to take tough decisions. And hence can mean a change in just the CEO or COO position.

   Once the organisation recognises the need for management change, the next job of the board of the directors is to select a new leader. The new leader can be an insider, i.e. from the organisation itself heading some other division, or can be an outsider, i.e. from some other organisation who has a good record of handling such situations. The selection of an insider would be advantageous as he has been working with the organisation and is much familiar with its operations but could be dangerous as well since he might have been involved in the earlier management that led to the organisational decline and therefore might attempt to cover their misdeeds.

   Therefore, usually an outsider is preferred to lead the company in distressed situations as he can evaluate the situation more objectively and can take more drastic measures without being biased to any segment.

2. **Evaluation Stage:** It focuses on the viability of the company and its preparation for the turnaround. It requires identification of problems and finding solutions for the same. The turnaround executive first finds out at what stage of seriousness the organisation is. There are three general levels – the survival (wherein there is a danger of bankruptcy and needs a drastic action plan), continuing losses (i.e. a company is in constant losses but its survival is not yet threatened) and declining business position (i.e. its market share and profitability are constantly declining and the business would start gaining losses if the trend continues for few years). Therefore, one of the immediate key actions involve gathering information. The preliminary viability analysis like strength and weakness of the organisation (SWOT), evaluation of its financial strength (its balance sheets and cash flows), its competitive position, market position and marketing organisation's effectiveness, evaluation of its personnel resources etc. helps judge the company's current 'strategic health' and company's current 'operating health'.

   Therefore, by ranking the company's strategic health and operating health as strong, average, or weak, a three-by-three matrix with nine possible combinations is generated (Table II). The matrix helps in identifying the strategic or operational problem of the organisation. An organisation with a strong operating and strategic position would not need a turnaround. On the other hand, a company with weak position in both the categories definitely requires a turnaround as it could also be on the verge of bankruptcy. Liquidation is considered as the best option for such firms.

Table II
Strategic/Operational Evaluation Matrix

Operational Health \ Strategic Health	Strong	Average	Weak
Strong			
Average			
Weak			

Source: Bibeault, B. Donald "The Evaluation Stage", *Corporate Turnaround – How Managers Turn Losers Into Winners!*, page 226

   However, the companies falling between these two extremes require turnarounds based on the severity of its position in any one category. An operating turnaround is suggested when there is a weak operating position and average or strong strategic position. On the other hand, strategic turnaround is considered for companies that have an average operating position and an average or weak strategic position. A firm with strong strategic position and an average operating position does not usually entail for a turnaround but aggressive action plans are suggested for improving operating efficiencies and net earnings.

After evaluating the type of turnaround required by analysing the matrix, the management carves out an action plan highlighting the various strategies to be followed and the detailed functional actions. The action plan generally consists of four basic elements – objectives, strategies, tactical plans and follow-up reviews (Table III). Once the action plan is crafted, the next responsibility is to communicate it both upward (i.e. the board members for its approval) and downward (to the key

Table III
Contrasting Elements in the Business Plan by Turnaround Stage

Planning	***Emergency Plan***	***Stabilisation Plan***	***Return-to-growth Plan***
Objective(s)	Survival, return to positive cash flow	Profit improvement, earn acceptable ROI	Growth and development, growth in market share
Strategies	Liquidation/divestment, product elimination, head count cuts	Divestment, product-mix enhancement, improve operations, reposture the business	Acquisition, new products, new markets, increase market penetration
Tactics	Asset redeployment, cash flow analysis, debt restructuring, working-capital improvements, profitability analysis, shutting down operations, reducing manpower, overhead reduction, marketing management, human resource management	Liquidity improvement, balance sheet cleanup, control system development, managerial accounting development, profit improvement programs, development of manufacturing efficiencies, marketing management, improving people mix	Creative financing schemes, tight financial discipline, efficient investment of human and capital resources, management by objectives, expanding margins through product mix changes, building a management development program, reorganising for faster growth, modifying compensation programs
Review and control	"Hands-on" management, daily and weekly cash reports	Managerial accounting emphasis, weekly operations re-reviews, monthly profit and loss reviews	In addition to stabilisation controls, quarterly planning reviews

Source: Bibeault, B. Donald "Planning Strategies in Turnaround Situations", *Corporate Turnaround – How Managers Turn Losers Into Winners!*, page 239 managerial team involved in the turnaround process). The action plan should also be presented to the key external parties like the bankers, major creditors and shareholders so as to regain their lost confidence.

3. **Emergency Stage:** It marks the survival stage of the company with priority to containing the cash overflow. It can be in terms of workforce reduction, improved operational management and elimination of loss-making subsidiaries. In a severe crisis, the management may even opt for divestment or liquidation of a particular division so as to avoid additional cash flow losses. To eliminate the operating cost, the organisation may divest whole product lines, shut down operations, reduce manpower significantly, reduce inventory investment, tightly control purchasing activities and focus on increasing the productivity.

