

CHAPTER 8

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CHAPTER 8

CONCLUSION

“The fact is, you can’t afford to think too much during a turnaround. Time is tight; money is tighter. If you sit around devising elegant and complex strategies and then try to execute them through a series of flawless decisions, you’re doomed.”

And

“Did you know that there are no rearview mirrors on an airplane? The runway behind is irrelevant.”

Brenneman (1998:163, 164)

8.1 INTRODUCTION

The closing chapter comprises a summary of the conclusions and empirical findings in terms of a turnaround framework. The research is concluded by revisiting the research objectives and discussing the limitations of the research. In addition, the contribution made by the study is identified and recommendations are made for future research. This chapter concludes with a critical summary of the main conclusions, definitions and frameworks.

In the previous chapters, the foundation for an academic framework was laid. In order to achieve the research objective of identifying verifier determinants, various opinions from a business, an accounting and a legal platform were presented. These opinions are identified within a framework of early warning signs and turnaround practice. In the discussions with a selected expert group, it became clear that some of the experts’ opinions are similar, but have varying denotations and use different terminology. Instances where the outlook on approaches was the same were grouped.

8.2 SUMMARY OF THE MAIN FINDINGS

This study introduced a number of new constructs that can be used in a business turnaround context, namely:

- business triage (section 1.3, fig. 1.1)
- verifier determinant (section 1.5, fig. 1.2)
- turnaround framework, introducing the constructs “business triage” and “verifier determinant” (section 8.5, fig. 8.1)
- a timeline schedule for executing the rescue process (section 5.6.2, fig. 5.1).

Although the psychology of turnaround was not the focus of this study, the relevant turnaround literature highlighted the importance of the psychological impact of turnaround on entrepreneurs. The successful administration of a business is only a small part of the challenges facing entrepreneurs, and the psychological impact that the decline, distress and turnaround of a business has on the entrepreneur should not be underestimated.

In order to save their businesses, entrepreneurs must be equipped with the knowledge needed to formulate and implement rescue plans. In chapter 2, the deduction was made that entrepreneurs operate under behavioural patterns of high-risk acceptance. In line with this, this research has identified and addressed the need for an early warning control system in businesses.

Formal rescue/turnaround routes are, owing to various negativities and high costs, undesirable and entrepreneurs will favour a more informal approach. However, there are a multitudes of dangers and constraints that can negatively affect a possible successful rescue/turnaround. The introduction of a commercial process of business rescue proceedings will hopefully address these constraints.

The literature study considered seminal work on early warning signs which was summarised and analysed comprehensively in Appendix A.

The deduction made was that authors use an array of terminology to arbitrarily describe early warning signs, *inter alia*:

:

- success versus failure variables
- causes of decline and/or failure
- warning indicators for business decline
- performing and non-performing variables
- root causes for decline or failure
- warning indicators
- material defects
- external and internal factors
- distress variables
- problems
- challenges.

Notwithstanding the various ways of describing early warning signs, the authors, as per appendix A, seem to have consensus on the five main early warning sign categories. The classification of warning signs identified by authors in the literature was largely confirmed in a comprehensive literature and case research, which was discussed in chapter 6 of this study. The case research conducted with a sample group of credit specialists in a banking environment identified various early warning sign categories. This group confirmed the main categories and explored the variables associated with each.

Using the five main categories identified by academics and confirmed by the case research, the literature research is summarised in Appendix A. Banking early warning signs are not discussed by most authors, as they are clearly industry specific and are favoured by authors researching financial institutions. These signs are included as Appendix B. Owing to the fact that this research was conducted within a financial institution, banking signs were reflected separately.

Turnaround management has evolved as more research data has become available over time. From the literature explored in this research it is evident that most authors approach the study of turnaround management from a non-accounting data perspective, with some authors adopting a pragmatic approach to turnaround, which tends to drill down into the fine details or qualitative issues.

The timing of a turnaround is one of the more contentious issues addressed by stakeholders both internationally and nationally. Turnaround is typified by very limited timeframes, while the very nature of business strategy planning and execution means that they move at a more pedestrian pace.

The second differentiating factor identified by this research is the availability and importance of resources; that is, in a turnaround situation resources are generally scarce, whereas under normal circumstances they are usually planned for.

Most of the countries investigated have adopted some form of debtor-friendly insolvency regime. Legislation and/or actions of a number of countries that have adopted specific turnaround planning methodology were identified and discussed in this study. Investigations into the South African Companies Act, Act 71 of 2008, established the format of turnaround plans under Chapter 6 of the Act; proceedings which were substantially dealt with in chapter 5 of this research. The literature review confirmed the following similarities between the various debtor-friendly regimes:

- rescue is seen as part of a business process
- there is a clear process for commencing with business rescue
- a person is appointed who is responsible for the turnaround process
- a turnaround plan is central to all turnaround options and has to be sanctioned by creditors.

It is envisaged that the same process will play itself out in South Africa as Chapter 6 of the Act is tested in the courts. It will take the South African courts some time to adjust to the proposed new way of treating 'bankruptcy'.

