CHAPTER 4

Theoretical development on turnaround management

CHAPTER 4
THEORETICAL DEVELOPMENT ON TURNAROUND MANAGEMENT

"Turnarounds are superb management schools. Everything needs fixing. Nothing is sure except the need to recover. The learning experience is intense. Never again will the turnaround leader assume that customers always buy, vendors always ship, bankers always lend."

Whitney (1987:49)

"What is the difference between running a business well under normal conditions and doing a turnaround?"
"Turnarounds differ from managing a company well by the compression of time and the scarcity of resources – there is no time and scarce human and financial resources."

McCann, Dermer, Hunter, MacDiarmid, Morgan, Örndahl, Robson and Wagman (2009:7)

4.1 INTRODUCTION

This chapter discusses the theoretical development of turnaround theory and philosophy, and the subsequent modelling of turnaround processes. A comprehensive literature review was undertaken and is summarised in a table attached as Appendix B. The research identified certain behavioural trends, which were used to compile a new strategic turnaround framework (see figure 8.1). The formation and development of the learning discipline Business Turnaround considered in a South African context is still in its infancy.

By comparison with the United States of America, South African literature on the subject of business turnaround is, to say the least, scarce. As the business rescue principle is incorporated into company legislation, it is hardly surprising that most of the early research and comments vest in the legal fraternity. With the limited number of "turnaround" students and academia currently involved in the formal study of this discipline, the body of knowledge is not expanding rapidly enough. A unique source of information and literature on turnaround is to be found on internet websites, in publications such as turnaround practitioner notes, and auditing and legal business's circulars and publications.

As a result, the national and international Turnaround Managers Association websites were used to great effect in this research in addition to the academic literature (see Appendixes A and B).

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Owing to the diverse sources of literature available, categorising secondary data sources in the different key sources was considered and subsequently deemed prudent as a departure point. In addition, the various practices and models that are available in the business environment and that will assist with the compilation of a South African entrepreneurial approach to rescue/turnaround, were researched.

The most salient strategies, steps and processes for rescue/turnaround are highlighted in this chapter. This chapter concentrates on the Turnaround section of the turnaround process flow as indicated by figure 3.1. The determining of the 'true' value of a business in a decline and/or distress situation is of the utmost importance. The value, the method used to determine the value, and the final foundation on which the value is based determine the future of the business. Moreover, a valuation will assist in answering the following questions: how, why and when do you exit a business or, how, why and when do you proceed with a turnaround initiative?

Once the decision is made in favour of contemplating a turnaround, the planning phase will commence by applying grounded theory and turnaround methodology. The salient business turnaround model that has evolved over time is discussed in this chapter.

The work of Hofer (1980), Bibeault (1982), Hambrick and Schecter (1983), O'Neill (1986), Boyle and Desai (1991), Robbins and Pearce (1992), Fredenberger and Bonnici (1994), Arogyaswamy *et al.* (1995), Sudaranam and Lai (2001), Lohrke *et al.* (2004) and, finally, Sheppard and Chowdhury (2005) is incorporated and illustrated in table 4.1.

4.2 BUSINESS TURNAROUND

The turnaround concept is not new to business. The term “turnaround” needs to be clarified as various applications exist; for example, in the United States of America, the shut-down and repair and maintenance of manufacturing plants are also referred to as turnarounds. (This study is concerned with business turnaround). A business turnaround event is triggered by deterioration in the performance (profits, financial difficulties) of a business, resulting in a business turnaround situation.

The term “turnaround” is used in various scenarios and is applied to numerous situations resulting in different outcomes. Section 1.7 contains a list of the terms used interchangeably in this study.

The word turnaround is used interchangeably with rescue, realignment, restructure, reorganisation and renewal. Some authors such as Mueller, *et al.* (2001), and Lohrke, *et al.* (2004), also use downsizing in discussions on turnaround. Although downsizing can be a response to decline in a business, downsizing is not always linked to decline. Freeman and Cameron (1993:13) state that downsizing and decline are two distinct constructs. They agree that a business can strategically downsize without experiencing decline. This study will, for the sake of consistency, refer to all these concepts as “turnaround”. In chapter 3, this study dealt conducted a secondary data analysis and the differing concepts were closely investigated and a clear distinction was drawn.

To illustrate the flow of the research process, figure 3.1 represents the steps in a turnaround situation from the time a turnaround event first occurs. A turnaround event is prompted by a condition of decline and/or distress within a business. Accordingly, an early warning sign, or most likely a combination of early warning signs, will be evident. The next step is to verify the warning signs in order to establish the true value, asset value or liquidation value of the business. The decision outcome will then determine whether a turnaround will be attempted. If it is decided to commence with a turnaround, a turnaround plan will be drawn up which, if accepted, will lead to the final steps depicted in the last column.

The relevant literature (As per Appendix C), indicates that very few sources on the subject of turnaround exist in the South African context. A local source of practitioner literature and industry information is the South African Turnaround Practitioners Association website, where South African turnaround practitioners publish industry-related articles. The industry is currently unregulated and, as such, these articles are unfortunately in some instances flawed by plagiarism, unsubstantiated data and untested assumptions, and are often not based on scientific principles. Turnaround planners, entrepreneurs and practitioners alike must be able to plan to re-enter markets at an opportune time. Financial distress unfortunately has a negative effect on suppliers and customers and the challenge is re-entry into the markets.

A turnaround practitioner's short-term strategy is to ensure immediate corrective measures and a short-term turnaround plan that will be managed on a project basis. Longman and Mullins (2004:58) are of the opinion that effective project management requires "the right people and skills". This statement emphasises the need for suitable experience and the appropriate academic background in a turnaround practitioner. Muir (2005:3) warns about the high cost involved in turnaround structuring.

A business can only embark on a turnaround attempt when the question: "Is the business worth saving", is confirmed in the positive. These are, in a very broad sense, the essential aspects that need to be addressed by the turnaround practitioner and the entrepreneur's strategic turnaround planning. Bowman, Singh, Useem and Bhadury (1999:49) attempted measuring these "models" but concluded that the negative performance effects of turnaround are the transfer of wealth, rather than value creation. The investigation into the literature suggests that there are various causes for business distress.

Consensus seems to propose that poor cash flow management and control is the single most common financial cause of initial distress and subsequent failure. However, company size does play a role, as Pant (1991:639) concludes that it is, in the short term, easier to improve the results of smaller rather than larger companies.

Current South African legislation does not allow the debtor (entrepreneur) any input into the insolvency/judicial management process. In this respect, it is worth noting that the Canadian Bankruptcy and Insolvency Act (Section 50.4(8) 1992) allows for a stay of (moratorium on) proceedings, which, in turn, allows the insolvent party to apply to the courts for a stay or extension for the duration of the moratorium.

Grant Thornton Catalyst Issues (2004b) states that Chapter 11 of the United States of America's insolvency law provides for a similar debtor-friendly approach, where the courts appoint a trustee to draft a plan for the reorganisation/restructure of the business (USC Bankruptcy Chapter 11, section 1104). In the case of the United States of America, the appointment of a trustee is obligatory for all public companies. The focus, however, is on the fact the trustee must develop a plan that is specifically designed to reorganise the business.

The investigation looked at numerous turnaround avenues that are available to the entrepreneur. When applicable to the research objective, these avenues were applied to a unique turnaround model in order to achieve turnaround in the current South African business environment. A turnaround is deemed viable only if it reflects the potential for creditable, sustainable recovery.

Zopounidis and Doumpos (2002:371) suggest that, when attempting to solve business problems, the alternative should be weighed up carefully. In this vein, Whitney (1987:49) argues that, with a turnaround attempt, nothing is certain except the need to recover. Thus, turnaround attempts are, without doubt, faced with different alternatives and it is up to the planners to discriminate effectively between the various options. In a study on airlines in distress by Gudmundsson (2004:462), it was established that distressed airlines pursued "market power" tactics. Market power approaches inevitably lead to overtrading. In contrast, the author found that non-distressed airlines have productivity and greater performance as their strategic focus. The Grant Thornton Catalyst Issues (2004a:1) is of the opinion that the entrepreneur needs to be aware of the following four key stages in steering a troubled business to safety:

- stabilising the distressed situation by introducing vigorous cash flow management (reducing cash losses and increasing cash flow)
- analysing and revisiting the business and/or strategic plan to determine new directions and action in meeting business objectives
- financial restructuring to reposition a business in line with new objectives
- organisational restructuring to strengthen the business.

The UNCITRAL guide points out that, if the business can be saved, creditors will receive maximum value and job losses will be minimal. The aspect of job creation in South Africa is a very politically sensitive and broadly discussed topic. Accordingly, a rescue/turnaround supportive legislative strategy could address the issue of job retention. Although South Africa's insolvency legislation clearly favours a culture of creditor-friendly regimes, it would seem that debtor-friendly approaches are not necessarily afforded proper consideration by all role players and stakeholders. Burdette (2004b:11) consequently concludes that "there appears to be general consensus that South Africa needs, and wants, a modern and effective business rescue model".

Business, government and academics all seem to agree that the present South African judicial management system, particularly as a business rescue system, has to a large extent failed. In the recent past, government, represented by the Departments of Justice and Trade and Industry, has made various attempts through various appointed committees to design a business rescue model. (Committees such as these would, *inter alia*, include the Centre for Advanced Corporate and Insolvency Law [hereafter CACIL] at the University of Pretoria.) Winer, Levenstein and Gewer (2005:3) argue that companies need to develop systems of internal control and risk management, as these systems will result in more efficient reaction times when financial distress signals begin to appear. The need for entrepreneurs to have a creative input into the preparation of a workable business rescue and redesign model, and to design a comprehensive and acceptable business rescue plan, is fundamentally important.

Informal agreements or arrangements which, in turn, can lead to the implementation of formal insolvency proceedings by such creditors accentuates the need for a change in current legislation that would allow such entrepreneurs adequate leeway to design proper rescue plans. In the South African context, Chapter 6 of the new Companies Act dictates that the business rescue or turnaround as an intervention is of a “temporary nature”. The Act is clear that a turnaround should be completed in a period of six months. This infers that the business will have returned to normal after six months. Hofer and Schendel (1978:73) opine that the return to “normality” is the final stage in the turnaround process. The normality stage is commented on later in this chapter.

The United States of America and Canada seem to be at the forefront of turnaround legislation and models. In the United States of America, the well-known Chapter 11 proceedings are often debated and reported in the literature. The short-term aim of turnaround will be to manage the distressed business out of commercial insolvency and the longer-term aim will be to sustain technical solvency. Chapter 6 of the new Companies Act dictates a framework as explained in table 5.1 in chapter 5 of this study. The salient issues, as per the Act, were discussed under the various turnaround stages indentified. In this chapter reference will be made to the applicable sections of Chapter 6 of the new Companies Act.

4.3 DEFINITION OF BUSINESS TURNAROUND

Turnaround management has evolved over a period of time, from a trial-and-error scenario to an important management science. As such, the definition of a turnaround has also been open to various debates and compositions. Eventually, a definition evolved and some authors added to the definition. However, as research theory developed, and legislation became more debtor friendly, the definition has seen various changes in order to adapt to the new findings and legislation. Some researchers, such as Thorne (2000:305), who place turnaround action on the same podium as business transformation, amplify the importance of business turnaround. Moreover, the importance of decision making during a turnaround event should not be taken frivolously by management.