4. **Stabilisation Stage:** After eliminating the losses and controlling the cash flows, the next stage is to achieve an acceptable return on investment. Apart from regular cash flows, the emphasis is on profitability, improved business operations and revival of the business. Reposturing the business is also stressed and involves planned withdrawal from unprofitable products, services and market segments/territories. The plan also involves development of alternative businesses through identification of new market niche or acquisition of related businesses. The financial management involves liquidity improvement, balance sheet cleanup, control system development and managerial accounting development. On the other hand, the operations management involves profit improvement programs, development of manufacturing efficiencies and overhead value analysis.

5. **Return-to-Normal Growth Stage:** It focuses on development and revenue growth of the business with emphasis on internal and external development. It includes adding new products, developing additional markets and improving the customer services, thereby facilitating revenue growth. In order to sustain a long-term growth and to make valuable investments, a sound financial platform for the business is required. Therefore, the organisation has to take into consideration the balance sheets and return on investment so as to position the company for a ten to fifteen years down the line. The organisation starts investing in the operational capabilities to enhance the productivity and capacity. Increased emphasis is also laid on marketing to explore new customer markets, improved products and new products. To develop the human resources, the management also introduces motivation and development programs.

After the organisation returns to normal growth, the turnaround leader looks for some definite signs like dramatic profit improvement and the increasing faith of creditors and financial partners that starts treating the organisation as a customer again. However, the decision of the turnaround leader can also change as there are no well-set standards to measure the success of a turnaround and problems can arise any time. Therefore, generally a turnaround leader continues its turnaround strategies for a two to three year period and apart from profit generation, also concentrates on rebuilding its lost market share and regain customer's and shareholder's confidence.

Since the turnarounds are mostly management process turnarounds, the management style plays a key role in the success of a turnaround. Generally, the management style pursued by turnaround specialists involves use of hands-on management style, introduction of tight controls (i.e. budgetary controls, product margin and cost controls and improved responsibility accounting) and stress on employee motivation. The delegation of absolute authority to the new management by the board also plays a key role in the managerial process turnaround. Most of the turnaround specialists use the 'back to basics' strategy i.e. concentrating on their core business. To bring the core business back to profitability, various strategies like capital investments and different marketing approaches are considered. On few occasions, despite being profitable and attractive, the companies have to divest few of its non-core businesses so as to focus on its core business.

Apart from meeting these survival needs, the management also has to sustain the employees' motivation as it plays a key role in defining the success of a turnaround. Therefore, to complete the turnaround cycle, the turnaround leader keeps the employee morale high and infuse in them positive thinking. He has the challenge of changing the attitude and culture of the company and therefore once the organisation reaches the growth stage, the management shifts the organisational focus towards various human resource development programs as a part of culture change.

Quite often, in a corporate turnaround, the basic business beliefs and philosophies are reversed, thereby making them a very difficult task for any turnaround manager. The management has to face severe and continuous challenges, both internally and externally. However, the challenges can be transformed into opportunity by responding appropriately at right time. And effective management, the instrument that is the heart of the company, can do this.

Therefore, corporate failure and its turnaround being a crucial part of any organisation, it is necessary for a management to understand the reasons for a decline and find various ways to avoid a potential bankruptcy. With an aim to provide valuable insights into these factors and to capture the management lessons for a corporate, the book has compiled some of the finest case studies on turnaround efforts of some of the famous corporates.

This book consists of twenty-two case studies on some of the world's most remarkable turnaround cases in contemporary times, notably Nissan, Mitsubishi, Cisco, Deutsche Telekom, Mazda, Fiat Auto, AirTran, Humana Inc., and Ford. These case studies, covering a wide range of diverse industries – airlines, automobile, computer hardware, telecommunications, banking and financial services etc. provide valuable insights into a wide spectrum of underlying reasons that push companies into trouble. One can also learn, by taking recourse to a radical thinking, how these companies could turn their fortunes around.

The case studies, *Turnaround Efforts at Ford, Volkswagen: Bernd Pischetsrieder's Turnaround Efforts, Tyco International Ltd.: The Revival Strategies and A&M's Turnaround Formula for Interstate Bakeries Corporation: The Testing Times,* illustrate the strategic missteps of these companies and the turnaround efforts being undertaken by the management to revive the companies.

On the other hand, case studies like *Nissan & Mitsubishi: A Tale of Two Turnarounds, LNM: Turning Around Sick Steel Plants and Mazda's Magical Turnaround,* highlights the success stories of the corporates that had timely identified the need for turnaround and by means of various strategies were able to successfully turn the company around.