What will be of interest is how business is going to react to the debtor-friendly regime and its implication for entrepreneurs and business alike.

This study contributes significantly to assisting entrepreneurs, banker officials and turnaround managers with a framework for approaching turnaround.

8.3 RESEARCH OBJECTIVE

The following objectives were identified for this research:

Primary objectives

- To identify and theoretically define early warning verifier determinants.
- To design and include “verifier determinants” as an integral part of a turnaround plan that supports corrective action.

Secondary objectives

- To research the current formal turnaround practices for verifiers that are applied in the United States of America, Canada, Australia, Africa and the informal practices evident in South Africa. These findings are aligned to include the changes in the applicable South African legislation.
- To design and propose a framework for use by turnaround practitioners and entrepreneurs alike.
- To identify which verifier determinants will confirm the early warning, and apply this outcome to the design of a reliable turnaround framework that is accepted by all creditors and financial institutions.
- To contribute to the South African entrepreneurial, turnaround fraternity, and future formal studies in this academically ill-represented field.

8.4 IN PURSUIT OF THE PRIMARY OBJECTIVE

The research conducted an investigation into various early warning sign constructs and elements, which should become a prerequisite for formal business turnarounds. One of the major changes in the legislation is the stipulation that an attempt must be made to turn around a troubled business before winding up or liquidating the concern. King includes this provision in the King III report (2009) on corporate governance.

The main objective of a turnaround/rescue must be that the entrepreneur and turnaround practitioner together develop a turnaround plan that is specifically designed to reorganise and rescue the business. This research has successfully attained the first primary objective by theoretically defining early warning verifier determinants. In this study a 'verifier determinant' is defined as the 'root' indicator that validates the cause of decline or distress that underscores the early warning sign.

- The literal meaning of verifier is thus to confirm, validate and ensure that the early warning sign identified is, in fact, present.
- The term 'determinant' reflects the agreement or consensus on the warning. sign verifier.

This study used early warning sign theory to establish verifier determinants that can guide entrepreneurs and turnaround practitioners in the timely planning of the current rescue and future sustainability of an enterprise. Verifier determinants, once identified, impact significantly on authenticating warning signs and can be used progressively in the diagnostic phase of the turnaround process. The effectiveness of business turnarounds depends on the chosen strategy, of which the verifier determinants will be an important component.

As soon as they are identified and confirmed, the verifier determinants can assist in defining a turnaround event. Verifier determinants are used to confirm early warning signs, which will be used extensively to confirm causes, verify the correct warning

sign and substantiate the issues to consider when compiling a strategic rescue plan. The identification of verifier determinants will also contribute to the uncovering of other hidden critical issues. The use of verifier determinants is essential when attempting to classify the warning signs used in the enormous array of business applications such as operational non-efficiencies. Verifier determinants can contribute to the day-to-day monitoring of the business, if used as a prolonged business activity.

The qualitative research contributed uniquely to the limitations of early warning signs by developing the verifier determinants, each with its own set of variables. Tables 7.10 to 7.14 contain the unique variables that experienced turnaround participants use to guide their decision making through the verification of early warning signs.

8.5 IN PURSUIT OF THE SECONDARY OBJECTIVE

This section now demonstrates that the second objective has been attained by proposing a turnaround framework which includes verifier determinants as an integral part of the turnaround plan. Figure 8.1 proposes verifier determinants as the first step in this plan, during the actual investigation and planning, as well as in the 'setting-up' phase. The verifier determinants, used as an integral departure point in the decision frame, should allow the stakeholders to reach a decision outcome within a very short space of time. Verifier determinants used on a continuum (continuum in a longevity process) throughout the turnaround phase will have the effect of instituting corrective action, as and when strategic change is necessary. The literature dealing with turnaround methods, strategy and processes was comprehensively analysed and is summarised in Appendix C.

The research results confirmed Early Warning sign theory - but expand theory by adding the Verifier Determinant as a construct. Verifier Determinants introduces constructs that provides for illogical, subcontious, and judgemental information that is not conteplated in the current early waring sign theory.