The importance of turnaround decision making under risk, is confirmed by Tversky and Kahneman (1974:1128; 1986:260) and Kahneman and Tversky (1979:264), who warn that decision makers follow a simple heuristic rule of thumb when making decisions under risk and uncertainty. It has been found that a relatively complex probabilistic approach is required under conditions of high risk, as decision makers tend to ignore the signals that clearly indicate the variables that should be considered when forced to make decisions. Ansoff (1975:22) describes the ignorance of weak signals by the entrepreneur as missing an opportunity or exposure to a threat. The instant realisation that dawn on the entrepreneur is labelled by Ansoff as the "moment of truth". At this point neither the cause nor the response is comprehensible by the entrepreneur. In practice, this moment of truth refers to the "turnaround event". A turnaround removes the entrepreneur (directors and/or management) from their comfort zone and places them in unknown territory.

Bibeault (1982:1) describes a turnaround situation as an abnormal period in any company's history. Turnaround situations require management approaches unique and distinctly different from those of stable or growth management. Consequently, old management tenets lose their validity. In reviewing related academic and practitioner literature to find common ground on the definition of business turnaround, the close association between business failure prediction and business rescue was evident. Figure 3.1 illustrates this association as a flow process, from early warning sign identification and verification as the departure point, to acceptance of decline/distress, to a turnaround response as the final stage.

Filatotchev and Toms (2006:408) state that the conditions responsible for the financial downturn (identifying and verifying the early warning signs) will have to be mitigated to achieve stability in the business. According to Pretorius (2006:6), turnaround will allow business to achieve acceptable performance and emphasise the importance of identifying signs. Sudarsanam and Lai (2001:183) argue that the downward trend towards failure in business is attributable to poor implementation of turnaround strategies. McRann (2005:38) points out that there are natural ebbs and flows that are part of every business; thus it is not always clear if your business is going to hit a significant bump or if you need a major change in strategy.

Simons (1999:85) maintains that it is in the good times that managers/entrepreneurs need to be more vigilant in identifying signs of impending danger. Simons (1999:86) concludes that "in dynamic markets, taking risks is an integral part of any successful strategy". Entrepreneurs need to understand the conditions that create unacceptable levels of risk.

In the research of preceding definitions on turnaround a number of interesting approaches were observed. Transformation is positioned on the level of turnaround by Levy and Merry (1986, in Thorne, 2000:305), who state that "transformation is the response to the notion that the organization cannot continue functioning as before … in order to continue to exist it needs a drastic reshuffling in every dimension of its existence". Ramakrishnan and Shah (1989:26) support the view that turnaround management "refers to a gamut of operations from identification of a problem to developing the plan needed to ameliorate them echo the turnaround process flow designed by this research". The most popular approach in defining turnaround is the restoration of performance and success. Thain and Goldthorpe (1989:55) thus define a turnaround as "the reversal of performance from decline and failure to recovery and success".

In the process of reversal of decline and failure, the turnaround management will execute various action steps. Boyle and Desai (1991:33), describe turnaround management actions as a process that involves the "establishing of accountability, conduction diagnostic analysis, setting up an information system, preparing action plans, taking action and evaluating results". Confirming this approach, Robbins and Pearce (1992:296) argue that a turnaround response consists of activities likely to overcome the business's troubles and return it to match or exceed prior performance.

Balgobin and Pandit (2001:301) define a corporate turnaround "as simply the recovery of a business's economic performance following an existence-threatening decline". The phrase used, "decline that threatens its existence", implies a distressed situation which fuels the perception that turnaround is only associated with business in distress.

The research results clearly indicate that turnaround is not only limited to distressed situations in business, but that the concept of turnaround incorporates various elements such as downsizing and restructuring. Although downsizing can be a response to decline in a business, downsizing is not always linked to decline. Freeman and Cameron (1993:13) state that downsizing and decline are two distinct constructs. They agree that a business can strategically downsize without experiencing decline. In an expanded model of the turnaround process, Lohrke *et al.* (2004:65) identify a three-phased process:

- turnaround situation
- turnaround response
- turnaround outcome

Sheppard and Chowdhury (2005:243) state that “a turnaround occurs when businesss persevere through an existence-threatening performance decline and end the threat with a combination of strategies involving skills, systems and capabilities to achieve sustainable performance recovery”. A popular view regarding financial distress is that expressed by Chathoth, Tse and Olsen (2006:604), who define a turnaround as the “action taken to prevent the occurrence of financial disaster”, for which the results are measured over a period of time.

A very recent definition which has substantial appeal was formulated by McCann *et al.* (2009:7). They describe a turnaround as a “process to restore a failing company to sustainable competitive vitality”. The centre point of all the definitions seems to be the reversal, restoration and recovery of former glory. McCann *et al.*’s definition has a more realistic approach in that its aim is to restore the business to a sustainable competitive vitality. This implies that the business can be downsized, restructured and aligned to form an economically viable enterprise, and not necessarily restore performance to previous levels. This is a very important observation, as until now the return to “normal” had not been clearly defined in any previous attempts. Clearly this opens up a new construct in turnaround management, namely “sustainable competitive viability”.

Carapeto (2005:743) states that “a business reorganizes successfully when it emerges from bankruptcy with either independence preserved, or else is acquired or merged”. In contrast to the independence view, Pretorius (2008b:20) defines a business that has been turned around as a recovery “from a decline that threatened its existence to resume normal operations and achieve performance acceptable to its stakeholders (constituents), through reorientation of positioning, strategy, structure, control systems and power distribution”, again supporting normal operations.

The recovery process is not well defined, but Ketelhöhn, Jarillo and Kubes (1991:117) consider a turnaround as being successful “if after the period of losses, management could sustain at least two consecutive years of profit”. This equation, however, fails to define the level of profit and the question remains. Various authors such as Knot and Posen(2005), and Pearce and Robbins (2008), have discussed the probability of mergers and acquisitions as a mechanism to turn a business around. For that purpose some salient literature on the subject was included in the main body of research. Castrogiovanni and Bruton (2000:27) quote Schendel, Patton and Riggs (1975), who define a successful turnaround as the “reversal of a business’s pattern of performance decline”. The UNCITRAL Guide (2005:7) defines business turnaround, or reorganisation as the process “by which the financial well-being and viability of a debtor’s business can be restored and the business continues to operate, using various means possible including debt forgiveness, debt rescheduling, debt-equity conversions and sale of the business (or part of it) as a going concern”.

Chapter 6 of the new Companies Act closely follows the UNCITRAL Guide by defining business rescue or turnaround in **Section 128(1)(b)** as "‘business rescue’ means proceedings to facilitate the rehabilitation of a company that is financially- distressed by providing for-- the temporary supervision of the company, and of the management of its affairs, business and property …”; and, "… rescuing the company" means achieving the goals set out in the definition of ‘business rescue’ in section (b)”.In this section of the Act "supervision" means the oversight imposed on a company during its business rescue proceedings and “temporary” is submitted to be a period of six months.

In light of the entrepreneur's high propensity to risk discussed in chapter 2, this study theoretically defined and proposed early warning verifier determinants in modelling a turnaround plan. The author of a turnaround plan has to introduce creativity into the strategic turnaround plan to overcome this bias.

Majaro (1992:230) compiled a creativity checklist to ensure that strategic planning includes creativity and innovation. Concepts such as the removal of barriers, communication procedures and motivational stimuli will be further researched and it is planned to include these concepts in the modelling of the turnaround plan. Von Oetinger (2004:37) argues that innovation and creativity is "escaping from your existing model". Clearly, if the existing strategic business model leads to distress, "escaping" from it is essential for survival. Furthermore, Merrifield (1993:384) argues that central to the successful execution of a turnaround plan is the creation of entrepreneurial initiatives.

Turnaround planning parameters should be officially researched but, as indicated, will not follow the same conventional business planning structure, as the end goal will be to return the business to commercial viability. Thus, changing the existing (failing) strategic model is unavoidable. Owing to the historic non-reliance on and negative perceptions of traditional business plans, a new creative approach to compiling turnaround plans, that is, business strategising, was attempted to create a functional framework for use by entrepreneurs and turnaround practitioners in South Africa.

4.4 STRATEGIC VERSUS TURNAROUND STRATEGY

Porter (1979:137), who shaped the future of strategic management when he introduced his five forces into the field of strategy research, did salient work on strategic management. Later, Porter (2008:8) enhanced his five forces theory by adding certain factors to the five forces.

By introducing these factors for consideration, Porter qualifies some of the forces such as “growth”, on which he now cautions the strategist. He states that “a narrow focus on growth is one of the major causes of bad strategy decisions”.

Hedley (1976:10) ponders the complexity of the development and understanding of strategic segmentation. It is concluded that the basis for strategic segmentation usually involves a detailed assessment of “cast and value addition” in the business. It is imperative that the segmentation of the business takes into account the life cycle stage of the business.

Nag, Hambrick and Chen (2007:952) conclude that strategic management “acts as an intellectual brokering entity, which thrives by enabling the simultaneous pursuit of multiple research orientations by members who hail from a wide variety of disciplinary and philosophical regimes”. In this context, Ketelhöhn (1995:74) discusses the re-engineering of management strategies as processes emanating from a “trial and error” continuum progression.

Oosthuizen (2009:14) debates the applicability of the traditional strategic positioning approach and argues that no real need exists to discard the conventional strategic planning approaches. This is contrary to Riana, Chanda and Metha’s (2003:83) approach that the turnaround practitioner “unfolds” the turnaround strategy “step by step” as the need arises to meet (short-term) objectives. The speed with which turnaround strategies are formulated is confirmed by Mueller and Barker III (1997:119), who argue that turnaround businesss develop decision-making strategies that are “fast”.

They also conclude that these strategies, although swift, are influenced by external perspectives. This view (influenced by external perspectives) is contradictory to the agency theory approach which Eisenhardt (1989a:70) propagated against outside intervention. If the agency theory is followed, the responsibility and accountability for strategic decision making will rest with the turnaround practitioner alone. What is critical in this stage of the turnaround is, according to Eisenhardt (1989a:60), to acknowledge the principles of agency theory in designing the optimal contract.

The complexity of a turnaround attempt is clarified by Zimmerman (1986:109) who is clear that “in order for a company to turnaround, many things have to be done, and, they have to be done together”. Chrisman, Hofer and Boulton (1988:413) state that researchers have developed standard strategy classification schemes to address extraordinary circumstances such as a business turnaround. The success of this methodology is questioned as it is clear that a unique set of preconditions dictates a specialised approach to turnaround. In confirmation, Chrisman *et al.* (1988:413) conclude that an optimal strategic solution was, however, not achieved using the standard strategy classification, as a turnaround event necessitates a unique solution and strategic approach. The deduction here is that the turnaround practitioner will have to establish a team of professionals to assist in the turnaround execution.

Owing to the very tight timelines imposed on a turnaround event, it is also indicated, or suggested, that a team approach is advisable. McCann *et al*. (2009:7) describe the difference between normal business conditions and turnaround conditions as follows: “… turnaround differs from managing a company well by the compression of time and the scarcity resources, … there is no time and scarce human and financial resources”. Hofer (1980:20) made a huge contribution in his time when he distinguished between strategic turnarounds and operational turnarounds. Although he discusses strategic and operational as two separate constructs, in strategising the turnaround plan both constructs will form part of the strategic planning phase. Sudarsanam and Lai (2001:183) distinguish between managerial, operational, asset and financial restructuring.

These constructs were further analysed and dissected as Sudarsanam and Lai’s research sample of turnaround businesses did not distinguish between informal and/or formal Chapter 11 (United States Legislation) turnarounds. If the turnaround were differentiated between the variables, it would have added valuable insights into the understanding of formal versus informal turnarounds. Whichever causes for decline and distress are identified, the turnaround solution decided on is of the utmost importance, as poor implementation of a turnaround plan can lead to further decline, with dire consequences.

