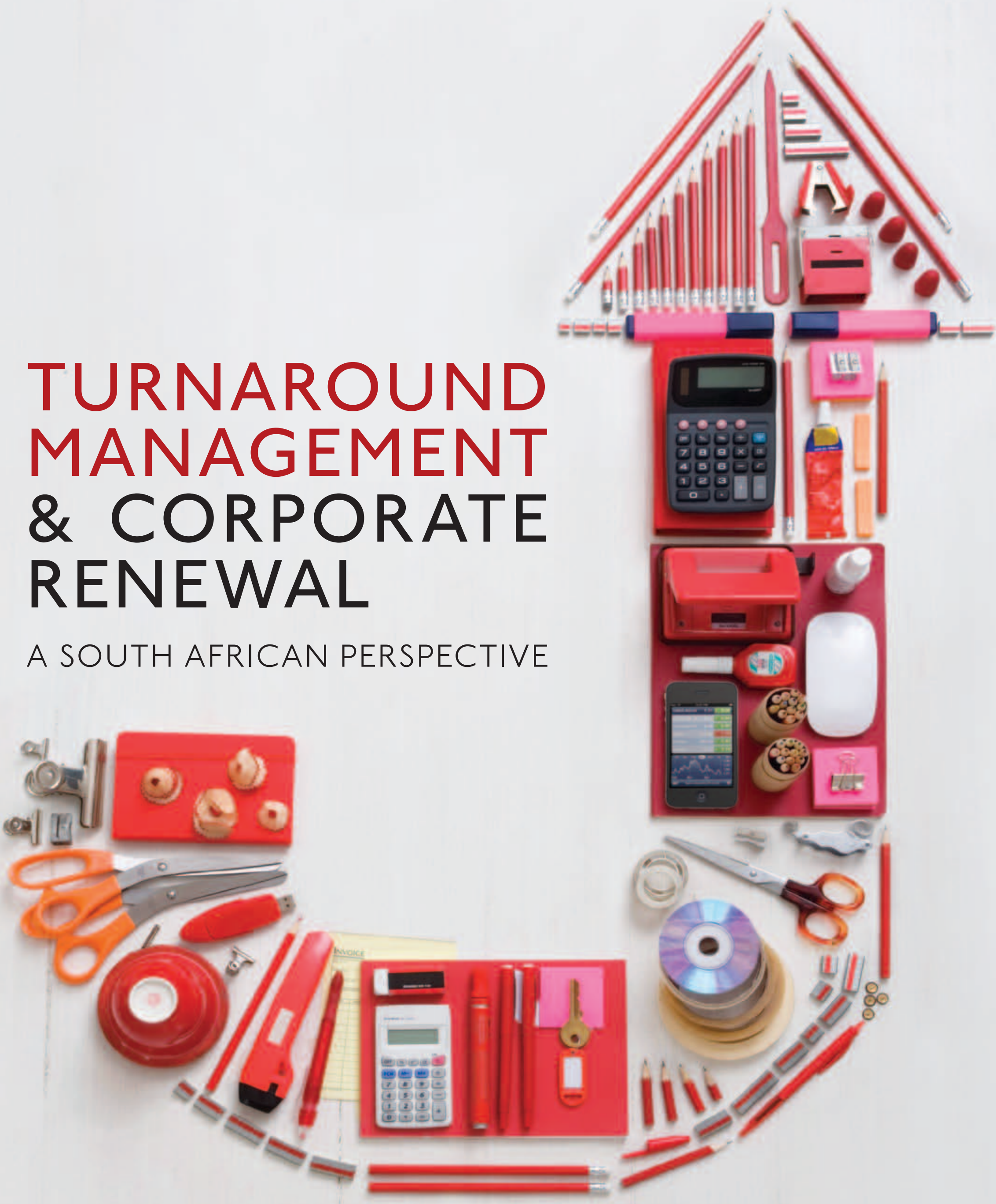
TURNAROUND MANAGEMENT & CORPORATE RENEWAL

A SOUTH AFRICAN PERSPECTIVE



EDITED BY NEIL HARVEY

Turnaround Management and Corporate Renewal

A South African Perspective

Edited by

Neil Harvey

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Introduction

Neil Harvey

The rationale for a South African book on turnarounds

Every person faces turnaround situations at various points in their lives. The circumstances may not be as dramatic as those of the CEO of a battered Wall Street bank, a Detroit automobile corporation or a beleaguered South African electrical utility. Nevertheless, the situations will be important, even crucial, to the people involved, whether these circumstances arise in their careers, personal lives or leisure activities. How people deal with the challenges of turnarounds often influences the quality of their future.