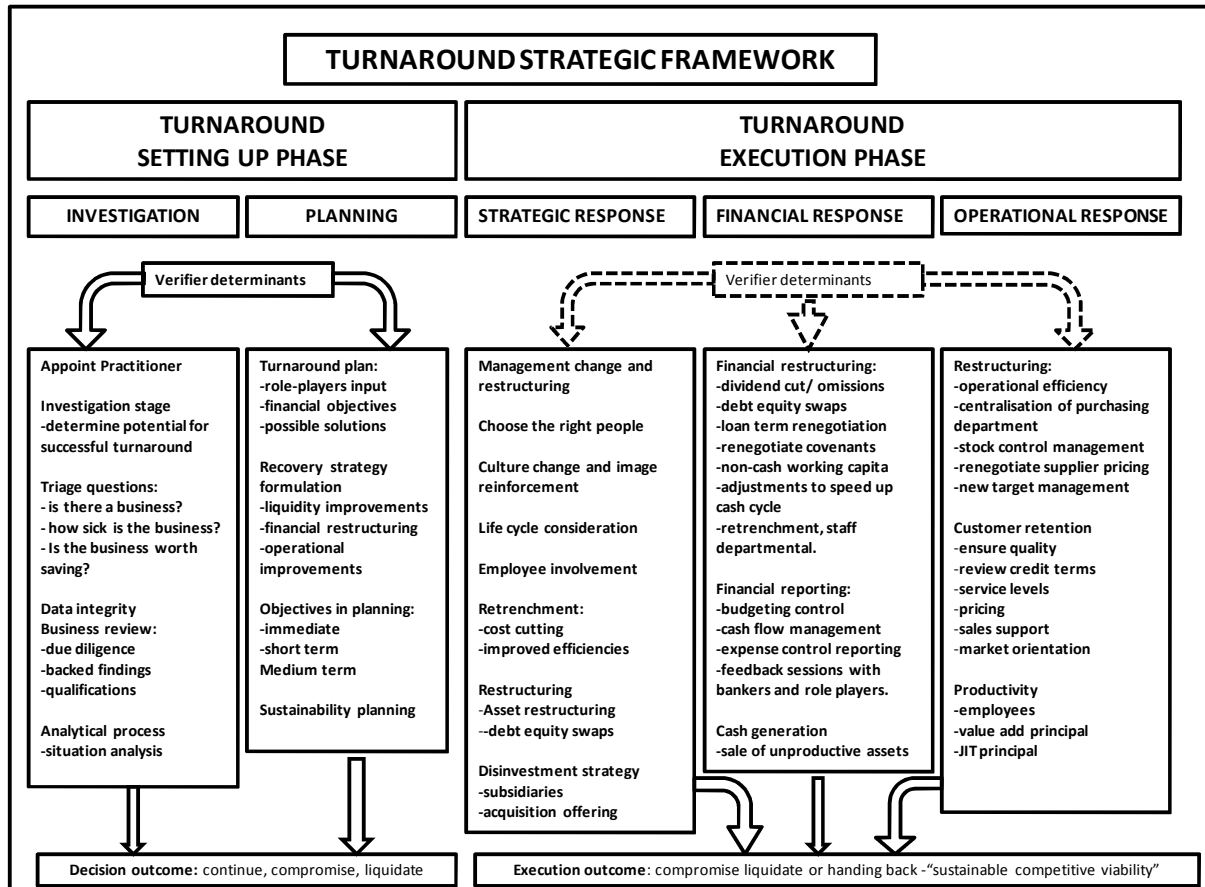


Figure 8.1 Turnaround strategic framework – process view

The framework in figure 8.1 shows the phases of a turnaround, each with its key elements. Verifier determinants are crucial to both the investigation and the planning phases but have also been shown to be valuable (if used) during the response phases. The possible outcomes are shown at the bottom of the figure.

In the literature reviewed, authors tended to concentrate on one or more of the constructs within the turnaround process. Some focus on the investigative stage (section 8.6.1) of the turnaround, while others focus on the implementation (section 8.7) of measures to execute the plan.

The focus of the turnaround framework proposed in this study is to consolidate the various viewpoints. In order to have a successful outcome, all the different constructs must be combined in one turnaround framework and the disciplines must operate in concert. Figure 8.1 illustrates the interaction by way of a flow from the setting-up phase through to the execution phase.