Three modes of restructuring are identified by Bowman *et al.* (1999:34): portfolio, financial and organisational restructuring. Lieberman and Montgomery (1988:48) argue that customer needs are very dynamic and opportunities are created through “first mover advantages”. The same early mover principle applies to the opportunity which is created for the management to turn a distressed business around. Joachim and Wilcox (2000:15) conclude that, if the business owner is a strategic opportunist and a fast mover, the business can survive. Chowdhury and Lang (1993:9) discuss the vulnerability of businesses toward gradual decline when discussing the theory of business turnaround. Hedley (1976:3) argues that “changes in the environment have brought the (strategic) requirements into sharper focus, made the constraints more severe”.

In conclusion, it can be deduced that, in a turnaround scenario, strategic modelling will definitely differ from traditional strategic formulation, as strategic decisions have to be made in a very short time.

Owing to the turnaround event, business decision making is far more situational and complex than in normal situations. As a result of limited, and therefore untested, data, the decisions made in a business turnaround are the best fit for the current situation. Riana *et al.* (2003:89) confirm this approach; they conclude that “turnaround managers ask for and frequently get total authority from the board to take quick decisions. As a result they often shoot from the hip with little time spent on collecting and analysing data and arriving at conclusions after careful consultations that good business demands”.

A question that is on every creditor’s agenda is: What is the duration of business rescue proceedings? Section 132(1) of the new Companies Act, is very clear as to when a rescue begins and when it ends:

> … *business rescue proceedings begin when the company files a resolution to place itself under supervision in terms of section 129(3); or applies to the court for consent to file a resolution in terms of section 129(5)(1);*

a person applies to the court for an order placing the company under 45 supervision in terms of section 131(1);

or during the course of liquidation proceedings, or proceedings to enforce a security interest, a court makes an order placing the company under supervision…"

Section 132(2) makes the inference that the rescue proceedings will end with the introduction of a notice that the plan has been substantially implemented. In practice, the turnaround can take a lot longer and the intention of the legislature will have to be subjected to a ruling by the court. Heller (1994:66), reporting on the turnaround in Compaq, the computer manufacturer and supplier, stresses that it took the new chief executive officer, Eckhard Pfeiffer, only two weeks to redesign Compaq "from top to bottom". Heller further states that Pfeiffer's aim was a long-term successful solution. Brenneman (1998:164) describes the most difficult part of a turnaround as "getting all (everything) done fast, right away and all at once".

Banks, as primary lenders to a business, play a large role when formulating a business turnaround strategy. When banks are in a well-secured position, they will, and can, close down the business if a turnaround plan is not compiled and presented to them very quickly and to their satisfaction. According to Brown (2005:60), banks need to see a clear directional focus in order to assess and approve debt restructuring in a business turnaround situation.

There seems to be frequent and lively debate on the duration of a business turnaround. Ketelhöhn *et al.* (1991:117) argue that the turnaround period could last up to four years. They do, however, add the period of decline as the first year of the turnaround process.

Ketelhöhn *et al.* (1991:117) describe these years as

- the first year of losses prompting the turnaround decision
- the second year as the breakeven year

- the third year is for profits and confirmation of recovering profits
- the final year – year four is the year for consolidation and proof of sustainability.

Kow (2004b:281) supports the view that the turnaround of a business is not a "quick fix" scenario and that it will take a lot of hard work over an extended period of time. The protracted period results because the turnaround practitioner, in his endeavours to cut costs and improve mobility, always changes the business structure. A shorter business turnaround term is discussed by Whitney (1987:49), who argues that the turnaround practitioner does not have the "luxury of abundant time and resources". The amount of time required for a turnaround is of interest both for its practical significance and for developing a research design.

None of the previous business turnaround researchers have stressed the sequential aspects of their findings, but some patterns are evident. In studying business turnaround, it was concluded by Hambrick (1983:235) and Friedenberger, Thomas and Ray (1993:327) that a typical fundamental turnaround classification will be financial, operational and strategic. They identify three stages of recovery:

- crisis
- stabilisation
- return-to-normal growth
    - content of strategy
    - process of turnaround.

Entrepreneurs often fail to take effective action to stop the decline owing to the fact that they do not want to acknowledge the deterioration in their business.

Failure to identify the decline will lead to omission of the very first stage of a business turnaround. Ramakrishnan and Shah (1989:26) describe turnaround management as a range of operations "from the identification of the problem to developing the plans needed to ameliorate it".

Balgobin and Pandit (2001:304) ponder on the fact that in successful turnarounds the incoming turnaround management and/or practitioner formulates a strategic recovery plan in a very short time span. These time constraints propose an identification process that addresses the real issues in a turnaround event as soon as possible.

Theriot, Roopchand, Stigter and Bond (2000:2) promulgate the use of Monte Carlo simulation owing to its ability to address elements under situations of uncertainty and variability. They list the following reasons for their argument:

- accuracy unequalled by analytical models
- explicit treatment of variability and uncertainty
- support for changes of key parameters over time
- explicit consideration of interaction and coupling
- flexibility in accommodating case-specific rules and constraints.

Owing to the specialised nature of the model, the actual duration of conducting a simulation is nowhere debated, or commented on in the literature but it is perceived to be time consuming.

4.5 DEVELOPMENT OF TURNAROUND STRATEGIES

4.5.1 INTRODUCTION

A whole host of turnaround models, strategies, steps, actions and process flows are described in an attempt to design the ultimate turnaround framework. As such, the works by various authors, such as listed in table 4.1, can be regarded as salient contributions to turnaround research. In table 4.1, the authors included in this discussion are contrasted using a shaded area.

As a result of a multitude of descriptive tables and figures, this research has only concentrated on those models that can add value (although the others are no less important) and these are indicated by background shading in the last column.

Table 4.1 The evolution of turnaround modelling, strategic thinking and theory

The Evolution of Turnaround modelling, strategic thinking and theory			
Author	**Date**	**Contribution**	**Turnaround model**
Carrington, J.H. and Aurelio, J.M.	1976	Careful planning and open relationship with stakeholders. Cost cutting and creditor concessions	
Hofer, C.W.	1980	The relationship between severity of decline and appropriate recovery actions Indentify four "gestalds"	Cost Reduction Activities Revenue Increasing Activities Market/product Refocusing Activities Asset Reduction Activities Moves to breakeven point
Bibeault, D.B.	1982	Identification of four key success factors for turnaround success	New, competent management Viable core operation Adequate bridge financing improved employee motivation
Hambrick, D.C and Schecter, S . M	1983	Identification of three "gestalds"	Asset and Cost Surgery Selective market/product pruning Piecemeal productivity
O'Neill, H.M.	1986	Identification of sub-strategies for turnaround	
Zimmerman, F.M.	1989	Identification of successful turnaround	Relating to the nature and severity of economic difficulties Relating to being a low cost producer Relating to the differentiation of products Relating to leadership and the turnaround organization.
Boyle, R.D. and Desai, H.B.	1991	Introduce four cell approach to generic turnaround	Internal External Administrative Strategic
Castrogiovanni, G.J., Baliga, B.R. and Kidwell, R.E.	1992	Concentrate on management change	
Robbins, D.K. and Pearce II, J.A.	1992	Identification of retrenchment and recovery in turnaround	Internal/External factors Situation severity Cost and asset reduction Stability Efficiency maintenance and entrepreneurial expansion Recovery
Dolan, P.F.	1993	Introduce four-phased rescue plan approach to turnaround	Bankruptcy score Diagnostic study Turnaround plan Monitor plan
Chowdhury, S.D. and Lang, J.R.	1993	Marshall financial support for a turnaround	
Pearce II, J.A. and Robbins, K.	1993	Same model as 1992	
Chowdhury, S.D., and Lang, J.R.	1994	Focus on operating turnarounds	
Fredenberger, W.B. and Bonnici, J.	1994	Introducing the life cycle extension theory	
Barker III,V.L. and Mone, M.A.	1994	Oppose Robbins and Pearce II retrenchment theory	
Pearce II, J.A. and Robbins, K.	1994	Defending retrenchment theory	
Arogyaswamy, K., Barker III, V.L. and Yasai-Ardekani, M.	1995	Introducing a two-stage contingency model of firm turnaround	Decline stemming strategies Recovery strategies
Barker III,V.L. and Duhaime, I.M.	1997	Investigate the extent of strategic change	
Barker III,V.L. and Mone, M.A.	1998	Introduce strategic reorientation in turnaround model	
Harker, M.	1998	Focus on marketing strategies during turnaround	

Harker, M. and Sharma, B.	1999	Focus on leadership strategies during turnaround	
Castrogiovanni, G.J. and Bruton, G.D.	2000	Retrenchment	
Balgobin, R. and Pandit, N.	2001	Discuss stages in turnaround process	
Barker III, V.L., Patterson, P.W. and Mueller, G.C.	2001	Focus on management changes	
Sudarsanam, S and Lai, J.	2001	Focus on restructuring strategies	Operational restructuring Managerial restructuring Asset restructuring Financial restructuring
Barker III, V.L. and Barr, P.S.	2002	Refer to 1998	
Lohrke, F.T., Bedeian, A.G. and Palmer, T.B.	2004	Introduce three phase turnaround process	Turnarounds situation; 1) Decline Turnaround response 2) Response Initiation Turnaround outcome 3) Transition 4) Outcome
Kow, G.	2004	Identify elements of turnaround	
Sheppard, J.P. and Chowdhury, S.D.	2005	Introduce success and/or failure into model	
Smith, M. and Graves, C.	2005	Turnaround as two key phases and a series of integrated steps	Depicts the turnaround process as a series of integrated steps Two key phases – the decline stemming- and the recovery phase. Concentrate on the severity of the financial distress, the amount of free assets available, size, ability to stem the decline, stabilise, retrenchment activities to improve efficiency and cash flows
Pearce II, J.A. and Robbins, K.	2008	Acknowledge the role of strategic change and growth in turnaround process	

4.5.2 HOFER'S CONTRIBUTION (1980)

Hofer (1980:20) distinguishes between strategic and operational turnarounds. He based his turnaround modelling on the patterns of decline in a business. These patterns dictate which turnaround strategy is to be followed. Hofer (1980:21) opines that before beginning a turnaround, the going concern value of the business must be greater than its liquidation value. Figure 4.1 illustrates the concept of a "health check", which Hofer introduced to choose the correct turnaround strategy, choosing between operational and/or strategic intervention. Where both the strategic and the operational health are weak, a combination approach is advocated. Strategic turnarounds will be strategies that call for entering new businesses or entering into new ventures.