The definition of a turnaround that I prefer comes from Stanley Goodman:[1]

> A turnaround is to produce a noticeable and endurable improvement in performance, to turn around the trend of results from down to up, from not good enough to clearly better, from underachieving to acceptable, from losing to winning.

Chapter 5 covers definitions in greater detail, but we can apply Goodman's broad definition to turnarounds in almost anything – a life, an endeavour, a company, a municipality, a non-profit organisation, a government, a country or even a continent. It not only encompasses dire situations, but also includes corporate renewal and making a good entity even better.

There are many outstanding books on turnarounds written by the authors mentioned in the Bibliography as well as other authors. Few people in the private, government and non-profit sectors in South Africa and Africa, outside the turnaround fraternity, have read any of these books, which are rarely seen in popular bookstores.

Everyone associated with this book, *Turnaround Management and Corporate Renewal: A South African Perspective*, as well as with the Managing a Turnaround and Corporate Renewal programme offered by the Wits Business School (WBS), believes that there is a need, and an opportunity, for a comprehensive book on turnarounds with a South African perspective. As Mthuli Ncube points out in his Foreword, there has never been a greater need for turnaround management than there is now. This book is certainly the most comprehensive book on turnarounds that I and the other contributing authors who read voraciously on the subject have come across. (We have had many others elsewhere in the world to learn from!) It is also pertinent to South Africa. All the contributors have local experience and ties. Eleven of the 13 case studies concern South African organisations, while the other two relate to Zambian companies.

Part of our rationale for the book is the uniqueness of the country. South Africa is one of the most diverse countries in the world:

> Diversity is a key feature of South Africa, where 11 languages are recognised as official, where community leaders include rabbis and chieftains, rugby players and returned exiles, where traditional healers ply their trade around the corner from stockbrokers and where housing ranges from mud huts to palatial homes with swimming pools.[2]

Following on from this, most South Africans from all walks of life, including many managers, have great experience and capabilities to meet the opportunities and challenges of change and diversity. They have much to offer, not only to others, but also to themselves. This also, surely, applies to the practice and study of turnarounds and organisational renewal.

This book covers many of the concepts that you would find elsewhere. However, it also gives considerable detail on some of the subjects and is written by turnaround practitioners, consultants and academics in South Africa. Its publication seems timely. The recent global recession still has a lingering impact on South Africa and Africa, there are many issues to be tackled, and turnaround situations and opportunities are developing even as the sales and readership of *Turnaround Management and Corporate Renewal: A South African Perspective* progress.

We hope that this book will gain a broad readership and that it will help to advance the cause of turnaround management. Turnaround management is a good cause, perhaps even a noble one. Consider the pain and human suffering caused by a business failure and people's consequent loss of their jobs and income. Turnaround management generally seeks to rescue businesses in distress and to rejuvenate ailing ones, thereby protecting resources and saving jobs. These rescued and rejuvenated businesses then have the opportunity to grow and create new jobs.

Those of us associated with the WBS expect the publication of the book to help expand the geographic and product reach of the programme. Besides delegates from neighbouring countries, we have had others from as far afield as Ghana, Kenya and Nigeria. We would naturally like to see this increase. Expansion and diversification of the programme should, in turn, improve sales of the book.

We have written *Turnaround Management and Corporate Renewal: A South African Perspective* for management practitioners, consultants, teachers, students and interested observers currently involved in or likely to be confronted with turnaround challenges. This audience includes CEOs, managers, HR practitioners, engineers, accountants and lawyers in the private sector, government, parastatals, municipalities, non-profit organisations and sporting clubs, as well as students at business schools and universities.

This book should provide readers with meaningful insight into the various stages and processes of turnaround management and corporate renewal. It covers definitions, stages of a turnaround, rapid appraisal and detailed analysis, and recovery plan development and implementation. Leaders in their fields evaluate in depth the strategic, financial, legal, human resources, marketing, operations, political, internal and external aspects of turnarounds. We have explained in considerable detail the tools and techniques that turnaround practitioners can use to deal with many different turnaround challenges. People who have led successful South African turnarounds have written the case studies used to complement the tools and techniques.