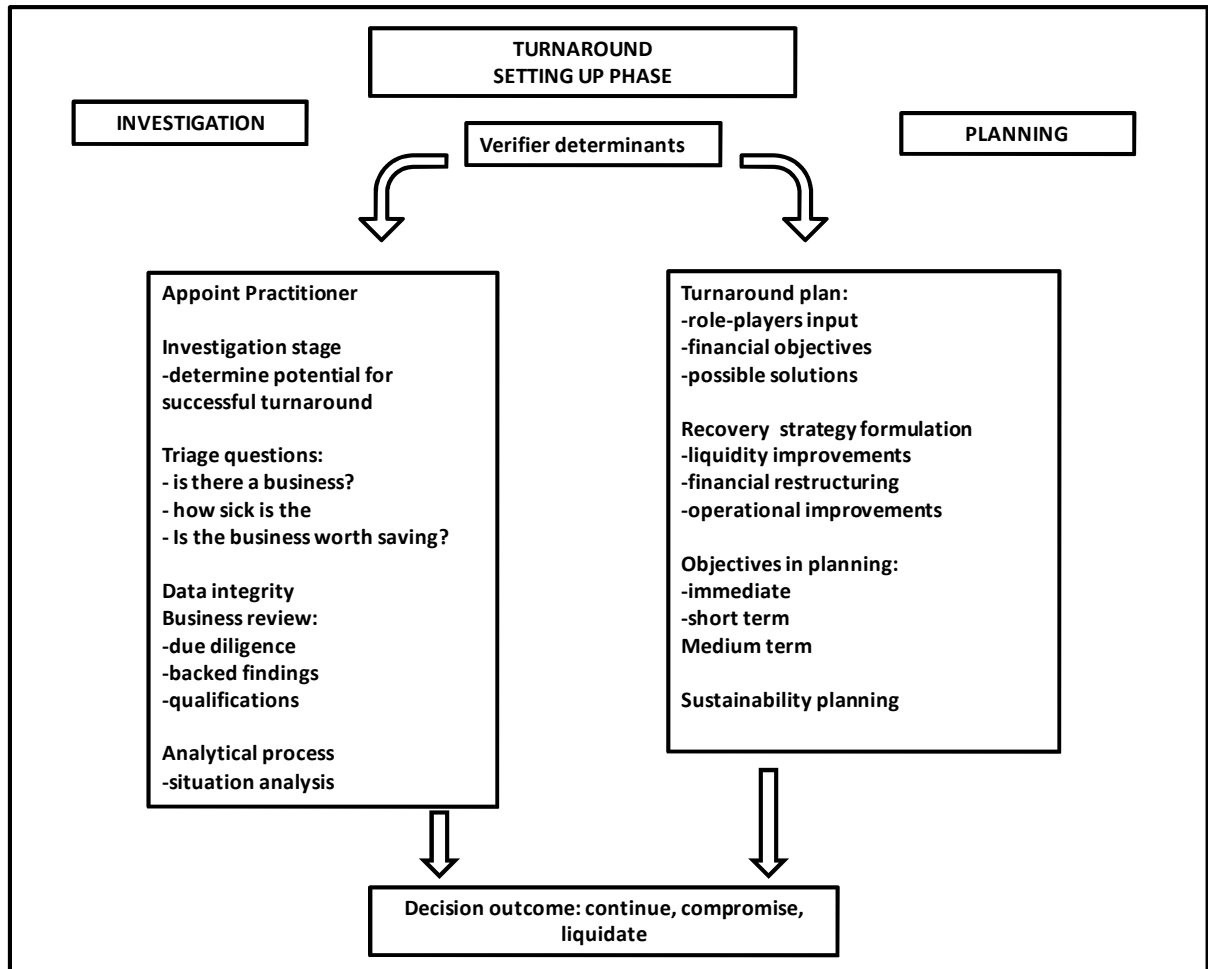


Figure 8.2 Turnaround strategic framework – setting-up phase focus

8.6 THE SETTING UP PHASE

The turnaround framework proposes two distinct phases in a turnaround situation. These phases are the investigative phase and the planning phase, as illustrated by figure 8.2 (abstracted from fig. 8.1). The investigative phase is critical in assessing the business environment once a turnaround situation occurs and during the actual turnaround execution. During this phase it is proposed that the verifier determinant theory will have its main impact on the decision-making process.

8.6.1 INVESTIGATION

Before a turnaround practitioner effects any major changes to the business, he or she must investigate and determine the business's chance (viability) of survival.

The business must appoint a turnaround practitioner within five days of filing the rescue notice at the court and this practitioner then is obliged to embark immediately on an investigation of the company's affairs. The new Companies Act requires that the turnaround practitioner must, as soon as possible, after his/her appointment; report on the turnaround viability of the business. In this initial assessment the use of verifier determinants is crucial to the investigation as they confirm problematic areas in the affected business.

8.6.1.1 Triage questions

In order to determine the potential for successful turnaround, the practitioner will have to do a quick assessment of the distressed business. What the turnaround framework proposes is that an assessment of the business is carried out by using the concept of triage, which was explained in section 1.3.