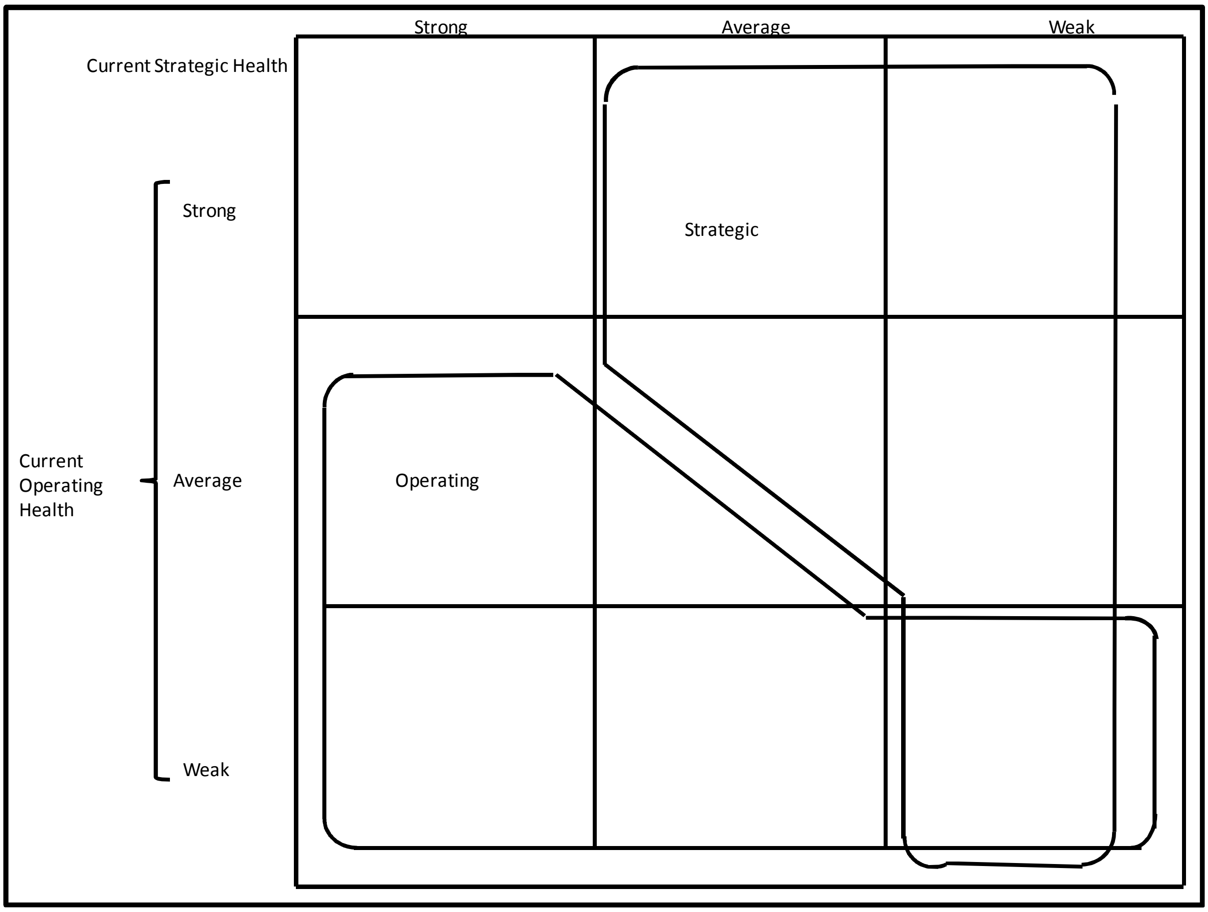

Figure 4.1 The strategies companies chose (Hofer, 1980:25)

Hambrick and Schecter (1983:236) present Hofer's four turnaround strategy indicators: revenue generation, product/market refocusing, cost cutting and asset reduction. Figure 4.2 illustrates the four strategies on a matrix where double signs suggest a primary indicator and one sign a secondary indicator. The focus of the turnaround will be directed at the two-sign indicators. Accordingly, the one-sign indicators are a lesser component of the turnaround strategy. The deduction made here is that, as the turnaround progresses, the Hofer matrix will have to be revisited and repositioned, and the necessary adjustments to the strategic direction will have to be made.

Hofer divides operational turnarounds (no strategy change at all) into four types:

- increasing revenues
- decreasing costs

- decreasing assets
- embarking on a combination effort.

In later studies, Hofer (1989:39) investigated the nature of turnaround situations by including a business review process which analyses the following variables:

- assessing current operating health
- financial condition
- market position
- technical stance
- production capabilities
- assessing current strategic health
- product/market matrix
- technological and production capabilities
- financial capabilities.

Expected Indicators of Hofer's Four Turnaround Strategies.

Strategic move	Strategy: Revenue generation	Strategy: Product/Market Refocussing	Strategy: Cost cutting	Strategy: Asset Reduction
Product/market Initiative				
Sales from new products	++			
Product R&D	++		-	
Marketing	++		-	
Product quality	--	+		
Price	--			
Market share	++	-		-
Efficiency				
Employee productivity		+	++	
Relative direct costs		+	--	
Asset levels and use				
Receivables/revenue	+		-	--
Inventories/revenue	+	-	-	--
Plant and equipment newness				--
Capacity utilization	+	-		++

Two signs suggest a primary indicator (stressed by Hofer as integral to the strategy); one sign suggests a secondary indicator (an expected by-product or lesser component of the strategy.

Figure 4.2 Hofer's four turnaround strategy indicators (Hambrick & Schecter, 1983:236)

Hofer (1991:20) further discusses patterns of decline as causes of decline, both strategic and operational, in comparison with the turnaround response – strategic and operational.

4.5.2.1 Summary of Hofer's contribution

Hofer (1980:25) introduced the business "health" concept as is depicted by figure 4.1. The two areas where a business's current position is plotted are the operating and the strategic areas. In plotting the business on a matrix, a clear indication of the state of current operating health, or the state of current strategic health, will emerge. Hofer advocated a relationship between severity of decline and appropriate recovery actions , and Indentified four "gestals", they are:

- cost reduction activities
- revenue increasing activities
- market/product refocusing activities
- asset reduction activities.

4.5.3 BIBEAULT'S CONTRIBUTION (1982)(reprint 1999)

Bibeault (1998:263) structured his turnaround model using five distinctive phases. The first stage is the "evaluation stage" where, as the name indicates, the business review or analysis is contemplated. During the second phase, the "planning strategies in turnaround situations", Bibeault argues that the turnaround plan and the tactics used need to follow the following stages:

- management change stage
- emergency stage
- stabilisation stage
- return to normal stage.

The third stage is the 'emergency stage' where, as the name indicates, the business will do what is necessary to survive.

This is a traumatic stage and the now generic phrase, “stop the bleeding”, is of the essence. However, the actions taken will not necessarily lead to survival.

The fourth stage, the “stabilisation stage”, is the settling down phase after major interventions. This stage reflects on the emergency actions and, although no less important, at a more subdued pace. The final stage in Bibeault’s turnaround process is “return to growth”. This will entail that the company’s financial position is restored to such a level as to sustain normal growth. The host of referrals in the literature to Bibeault’s contribution is a testimony to the salient work done by him, which acknowledged by a host of turnaround academics, practitioners and business in general.

4.5.3.1 Summary of Bibeault’s contribution

Bibeault’s identified four key success factors for turnaround success:

- new, competent management
- viable core operation
- adequate bridge financing
- improved employee motivation.

4.5.4 HAMBRICK AND SCHECTER’S CONTRIBUTION (1983)

Hambrick and Schecter (1983:245) discuss failed turnarounds and warn that “moving too fast” can lead to further demise and ultimately failure. Hambrick and Schecter (1983:247) introduced a cluster analysis in the research on turnarounds. In this research, Hambrick and Schecter used published case histories from *Fortune Magazine*. In their analysis they used Hofer’s four strategy approaches to derive at three successful turnaround gestalts. Consequently, the application of the asset/cost surgery would apply to businesses with low levels of capacity utilisation, selective product/marketing pruning would be applied to businesses with high capacity utilisation and the piecemeal strategy would apply to businesses that have high market share.

4.5.4.1 Summary of Hambrick and Schecter's contribution

Hambrick and Schecter (1983:247) contributed to turnaround modeling by identification of sub-strategies for business turnaround and three "gestalds" out of Hofer's four tier approach. They are:

- Asset/cost surgery,
- Selective product/marketing pruning
- Piecemeal strategy.

4.5.5 O'NEILL'S CONTRIBUTION (1986)

O'Neill (1986a:82) introduced sub-strategies to underscore the main turnaround strategies implemented by Hofer (1980:25). O'Neill used a sample of nine manufacturing and four service businesses, nine of which were turned around and four of which were non-turnaround businesses. Using selective market and product pruning, he identified a number of sub-strategies underscoring the main turnaround strategy. These sub-strategies are the following:

- Management process
  - turnaround effort usually preceded by management change
  - redefinition of businesss business
  - policy changes
  - growth strategies
  - attention to re-structuring
  - planning.

- Key factors in turnaround
  - competitive position
  - product life cycle/ general market conditions
  - industry type
  - change in competitive patterns
  - cause of decline

- o new strategic era.

4.5.5.1 Summary of O'Neill's contribution

The main contribution is the identification of sub-strategies for turnaround. The sub strategy approach broadens the scope of the investigative stage of the turnaround process. It does not necessarily contribute a new formula to turnaround strategy but emphasises the finer detail in the process.

4.5.6 ZIMMERMAN'S CONTRIBUTION (1989)

During 1986, Zimmerman (1986:113) investigated four turnaround businesses and concluded that there is a call for control in business turnaround situations. He argues that effective control can be achieved through the use of the right people, who will be characterised by their willingness to play an active role in establishing control. He conducted two studies: in study 1 the sample comprised four manufacturing businesses, including two turnaround businesses, one marginal business and one non-turnaround business. The data source used was public archives.

In study 2, the sample consisted of 15 mature manufacturing businesses, eight of which were turnaround and seven non-turnaround businesses. Zimmerman used financial records, manuscripts, case histories and interviews in his endeavour to identify successful turnarounds.

In conclusion, Zimmerman (1986:113) summarised a turnaround as the following:

- a multifaceted process which has minimum requirements
- a referent organisation
- a new and additive view of the environment
- a systematic approach to the process of examining the environment
- the critical clarification and articulation of values
- old values are preserved as new values are added
- traditional morality and values influence turnarounds

- the systematic withdrawal of resources improves organisational performance.

Later, Zimmerman (1989:117) structured a turnaround process that dealt with the planning of efficiencies, and he concluded that a moderate overhead structure is required. The focus is clearly on production efficiency and operational issues, as indicated by the lower left-hand column in figure 4.3. The process concludes with a "successful turnaround". The Zimmerman model mainly concentrates on operational inefficiencies in the business, and if these inefficiencies are addressed, caters for one outcome – a successful turnaround.

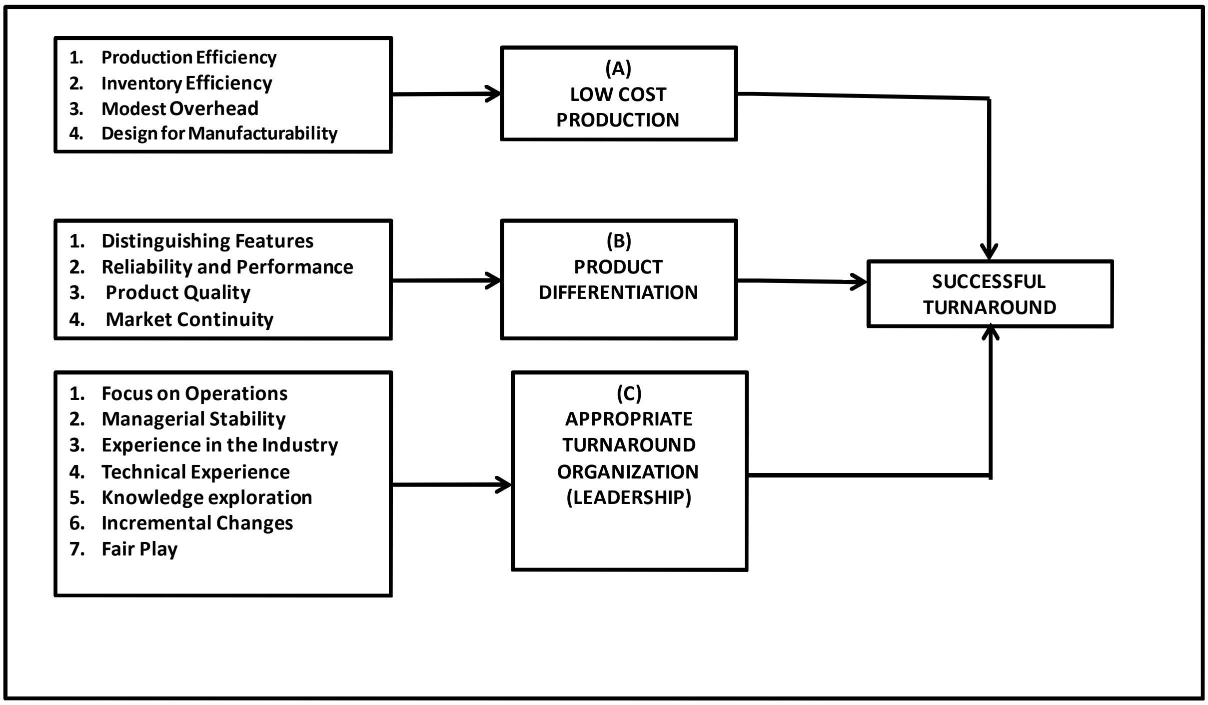

Figure 4.3 The successful turnaround process (Zimmerman, 1989:117)

4.5.6.1 Summary of Zimmerman's contribution

Zimmerman contributed to business turnaround by introducing a model that relates to the nature and severity of economic difficulties, a low cost producer, the differentiation of products and leadership, and the turnaround organisation.