Turnaround Management and Corporate Renewal: A South African Perspective deals mainly with the turnaround of business organisations. However, readers could apply many of the concepts, practices and principles to the various non-business turnaround aspects of life and the world, as mentioned above. They could be applied, for example, to lose weight, to better one's tennis or golf game, or to improve the performance of a soccer or rugby team. For those interested in the turnaround of a country or continent, I recommend the following books: Paul Collier *The Bottom Billion*;[3] Hernando de Soto *The Mystery of Capital*;[4] David S. Landes *The Wealth and Poverty of Nations*;[5] C.K. Prahalad *The Fortune at the Bottom of the Pyramid*;[6] and Jeffrey D. Sachs *The End of Poverty.*[7]

There is a chilling statement in Collier's book – the average length of time it takes to turn around a failing (nation) state is 59 years. The message is thus clear and it is one we have stressed continually in this book – actions to remedy deficiencies should be taken as early as possible.

The structure of this book

We have attempted to follow a sequence similar to the Wits Business School's Managing a Turnaround programme in organising the parts and chapters. There is some overlap between certain chapters and, at times, there are even conflicting views. We have sought a semblance of uniformity in formatting the chapters, but have left the contributors free to use their own styles and to express their own views. There are six main parts:

- Part 1 Introduction
- Part 2 Fundamentals
- Part 3 Perspectives
- Part 4 Implementation
- Part 5 Case studies
- Part 6 Conclusion.

Certain of the chapters in the parts deal with fundamentals, perspectives and implementation all at once so that allocation to the different parts is judgmental, perhaps even arbitrary. This resembles a turnaround decision – the information may not be perfect or even adequate, but a decision has to be made!

The Companies Act 71 of 2008, as amended, is scheduled to become effective in 2011. New business rescue legislation, contained in Chapter 6 of the Act, will replace the judicial management procedures in the Companies Act of 1973. We therefore have chapters covering business rescue legislation by a practising lawyer in restructuring and insolvency, a professor of law and also senior consultant (restructuring and insolvency) to the World Bank, a turnaround practitioner and a banker to provide different perspectives. A trade unionist provides a diverse viewpoint in another chapter. Further details on business rescue legislation, developments and related topics can be found at www.tma-sa.com, www.corporate-renewal.co.za and www.business-rescue.co.za.

Part 1 Introduction provides an overview of the turnaround process. Chapter 2 discusses how turnarounds differ from normal management. Chapter 3 is an overview of managing a turnaround. Chapter 4 covers the Turnaround Management Association – Southern Africa (TMA-SA), while Chapter 5 discusses different turnaround situations – it is complementary to, and enlarges on, certain aspects of the overview.

Part 2 Fundamentals covers the basic specialist or functional aspects such as strategy, legal and financial aspects, human resources, operations and marketing. Location of a chapter in Part 3 Perspectives does not mean that it is less important than the chapters in Part 2 Fundamentals. The relative importance depends on the turnaround being studied.

Part 2 Fundamentals starts with turnaround strategy in Chapter 6. This subject is followed by a discussion on choosing a leadership style in Chapter 7, while Chapter 8 deals with legal aspects of turnarounds. Chapter 9 discusses the new business rescue procedure. Part 2 also includes Chapters 10 to 14 on financial, human resources, marketing and operations aspects of a turnaround. Chapter 11 on change management augments Chapter 12 that deals with human resources. The part concludes with Chapter 15 on managing stakeholders.

Part 3 Perspectives begins with Chapter 16, which expounds a view of a corporation or business turnaround as a pre-emptive action to realign the core business with changing market trends, rather than as a business in trouble taking reactive, often belated, action. It is followed by an examination in Chapter 17 of legislative frameworks for the facilitation of turnarounds in the United States of America (USA), the United Kingdom (UK) and South Africa, and a turnaround practitioner's view in Chapter 18 on new business rescue legislation in South Africa. Organisational politics in a turnaround is covered in Chapter 19, but is clearly related to many other chapters. Chapter 20 on the valuation of a business facing distress or decline supports Chapter 10 on financial aspects that appears in Part 2. We next examine turnarounds from the perspectives of a trade unionist and a banker in Chapters 21 and 22. Chapter 23 covers small business turnarounds in general, while Chapter 24 deals with the role of the Internet in the turnaround strategies of small businesses. Part 3 concludes with Chapter 25 on a liabilities approach to critical variables of venture turnarounds.