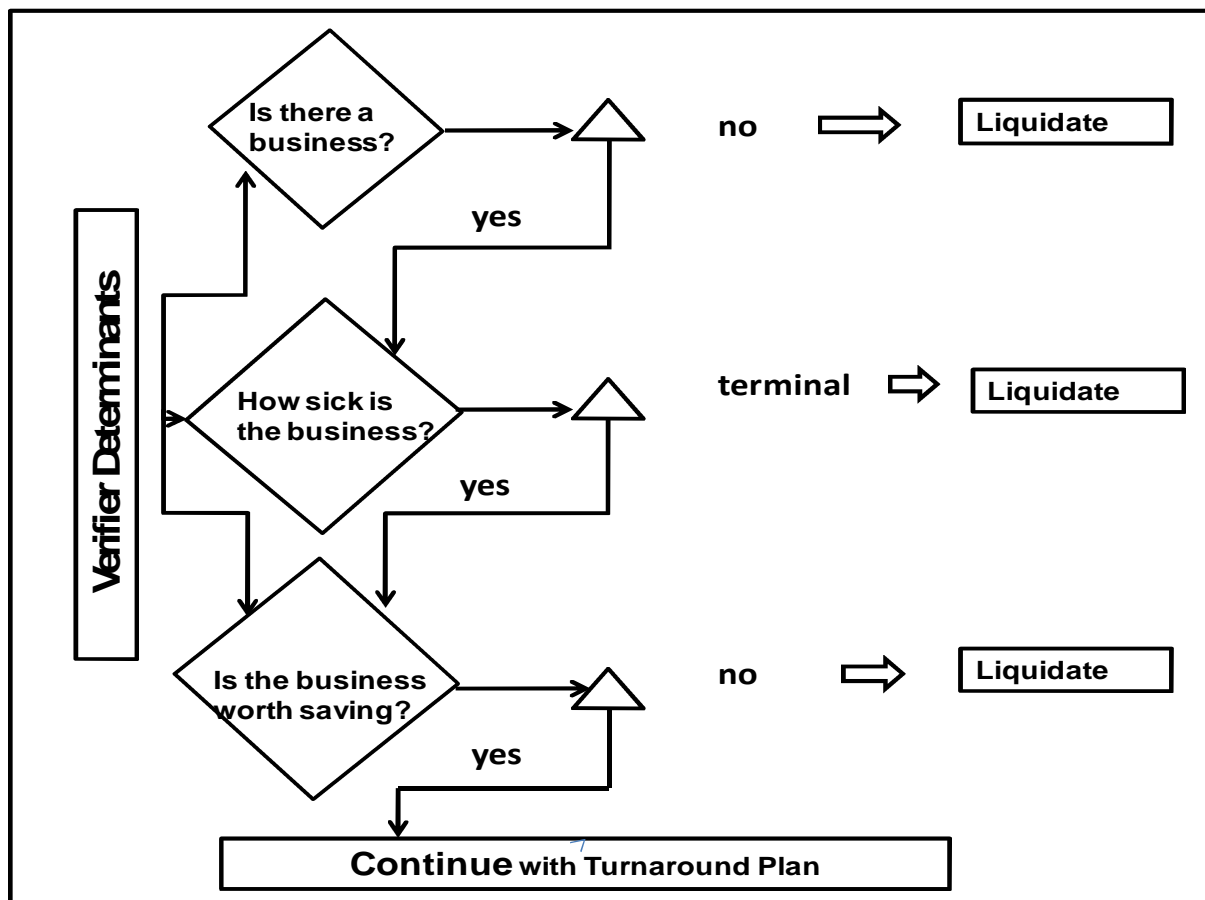


Figure 8.3 Role of verifier determinants in the triage process of the investigative phase

The answers to the following questions in the triage sequence are important:

- Is there a business?

If the answer is no, then liquidation is inevitable.

If the answer is yes, the health of the business has to be determined by asking the next question:

- How sick is the business?

If the business is terminal, then a compromise or liquidation is probably inevitable. If business health can be restored, the next question is then important:

- Is the business worth saving?

If a rescue is attempted, it should restore sustainable competitive viability.

8.6.1.2 Data integrity and verifier determinants

The practitioner will rely on information supplied by the business's management. Accordingly, it is proposed that, in testing the information's integrity, verifier determinants are used as an indicator for concentrating the focus on problem areas.

A sound knowledge of the financial statements, the business's tax position and any failed strategy is vital for achieving turnaround success. Hence, verifier determinants confirm the integrity of the data to be used in a turnaround.

8.6.1.3 Business review and verifier determinants

It is proposed that the verifier determinants will focus the business review. By identifying verifier determinates the practitioner can focus on the problematic areas identified through the verifier process. Consequently, an adequate business review will have to be conducted in order to persuade stakeholders to agree to the practitioner's proposal.

The minimum requirements of the review will be a proper due diligence, backed with findings and qualifications. In doing this, a proper analysis process will have to be followed and proposed as a situation analysis. In order to save time, verifier determinants are used to examine the situation quickly before a detailed due diligence is done. A due diligence process comprises the following:

- feasibility assessment with stress testing
- forecasts
- sustainability after rescue process
- corporate governance
- data integrity
- simulations, such as Monte Carlo simulation

8.6.1.4 Final decision

The final decision in the investigative stage is to whether to continue or not with a turnaround of the business. Alternatively, a compromise may be entered into with the affected persons, or the business may be liquidated. If the viability of a business is suspect, liquidation is probably inevitable. If the decision is to continue with the business turnaround the practitioner and management will enter the planning phase. The verifier determinants will direct the planning towards the most salient causes of distress which need to be addressed in the plan.

8.6.2 PLANNING PHASE

With reference to section 5.7 of this study, Section 150 of Chapter 6 of the new companies Act stipulates the minimum requirements for a business rescue plan. Accordingly, figure 8.2 illustrates the planning phase and elaborates on the various actions that need to be carried out. Chapter 6 of the new companies Act is, however, prescriptive on the content of the rescue plan, the minimum requirements for which are set out and illustrated in figure 8.3.

8.6.2.1 Turnaround plan

Verifier determinants are of the utmost importance, as they will dictate the level of the role players input, the financial objectives and the possible solutions. The turnaround practitioner must prove to the body of affected persons that a turnaround is viable and that it will save the business. Of secondary importance is whether the creditors will be in the same or a better position after a turnaround than if the business is liquidated.

Verifier determinants will, for example, be used in Part A to support one of the sources of information, such as a dividend distribution. In Part B, the verifier determinant will support proposals by highlighting the required proposal.