4.5.7 BOYLE AND DESAI'S CONTRIBUTION (1991)

Boyle and Desai (1991:33) researched and characterised the causes of failure in small businesses, subsequently forming typologies from which to construct a generic approach to turnaround. They grouped 24 failure factors into four categories. The main aim of the grouping was to determine the origin of the warning signs – whether they are internal or external to the business, and whether they require an administrative or a strategic response. Figure 4.4 illustrates the response requirements against the matrix of origin and locality.

4.5.7.1 Summary of Boyle and Desai's contribution

Boyle and Desai contributed to turnaround modelling by introducing a four-cell approach to generic turnaround. These four cells are depicted in figure 4.4. The main attribute of this approach is that within these cells the variables are measured against the following quadrant matrix:

- internal
- external
- administrative
- strategic.

4.5.8 ROBBINS AND PEARCE'S CONTRIBUTION (1992)

Robbins and Pearce (1992:296) maintain that, at the stabilisation stage, the recovery must be matched to the causes of the decline, as this will be the test for implementing return-to-growth, entrepreneurial and/or operating strategies. Robbins and Pearce (1992:291) designed a two-stage turnaround response model including governance factors, which they used on 32 textile mill businesses in their research. The research was conducted using questionnaire and public/company archives.

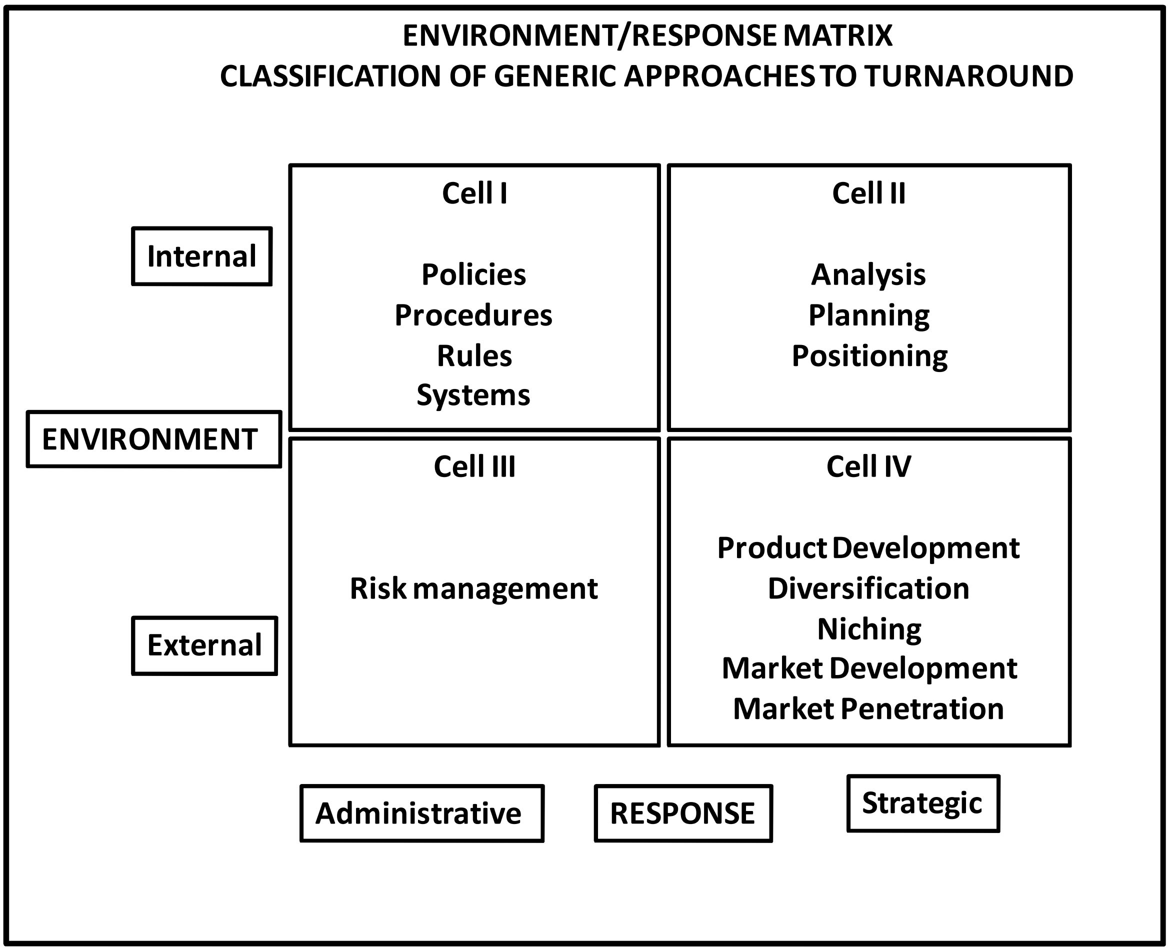

Figure 4.4 Environment/response matrix (Boyle & Desai, 1991:38)

The two stages identified are the turnaround situation and the turnaround response. Within this two-stage model they included three sub-stages namely the "cause", the "retrenchment phase" and, finally, the "recovery phase". The retrenchment phase was further developed by Robbins and Pearce and led to various academic debates. Pearce and Robbins (1993:614) extend the retrenchment theory, which they describe as a "deliberate reduction in costs, assets, products, product lines, and overhead" in the commencement stage of a turnaround. Castrogiovanni and Bruton (2000:25) raise a counter argument, when they challenged the Robin and Pearce II approach. They are against the generic approach of a retrenchment phase applicable to all turnaround situations.

According to Castrogiovanni and Bruton (2000), a turnaround strategy should be purpose made for a specific turnaround case, addressing the causes of decline. The Robbins and Pearce II turnaround model, illustrated in figure 4.5, acknowledges internal and external causes for decline. The focus of the model is retrenchment of costs and assets. In itself retrenchment forms part of any successful turnaround but it is not the only focus area of importance. The model finally allows for a recovery phase.

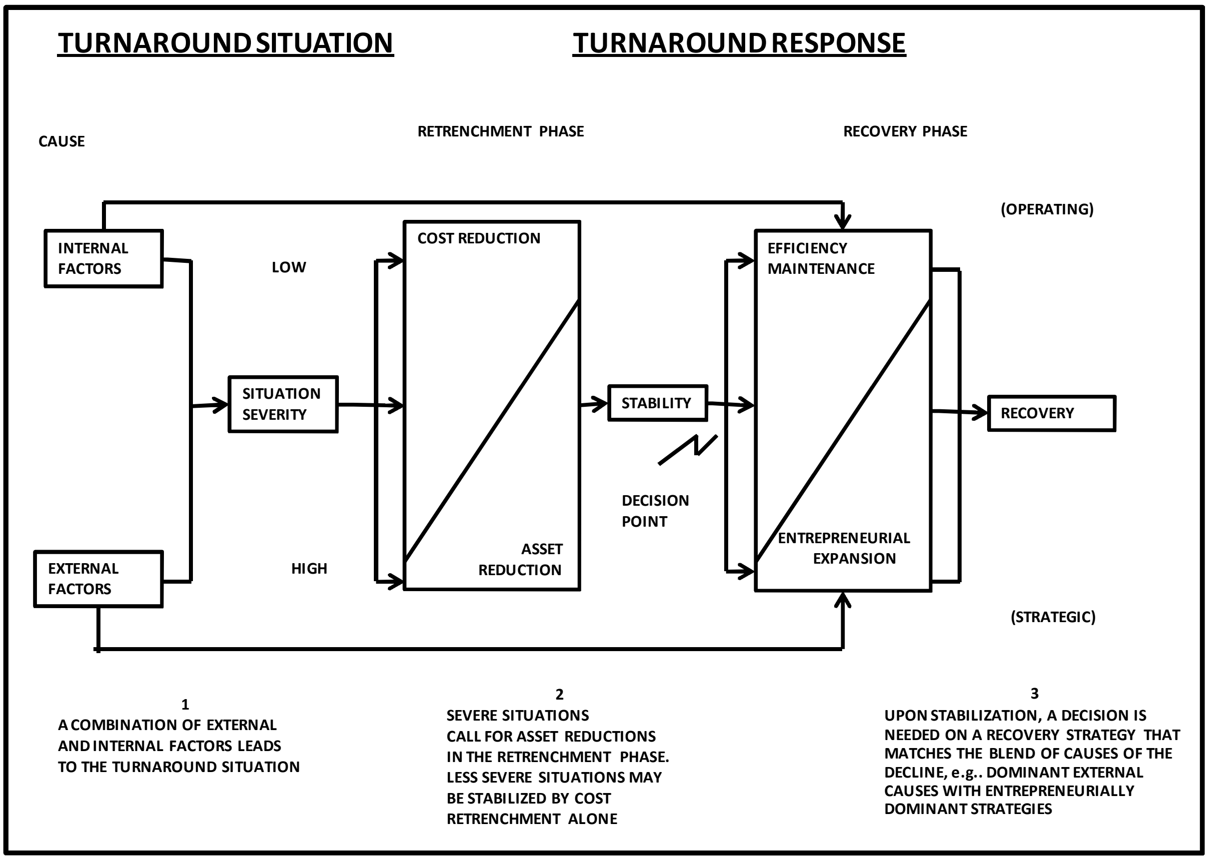

Figure 4.5 A model of the turnaround process (Robbins & Pearce, 1992:291)

4.5.8.1 Summary of Robbins and Pearce's contribution

Robbins and Pearce contributed significantly by identifying retrenchment and recovery processes in turnaround situations. They also added internal and external factors and concentrated on the situation severity, cost and asset reduction, and the stability of the business during turnaround. Finally, they concentrated on the recovery; when turned around the business focus is on efficiency maintenance and entrepreneurial expansion.

4.5.9 FREDENBERGER AND BONNICI'S CONTRIBUTION (1994)

Fredenberger and Bonnici (1994:60) argue that the turnaround process "if successful, may be chartered as an inverse product life cycle". Life cycle theories entail the "extension" of the life of a product or, as the authors indicate, the life of a business. They ponder on the information types that should be included in the investigative stage, which forms the focus of their study, and list the following types:

- cost analysis
- expense analysis
- productivity and human resources
- productivity and physical resources
- productivity of market
- financial analysis
- working capital analysis.

4.5.9.1 Summary of Fredenberger and Bonnici's contribution

In introducing the life cycle extension theory, Fredenberger and Bonnici align the product life cycle theory with turnaround and argue that a turnaround is an extended life added to the existing deteriorating life span of a business.