Part 4 Implementation starts with Chapter 26 on tools and techniques that practitioners can use in turnarounds. Chapter 27 examines value management (value engineering) techniques, followed by Chapter 28 that deals with corporate governance issues with regard to restructuring and managing turnarounds. Chapter 29 deals with recruiting for a turnaround, and could arguably be located in either of the two previous parts. Chapter 30 discusses converting debt to equity, while Chapter 31 details early warning signals of impending problems. By now the reader should have realised that turnarounds can be stressful and Chapter 32 therefore deals with stress control and management.

Part 5 Case studies appears before the conclusion. Often, cases appear at the end of textbooks, but I believe that readers will obtain more value by going through at least some of the case studies before going on to the conclusion. The cases are set out in alphabetical order and include Amalgamated Electrical Industries, Amquip, Barloworld, Bevco, BKS, Food Corporation, Karoo Farming, Konkola Copper Mine, NEPAD, *Professional Management Review*, the South African Post Office, XYZ Company and Zambia Breweries.

Part 6 Conclusion is divided into three chapters. Chapter 46 reviews the highlights of the first five parts and uses them to reach conclusions in Chapter 47. Chapter 48 recommends guidelines for managing turnarounds and corporate renewals based on the conclusions in Chapter 47.

The biographies of contributors give the academic and career backgrounds of the 35 contributors. The appendices include new business rescue legislation and NEPAD in brief.

Notes

1 Goodman, S.J. 1982. *How to Manage a Turnaround*. New York: Free Press, p. 4.

2 BBC News. 2009. *Country Profile: South Africa*. 10 May 2009. [Online]. Available from: http://news.bbc.co.uk/2/hi/africa/countryprofiles/1071886.stm [Accessed 10 June 2009].

3 Collier, P. 2007. *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*. New York: Oxford University Press.

4 De Soto, H. 2000. *The Mystery of Capital*. New York: Basic Books.

5 Landes, D.S. 1998. *The Wealth and Poverty of Nations*. New York: W.W. Norton and Company.

6 Prahalad, C.K. 2006. *The Fortune at the Bottom of the Pyramid*. Upper Saddle River, NJ: Wharton School Publishing.

7 Sachs, J.D. 2003. *The End of Poverty: Economic Possibilities for Our Time*. New York: Penguin Press.

Chapter 2

How turnarounds differ from normal management

Neil Harvey

Introduction

> A turnaround is to produce a noticeable and durable improvement in performance, to turn around the trend of results from down to up, from not good enough to clearly better, from underachieving to acceptable, from losing to winning.[1]

According to the above definition, turnarounds can apply to almost anything, from a person's life, to a company, a country or even a continent. Have you ever studied the turnaround of Singapore? At independence in 1965, the income per capita of this island state was less than US$1 000 per annum. Today, this figure is US$37 600 per annum.[2] This country not only has the world's number one airline, the best airport and the busiest port of trade, but is also a world leader in oil refining and publishing.[3]

The Treasury Department and the South African Revenue Service are recent examples of tremendously successful turnarounds in South Africa. The South African Post Office, featured in Chapter 43, is another notable turnaround achievement. Finanzauto SA, the Caterpillar distributorship in Spain and Portugal, which Barlows acquired in 1992, and NF Die Casting in Alrode were turnarounds in the 1990s that I regard as classics. NEPAD is a recovery programme aimed at an entire continent. Examples of turnarounds with global impact include IBM, Harley-Davidson, Selfridges, Wolverine World Wide and, recently, Puma, Nissan and Ford.

How turnarounds differ from normal management

I am sometimes amused when I hear people imply that turnarounds, or a particular turnaround, are easy. For example, 'ABC company was in such bad shape that it could only get better.' This statement is complete nonsense. Physics teaches us that the momentum of a troubled business is down, not up. There are no easy turnarounds. Some are just less difficult than others. A turnaround may not be that different from the management of a normal business in terms of ultimate objectives, that is, providing value to customers, shareholders, employees and other stakeholders. It is the getting there that is different – turnaround management involves radical rather than incremental change.[4]

The major differences between a turnaround and a normal business include the following:

- *A different type of leadership is usually required*:

  > Turnarounds require a different breed of cat from a management standpoint than do more prosaic, stable business situations. That doesn't mean turnarounds require Clark Kent's better half. Rest assured that most turnarounds are accomplished by mortals, even rather ordinary mortals, who have certain strengths and, as in most mortals, weaknesses ... No matter how awesome the task may seem, the turnaround job will yield to an organised approach. But that organised approach must by directed by a strong leader.[5]