8.6.2.2 Recovery strategy formulation

The recovery formulation strategy needs to illustrate measures that will lead to liquidity improvements, objective financial restructuring and operational improvements.

8.6.2.3 Objectives in planning

The turnaround objectives must include immediate, short-term and medium-term targets. These targets must be obtainable in order to ensure buy in from the affected bodies. The primary objective of the plan is to prove sustainability during and, especially, after the turnaround.

8.6.2.4 Decision outcome

After compiling the plan, the practitioner must distribute it to all the affected persons who will have to vote for or against the plan. The plan should contain sufficient information for making a decision on whether or not to continue with a turnaround attempt. The comprehensiveness of the information in the plan should guide stakeholders either to opt for a compromise or to liquidate the business.

8.7 TURNAROUND EXECUTION PHASE

Action taken in the execution phase of a turnaround will be predominantly dictated by the business and industry in which the turnaround is being executed. Accordingly, a host of variables and preconditions may influence the strategy to be followed. The framework proposed in this study identifies the use of three response constructs, namely, strategic, financial, and operational/market responses.

Appendix C summarises the various actions, strategies and steps that can help to effect a successful turnaround. The most important responses are illustrated in figure 8.4 (abstracted from fig. 8.1). A turnaround response does not necessarily proceed in a specific sequence; in reality everything happens more or less at the same time.

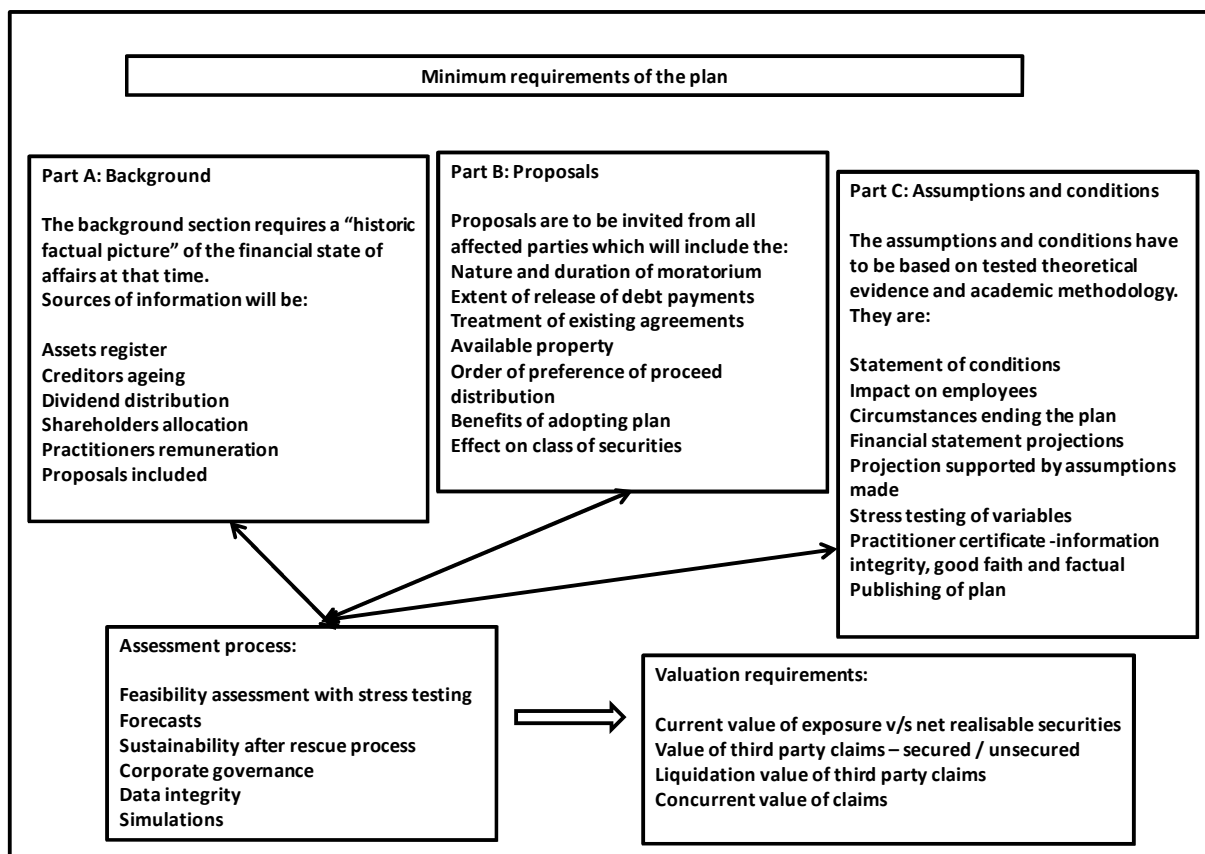


Figure 8.4 Turnaround plan – framework

The main critical actions are proposed in the framework, namely, strategic, financial and operational responses. The discussion is limited to the three main responses, as each type of business will have to adapt to its own unique environment, level of resources and conditions.