4.5.10 AROGYASWAMY, BARKER AND YASAI-ARDEKANI'S CONTRIBUTION (1995)

Figure 4.6 concentrates on strategic reorientation and incremental strategic change. Arogyaswamy *et al.* (1995:494) debate the constraints of turnaround modelling, highlighting their major concerns:

- modelling focussing primarily on, retrenchment and efficiency improvements as initial response to decline
- turnaround often does not model the most important contingencies affecting the turnaround process

- turnaround models fail to capture the complexity of the turnaround process.

The model concentrates on the interaction between variables and forces within the business. It proposes that turnaround businesses demonstrate two distinct outcomes in response to decline. The first response is “decline-stemming strategies that reverse the dysfunctional consequences of decline”, and the second response, which is in line with this research focus, “recovery strategies that position the business to better compete in its industry”.

4.5.10.1 Summary of Arogyaswamy, Barker and Yasai-Ardekani’s contribution

They contributed by introducing a two-stage contingency model of business turnaround:

- decline stemming strategies
- recovery strategies.

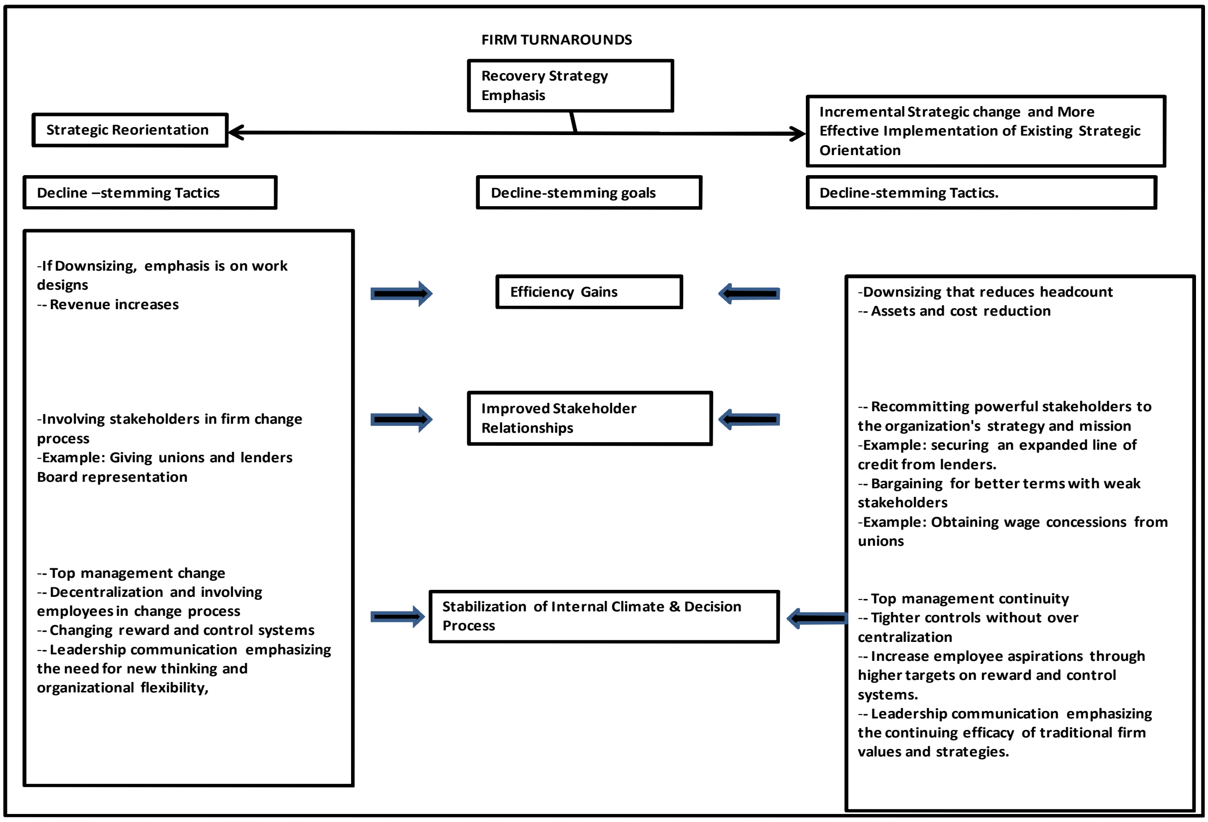

Figure 4.6 Business turnarounds (Arogyaswamy *et al*. (1995:494))

4.5.11 LOHRKE, BEDEIAN AND PALMER'S CONTRIBUTION (2004)

Lohrke *et al.* (2004:172) agree that the first stage of a turnaround is a situation analysis (see fig. 4.7). These authors (2004) conclude that it is necessary to look beyond financial decline to broader indices that trigger the turnaround process, and thus introduced the Top Management Team (TMT) scanning behaviours.

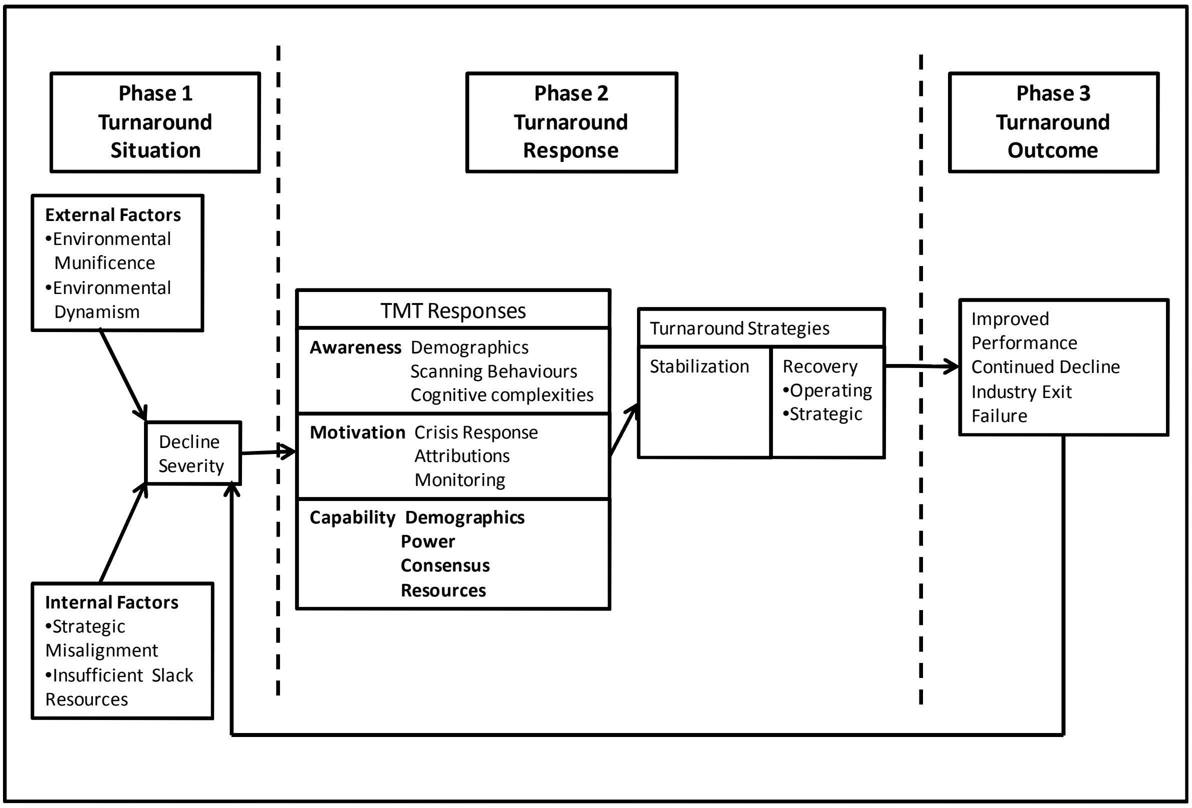

Figure 4.7 An expanded model of the turnaround process (Lohrke *et al.*, 2004:73)

4.5.11.1 Summary of Lohrke, Bedeian and Palmer's contribution

Lohrke *et al.* introduced the Top Management Team (TMT) approach. In terms of this approach they identify a three-phase turnaround process:

- turnaround situation
  - decline
- turnaround response
  - response initiation

- turnaround outcome
  - transition
  - outcome.

4.5.12 SMITH AND GRAVES'S CONTRIBUTION (2005)

Smith and Graves (2005:308) attribute the distressed state of a business to the severity of the problem. They ponder on the influence of the business size and the free assets available. Under the heading "decline stemming strategies", they discuss the execution of the turnaround which evidently led to stabilisation, and address the causes of decline and the business's competitive position. Smith and Graves (2005:316) developed a turnaround model to reduce the misclassifications brought about by type I and type II errors, measuring the severity of distress.

The turnaround process (fig. 4.8) that they propose is quite comprehensive, and addresses the turnaround situation in terms of the causes of decline. The second stage in their model is to formulate decline-stemming strategies, which concentrate on internal efficiencies and support. Then, before entering into the recovery phase of the model, the causes of decline are revisited. The recovery decision will have two proposed directions, firstly, maintenance and, secondly, reconfiguration. The final phase is the extent of the recovery, which can be successful or not.

Smith (2005:73) argues that a liquidation analysis of the business's balance sheet is useful when considering a going concern. A range of researchers and authors, (as indicated in appendix C), however, did not include the investigation of the affairs of the business in their research as a first stage analysis of the turnaround event. Nevertheless, the researchers that did include the investigation of the business's affairs have various approaches and terminology for this stage.

4.5.12.1 Summary of Smith and Graves's contribution

Smith and Graves see turnaround as two key phases and a series of integrated steps. The two key phases are the decline stemming and the recovery phase. These concentrate on the severity of the financial distress, the amount of free assets available, size, ability to stem the decline, stabilisation, retrenchment activities to improve efficiency and cash flows.

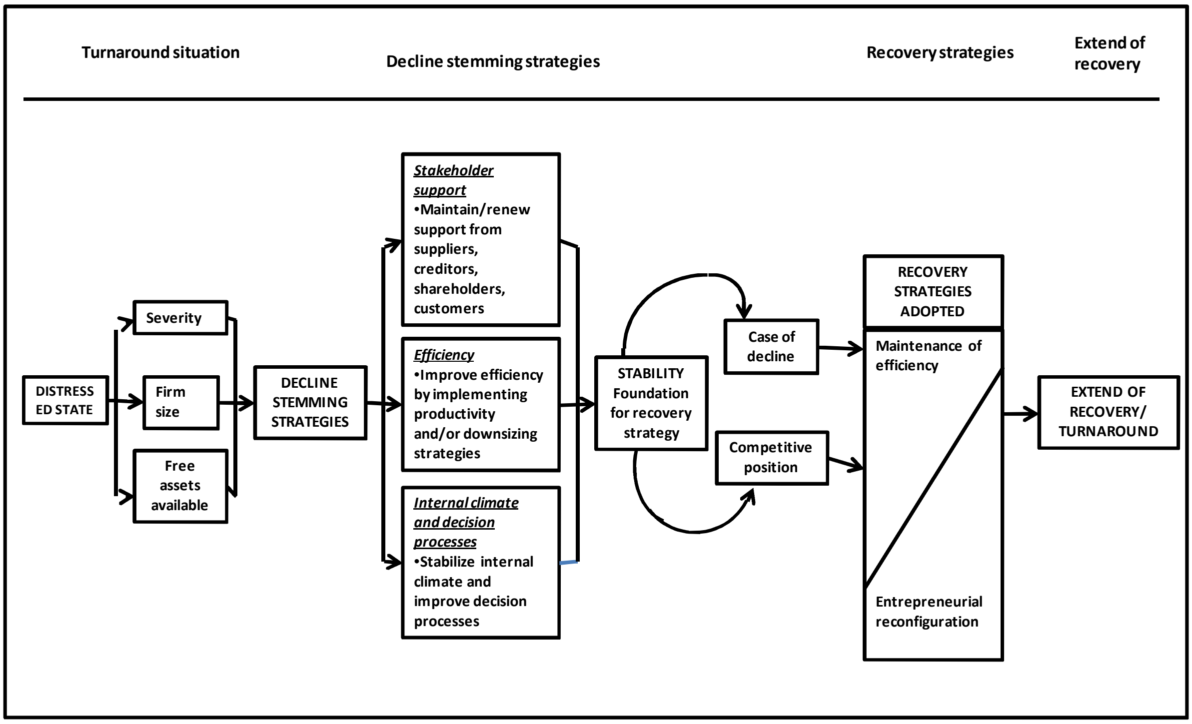

Figure 4.8 Turnaround process (Smith & Graves, 2005:308)

4.5.13 SHEPPARD AND CHOWDHURY'S CONTRIBUTION (2005)

Sheppard and Chowdhury (2005:245) add a specific outcome to the turnaround process. This can be either success or failure, as shown in figure 4.9. The perceived shortcoming would be to have a step in the process that will highlight the probability of failure early in the process.