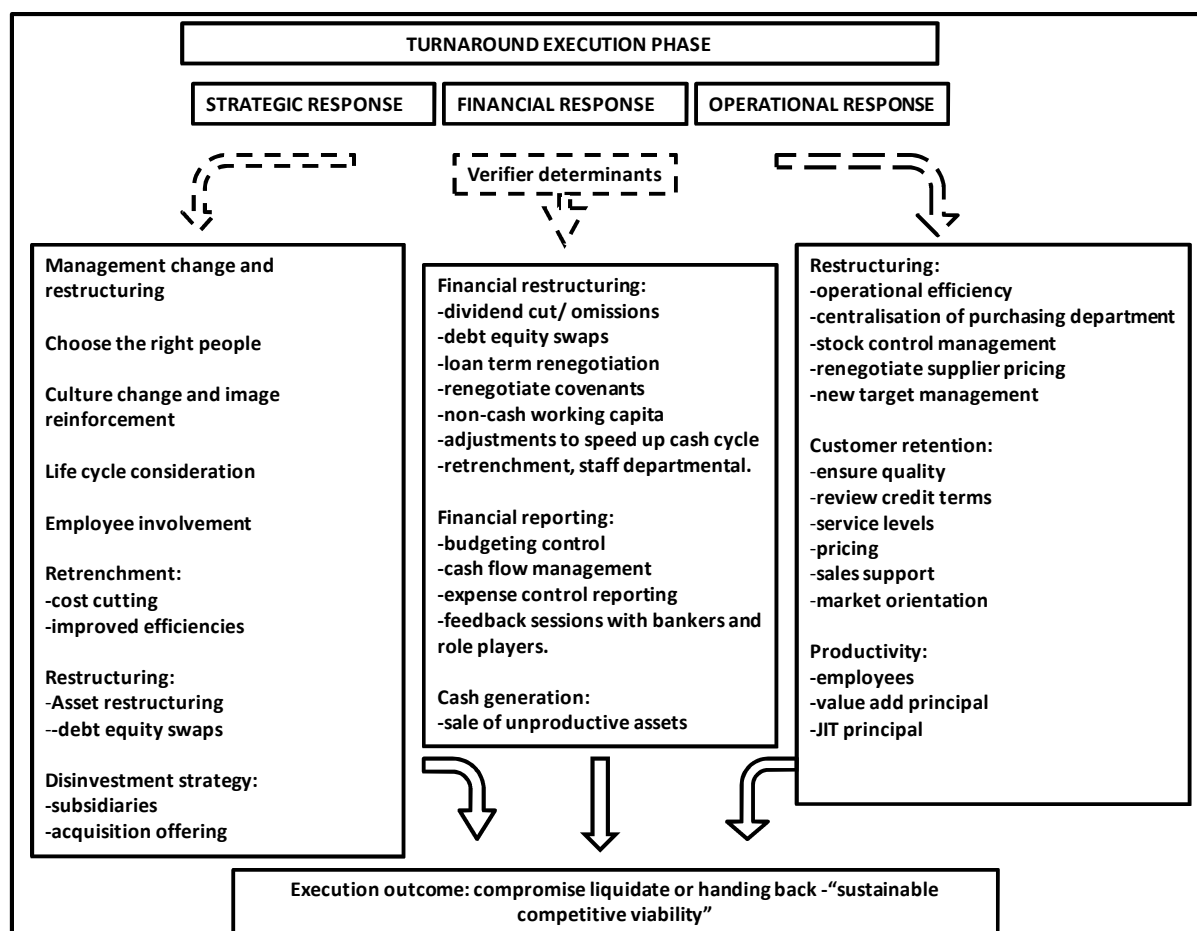


Figure 8.5 Turnaround strategic framework (own compilation)

8.7.1 STRATEGIC RESPONSE

The strategic response framework proposes a change in the top management structure of the business, as it is imperative that this structure complements the turnaround objectives. A change in CEO is almost inevitable, as a turnaround practitioner is required to lead the business through the turnaround intervention. The new Companies Act sees this intervention as being of a temporary nature – three to six months. As an outsider, the turnaround practitioner should add autonomy to the turnaround process.

During the second stage of planning, the right people must be chosen to fill the key critical positions, that is, the hunt for heroes in the business – people who can make things happen. Culture change and image reinforcement is crucial at this stage to reinforce confidence in the affected parties, especially the staff. Culture change is enforced as a consideration for the revival of the business life cycle..

In terms of response, the verifier determinants play a significant role as the turnaround unfolds and new information surfaces. Subsequently, the verifier determinant process is repeated as new data are uncovered. This stage of the turnaround process would suggest that employees are involved in order to ensure as smooth a transition as possible.

8.7.2 FINANCIAL RESPONSE

When attempting to find a financial solution, financial restructuring is unavoidable. Creative financial re-engineering will see dividend cuts, debt restructuring and, certainly, long-term debt renegotiation. It is also important to maintain existing alliances with trade creditors. In the South African context, staff retrenchments are a very sensitive issue and should only be considered as a last resort. This places an additional burden on the practitioner as employees are “affected persons” in terms of the new Companies Act.

Foremost in any financial action plan is that immediate steps should be taken to generate cash, for example, unproductive assets should be sold. In addition, financial reporting before and during the turnaround is essential for feedback, transparency and decision making. The following information is critical:

- budgeting control statements
- cash flow management projections
- expense control reporting analysis.

8.7.3 OPERATIONAL RESPONSE

The operational response includes all the necessary steps that have to be taken to retain and protect the business's client base. To be able to do this, practitioners must liaise with the client base and sort out any problems regarding quality, service levels, sales support and market orientation.

Actions to restore operational efficiency should be carried out immediately. This can be done by centralising the purchasing department and stock control management.

8.7.4 EXECUTION OUTCOME

Once the turnaround plan has been substantively implemented (the execution phase), the outcome is ideally to hand back the business. Failing this, the practitioner will have to negotiate a compromise with the stakeholders. If all else fails, the outcome is unfortunately liquidation.

The main objective of a business turnaround is the restoration of the business to sustainable competitive viability.

8.8 BENEFITS OF THE STUDY

This research has contributed to the process of turnaround management through the following potential benefits:

Major direct benefits of the verifier determinants' research:

- Verifier determinants confirm early warning signs. They are used as an analysis tool for enhancing turnaround decision making – they act as a confirmation.
- The proper application of verifier determinants can lead to
 - confidence in the turnaround decision-making process

- identification of verifier results in problem understanding
- a system for decision making
- less time being spent on rejecting or accepting turnaround decisions
- less probability of turnaround practitioners making type I or type II errors
- a focused approach to resource allocation and efficiency management
- the acceptance of overall turnaround strategy.

Indirect benefits of the verifier determinants' research:

- Verifier determinants hone the judgement of the managerial team.
- They ensure the buy in of other role players (affected persons) – organised labour, trade creators etc.
- Early warning systems can be very useful for those managers and practitioners who have to prevent failure.
- Verifier determinants blend information for use in an intelligent, strategic decision in the form of a business review.
- The reasons for turnaround are confirmed by proper analysis.
- Help failed entrepreneurs who want to re-enter business.

8.9 LIMITATIONS OF THE STUDY

Owing to the limitations placed on financial institutions concerning third-party confidentiality, the study sample was limited to one financial institution where the security, integrity of the data and anonymity of the sources could be controlled; consequently, this has limited the extent of the sample groups.

A more comprehensive search including other financial institutions would have been desirable but here is no reason to suspect that different data would have been collected just because it was another institution. The specialists participating in the interviews have substantial exposure to other banks.

Seventy percent of the specialists have work experience in other financial institutions. The questionnaire response rate of 45% was, taking into consideration the 'captured' population within which the research was conducted.

During the same period in which this research questionnaire was distributed, various in-house research projects were launched (forced) which resulted in possible questionnaire fatigue among the respondents, which could have had an impact on the results. The low response rate, however, negatively affected the options for factor analysis and statistical calculation, as the sample was too small for extensive analysis.

The turnaround practitioner fraternity was significantly unhelpful. Most of the practitioners who were approached to participate with the research were sceptical, evasive and suspicious. Knowledge is seen as proprietary and as a trade secrets, which is not shared with or disclosed to 'competition'. The extensive interviews with the specialists took over three hours per interview. Although extensive notes were taken and discussion took place to identify verifier determinants, much of the detail such as body language, action and reaction were not captured.

8.10 FUTURE RESEARCH

The field of business turnaround or business rescue is wide open for research owing to its uniqueness as a new management discipline in South Africa. Turnaround management encapsulates a host of disciplines such as accounting, income tax, legal and project management. A great challenge for future studies will be to include more financial institutions in the population.

As banks are working closer together through the application of INSOL principles, there is an opportunity to involve other financial institutions in similar research. The following areas for future research identified by this research have potential:

- the correlation of verifier determinant concept and data integrity

- a longitudinal study on the use of verifier determinants in a decision framework
- Verifier determinants can be used with great success in building neural networks for turnaround situation prediction. In cognitive science, neural networks are used to model higher level reasoning such as problem solving, and, in lower level reasoning, for modelling elements such as vision and speech.

8.11 CONCLUSION

This study highlighted the importance of establishing the true value of a business in the early stages of the turnaround process. Verifiers can be used successfully to determine the extent of the problem (“depth of the rot”), the difficulties involved and the lack of financial control. When verifiers are used, it can alleviate the time constraints in a turnaround situation by assisting to assess the real situation quickly. Verifiers will lead to a better understanding of the cause of decline or distress and will be beneficial for coping with the psychological effects on managers/owners and personnel.

If identified correctly, verifiers can be the key variables when deciding if a turnaround is feasible or not. As a result of having a better understanding of the business using the identified verifiers, the ultimate costs of a turnaround should be determined in a relatively short period. The most important part verifiers need to play is to prevent decline and distress in businesses. Some verifier determinants can contribute to the day-to-day management of a business if used as a management tool on a continuum.