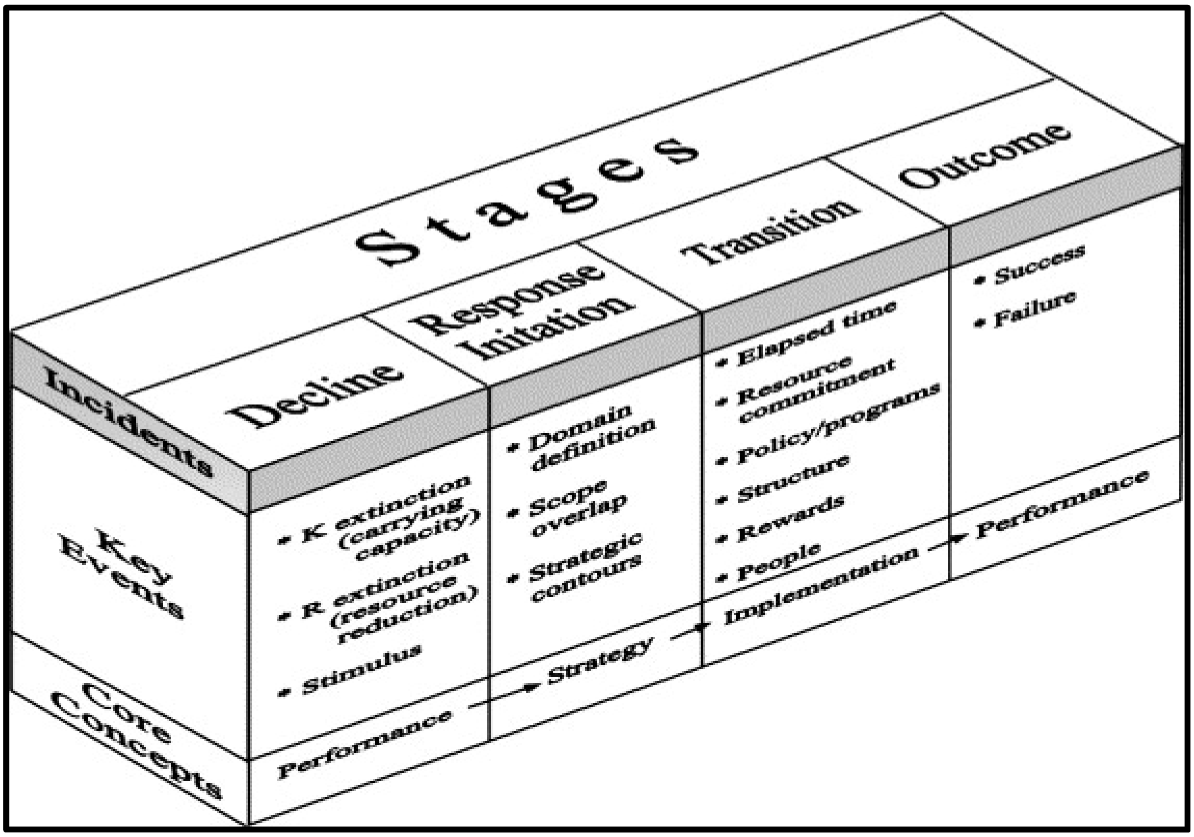

Figure 4.9 Key events and core concepts in turnaround/failure (Sheppard & Chowdhury, 2005:245)

4.5.13.1 Summary of Sheppard and Chowdhury's contribution

The introduction of success and/or failure into a model.

4.5.14 PRETORIUS (2008)

Figure 4.10 illustrates the way in which Pretorius (2008a:23) perceives the unique set of preconditions that prevail in the Porter strategic model. He opines that the Porter model's view of opportunity and competitive advantage are analogous to a turnaround situation. Ormanidhi and Stringa (2008:62) also favour the Porter model of generic competitive strategies to evaluate business. They argue that the use of this model is complementary owing to the following qualities:

- its popularity, as it is substantially used
- the model has a well-defined structure
- the feasibility of the structure in empirical use
- concept clarity of the model

- the simplicity and generality of the model.
- owing to the high degree of detail the model complements other models.

Pretorius splits the precondition for a turnaround event into four distinct categories: performing well, underperformance, distress and, finally, decline. A turnaround situation is determined by its own configuration of preconditions (see fig. 4.10) and many additional lesser variables may play a role or act as triggers.

Businesses in the "performing well" quadrant, depicted on the top left of figure 4.10, are not experiencing conditions that warrant a turnaround. Typically, they experience good sales demand, growing market share and established competitive advantage.

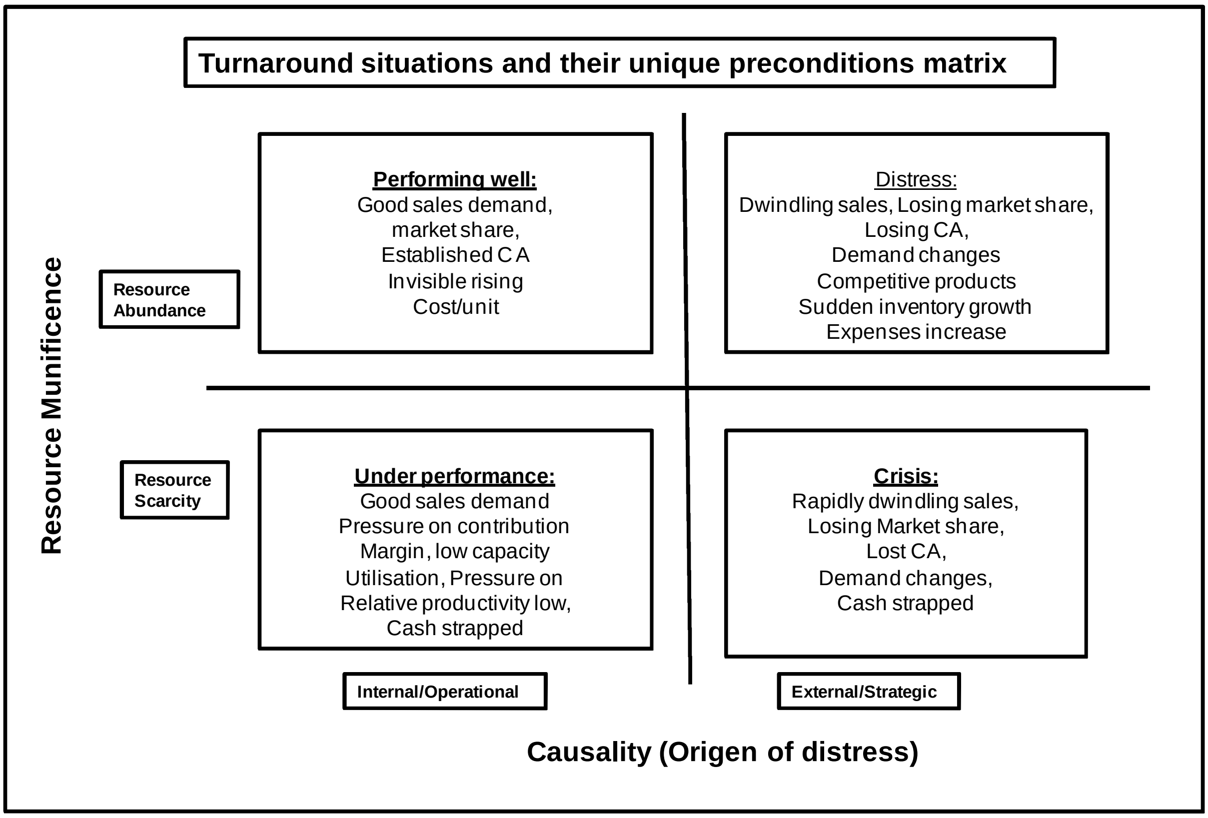

Figure 4.10 Turnaround situations and their unique preconditions matrix (Pretorius, 2008:23)

The quadrant depicting "underperformance", is disposing of scarce resources. Capacity utilisation is low, and a poor positioning on competitive advantage is evident. Consequently, a turnaround situation is inevitable to address the very inefficiencies that create the underperformance.

The preconditions for the distress quadrant are characterised by abundant resources but declining sales demand owing to a loss of competitive advantage.
Hence, a turnaround situation is inevitable to address the loss of market share, quality and/or service issues causing the distress.

Decline quickly turns into a crisis and a definite turnaround event. However, a turnaround intervention may be too late, depending on the severity of the crisis. As part of a turnaround, liquidation or the selling of non-core divisions could be contemplated.

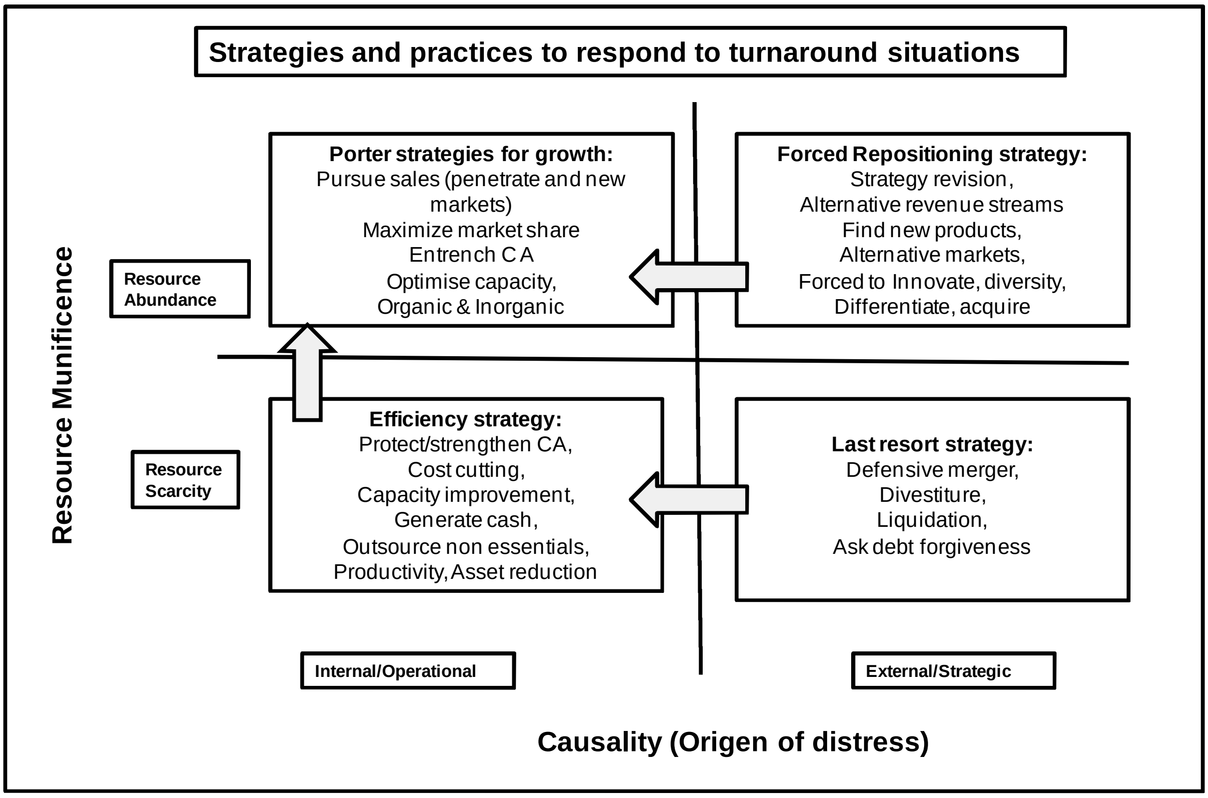

Figure 4.11 Strategies and practices to respond to the turnaround situations (Pretorius, 2008:24)

4.5.14.1 Summary of Pretorius's contribution

Pretorius (2008a:24) states that business turnaround essentially demands a new choice of Porter's generic strategic options as a focal point. In last resort strategy it requires divestiture or liquidation and the start up of new ventures, which involves determining the new positioning and where competitive advantage will be sought. With abundant resources, Pretorius concludes that "Porter's matrix is still core, but when there is scarcity of resources, the focus moves towards finding efficiency first".

4.6 TURNAROUND PLANNING

Seminal work has been done by Bibeault (1982), Hofer (1990), Barker (1998, 2005), Brenneman (1996), Dolan (1983), Fredenburger (1994) and Pearce and Robbins (2008) and, in the South African context, Harvey, (2002), Burdette (2004), Loubser (2004) and Pretorius (2004). Pandit (1997:33) has grouped the salient research done by researchers, academics and authors from 1976 up to 1995. Pandit's table classifies the theory into 1) unit of analysis; 2) sample characteristics; and 3) data source(s). His summary of research progress is reflected in Appendix D. All the authors, some to a lesser extent, agree on the investigation of the sources of decline. Turnaround practitioners and other stakeholders are constantly challenged with type I and type II errors. A type I error is to turn around a company that should not be turned around, and type II error is to not turn a business around that should have been turned around.

The alleviate this problem, Quinn *et al.* (1988:681) posed the following questions to be answered when assessing a business turnaround:

- Is the business worth saving?
- Sustainable or disinvest or liquidate?
- State of current operating health?
- State of current strategic health?

Castrogiovanni, Baliga and Kidwell (1992:27) pose the following questions, which need to be added to the questions posed by Quinn *et al.* (198:681):

- How sick is the business?
- In what stage of decline?
- CEO management involvement?

To arrive at appropriate answers to these questions, Gopal (1991: 81) proposes that the analysis should include an investigation of the:

- strengths and weaknesses of the business
- market
- organisational structure and quality and quantity of manpower
- finances.

The importance of establishing the business's value at an early stage of turnaround, in this instance the investigative step in a turnaround, is confirmed by Brockman and Turtle (2002:512) and Glantz (2003:314), maintain that an ideal situation for decision making at this stage would be to compare a liquidation scenario valuation with a going-concern (turnaround) scenario. Cocq, Legoux, De Loe, Oka and Zorn (2006:43), who conclude that there seems to be consensus that some form of feasibility and/or due diligence must be done in a very short space of time, confirm this consideration.

Akason and Kepler (1993:38) discuss the difference between a business review and the due diligence process. They conclude that the investigation should include:

- fully backed findings
- quantifications
- possible solutions
- guideline on managing a review which is also applicable to turnaround planning.

The due diligence process was discussed in chapter 1 as a tool for investigating a business's activity effectively. In the context of business turnaround, where a merger or acquisition is contemplated as part of the turnaround plan, Gillman (2001:7) defines a due diligence as follows:

- the examination of a potential target for merger, acquisition, privatisation or similar corporate transaction, normally by a buyer
- a reasonable investigation focusing on future material matters
- an examination being achieved by asking certain key questions, including, do we buy, how do we structure the acquisition and how much do we pay?
- an examination aiming to make an acquisition decision via the principles of valuation and shareholder analysis.

Business consultants, accountants and legal practitioners have embarked on their own design and approach to formulating a due diligence process. The Axiomate Group (2004) focus on the five key elements in a business infrastructure.

They are:

- technology
- finance and administration
- operations
- sales and marketing
- people, culture and organisation.

The importance of data integrity is underpinned by Cole (1994:48) in the early stages of the due diligence process. Cole states that it is crucial to get entrepreneurs to understand that providing high-quality information will speed up the process. This imperative is also true for a turnaround intervention.

The first phase of business turnaround planning, the investigative phase, is discussed briefly under the heading "Investigative phase". The application of verifier determinants during the investigative stage are of the utmost importance. Chapter 3 of the study has dealt comprehensively with the concept of verifier determinants.

Subsequently, the second phase of the turnaround planning is the actual drafting of the plan.

4.6.1 INVESTIGATION PHASE

The investigative phase is paramount in most authors' turnaround modelling discussed earlier in this chapter. In Section 130 of Chapter 6 of the new Companies Act is quite clear as to the responsibility of the turnaround practitioner. The practitioner must establish whether there is no reasonable basis for believing that the company is financially distressed, or that there is no reasonable prospect of rescuing the company. Section 141 states that the practitioner must, as soon as the investigation into the company's affairs is completed, "consider whether there is any reasonable prospect of the company being rescued".

This section further dictates that if the turnaround practitioner detects any adverse problems which will have an impact on the feasibility of doing a turnaround, the practitioner must inform all stakeholders. The most important outcome of the investigation phase when it is decided not to continue with a turnaround is depicted at the bottom of figure 8.1 (p233). The business can arrange for a compromise in terms of Section 150 of the Act, or the business can be liquidated as per Section 141(2)(b), which reads as follows: *"… apply to the court for an order discontinuing the business rescue proceedings and placing the company into liquidation."*

After due consideration of the responsibilities implied by the new Act, and predicting a positive representation, a decision will be made to continue with a business turnaround plan.

4.6.2 THE PLAN

The considerations that have to be included in the turnaround plan, as prescribed by the new Act, are dealt with comprehensively in section 5.7 in the next chapter. For the purposes of this chapter, reference is made to the salient research on the subject. The second column of Appendix B illustrates the full literature response to the planning phase.

The plan must demonstrate a defensible strategy in order for the courts and creditors to favour turnaround proceedings. In Grant Thornton's Catalyst Management Issues (2005b:2), they conclude that the funding requirements, future cash flow and debt repayment in relation to the turnaround plan must be "assessed with a high degree of certainty". Turnaround plans are clearly divergent (but not exclusive) from conventional business plans. Start-up businesses have projections for future possible performance issues, whilst existing businesses apply business plans to create new ventures, acquisitions and a change in business strategy.

The lack of proper measurements to test the validity and reliability of business turnaround plans by financial institutions and trade creditors has resulted in a deterioration in the use of and reliance placed on business plans as a business assessment tool. It is important that entrepreneurs identify the associated warning signs in a timely fashion in order to re-strategise and reorganise the business and steer it to safety. Entrepreneurs are reluctant and in many instances ill-equipped to compile the turnaround plans needed to initiate negotiations with creditors. This important management tool is then outsourced, and left to "professionals" to compile.

The environment in which an entrepreneur needs to promote his change (turnaround) plan is predominantly a hostile environment. Nevertheless, Hall (1980:75) concludes that survival is possible in a hostile environment if successful survival strategies are planned and implemented. The mere fact that entrepreneurs often do not compile their own turnaround plans lead to a total lack of understanding of their own businesses and contributes further to the poor reliance placed on turnarounds by creditors in general. Entrepreneurs seldom, if ever, apply turnaround plans as a strategic management tool to enhance their businesses. Section 150 of Chapter 6 of the new Companies Act requires that a business turnaround plan has to be presented to all creditors concerned, including the courts, in order to convince them to agree to a stay of proceedings.

Creditors have to be placed in a position to assess the turnaround plan before they can be expected to support the turnaround attempt by either reducing their claims and/or supporting it by extending lending or trade credit.

A turnaround plan will most probably not mirror a conventional business plan, as a more vigorous approach to strategic change will be required.

Balgobin and Pandit (2001:304) identify four categories addressing the formulation of a turnaround plan. They are “situation analysis, gaining control, managing stakeholders and improving motivation”. Once approved, the entrepreneur’s behaviour will have to adapt to the planned restrategising of the venture and they need to be aware of the possible impact. For this reason, a willingness to change needs to be present.

It is of the utmost importance that the personnel of the business are aware of the turnaround situation and the planned turnaround execution. Balgobin and Pandit (2001:314) argue that a turnaround plan which is communicated properly will reduce confusion and protect key critical resources. Kow (2004a:242) confirms this view by concluding that a communications plan must be part of the turnaround strategy in order to ensure that the concerns of employees are dealt with. The turnaround models in the literature (discussed under subsection 4.5), research did not include communication as a specific step, although clearly a very important factor is maintaining motivation levels.

The second and maybe the most important function of a proper turnaround plan is to ensure that future investors (post commencement finance) are confident that the business can return to sustainable competitive viability. Han, Huml, Kkaragal, Saito and Sundjaja (2007:7) are of the opinion that investors tend to divest if the turnaround plan lacks momentum and adequate execution. Cozijnsen, Vrakking and Van Ifzerloo (2000:153) also believe that the turnaround plan should include and consider the following variables:

- planning objectives
- organisational structures
- increased profits
- increased turnover
- increased efficiency

- improved effectiveness
- higher productivity
- increased market share
- improved environment
- quality improvement
- human objectives
- reduction of staff turnover
- increased employee satisfaction
- enhanced motivation of employees
- improvement of work environment.

Harker (1998:325) concludes that the foundation of a turnaround plan "is sound market knowledge". He states that there is a need for information and proper analysis of variables before constructing a turnaround plan. Clearly, sifficient time needs to be allotted to a business review in order to prepare and do a due diligence before the plan is presented to all parties. In this study, the possible turnaround models currently available to entrepreneurs in South Africa were investigated. Findings indicate that two distinct directions can be followed, namely, formal and informal turnaround.

The United Nations Commission on International Trade Guide (UNCITRAL) (2001:10) clearly indicates that one of the objectives of restructuring a business is to create a framework that will encourage entrepreneurs (businesses) to address their financial distress factors at an early stage.

4.7 CONCLUSION

From the literature exploration it is evident that some authors, such as Altman and Hotchkiss (2006), approach the study of turnaround management with a qualitative data approach, although accounting data formed the basis for most of the empirical research debated in the academic journal articles. Fortunately, a number of authors, such as Bibeault (1982), O'Neill (1986), Riana *et al.* 2003) and McCann *et al.* (2009), have a more pragmatic approach to turnaround and tend to drill down into the micro or qualitative issues. The timing of a turnaround is one of the more contentious issues addressed by stakeholders both internationally and nationally; and the main differentiator between business strategy and turnaround strategy manifests itself in the time factor. Turnaround is typified by very limited time as opposed to a business strategy that is moving less urgently. The second differentiating factor is that of resources, that is, scarce resources in turnaround, versus planned resources in normal strategic planning.

A number of models and/or actions in turnaround planning were identified and discussed in this chapter. Investigations into the new South African Companies Act, Act 71 of 2008, established the format of turnaround plans under Chapter 6 proceedings which will be dealt with in chapter 5 section 5.7.