  Turnaround executives insist that distressed businesses require perhaps two or three times more hands-on management than more stable companies do.[6]
- *The CEO and management will be under more pressure* because the turnaround has to be done in addition to normal ongoing management. They really have three jobs – the ongoing task of normal business, plus the intensive management required by turnarounds, together with the need to manage stakeholder relationships.
- *Required actions are usually more severe* because of actions not taken in the past. This is called 'playing catch up'. For instance, if productivity increases of 5% per year are required and a distressed company has not achieved this for two years, then 15% is needed in the current year.
- *Faster decisions and actions are generally required* because of the prevailing critical situation. Again, we have the catch-up factors where it is now time that has to be made up.
- *There is generally less margin for error and also more severe consequences of errors*. A mistake that would be a mere hiccup in a strong, stable company could be fatal in a weak, over-geared company.
- *The situation will usually be worse than thought*. It is often difficult to accept the enormity of approaching calamities, especially by those who were incumbent while the bad situation was developing. Sales forecasts of companies in trouble are notoriously off the mark.
- *There is a different set of legal circumstances and risks*. Operating a company that is insolvent is illegal except in special circumstances, as will be seen in Chapters 9, 17 and 18 on legal aspects of a turnaround and the new business rescue legislation. A newly appointed CEO therefore risks not only his or her reputation, but also possibly legal sanction. Business

risks extend beyond the usual ones of missing budgets or losing market share to having to sell or merge the business under adverse circumstances. The worst-case scenario is closure, with or without liquidation proceedings.

- *There will be more stress in a turnaround situation than in a business-as-usual situation*. What we need to do is look beyond this generalised statement to the possible consequences of, and antidotes to, stress. For instance, I have seen a disproportionate failure of marriages of managers involved in turnarounds. This is not predominantly because anxiety causes managers to pursue members of the opposite sex, although I have certainly seen this happen on occasion. The major reason for the marriage failures is, I believe, a breakdown in communication between spouses, partners or companions because the turnaround person becomes so preoccupied with the task at hand that the relationship suffers. I am not saying that turnarounds destroy marriages or relationships. Successful turnarounds probably do the opposite. What I am trying to communicate are some of the risks. Chapter 32 that deals with stress is consequently included in this book.

How corporate renewal differs from turnarounds

The Oxford English Dictionary defines 'renew' as:

> 1. Resume or re-establish after an interruption. 2. Give fresh life or strength to. 3. Extend the period of validity of (a licence, subscription, or contract). 4. Replace or restore something broken or worn out.[7]

Leaving aside point 3, the definition of corporate renewal is similar to what many turnaround authors regard as transformation:

> Transformation [*or corporate renewal*] generally describes an enterprise-wide performance improvement programme for companies that are moderately, rather than substantially, underperforming. The organization may be seeking to achieve world leadership; or, if it is a mature business, trying to regenerate growth; if in decline, seeking to reverse the trend.
>
> …
>
> Although both turnaround and transformation [*or corporate renewal*] aim to achieve a quantum leap in performance, the speed of recovery and desired end-state differ. Transformation [*or corporate renewal*] projects aim to achieve a high level of absolute and relative performance improvement over the medium term; turnarounds are seeking to achieve sustained viability fast.[8] [*Words in italics added by author*]

There is a difference in the scope of turnarounds and corporate renewal. Corporate renewal or transformation is generally restricted to business improvement and does not encompass crisis management, capital restructuring and dealing with stakeholders in emergency conditions.[9] There is also hopefully less stress.

The difference between a turnaround and a corporate renewal can be explained using a medical analogy. A corporate renewal is similar to a doctor's patient who is somewhat run down, gets colds frequently and is not quite in the robust health that he or she should be. The doctor prescribes diet and exercise. The patient carries this out diligently and achieves an excellent standard of health. In the case of a turnaround, the patient has double pneumonia, is in an intensive care unit and is at risk of permanent damage if not death.

Causes of business decline

Figure 2.1 shows the three major areas into which an organisation's external environment can be divided, namely the general, industry and competitor environments. When one considers the general environmental factors – economic, sociocultural, global, technological, political-legal and demographic – there are many variables that can change, either favourably or unfavourably, for an organisation. Table 2.1 lists some of the variables in each of the six segments.

Figure 2.1 The external environment

Source: Adapted from Hitt, M.A., Ireland, D.R. and Hoskisson, R.E. 2005. *Strategic Management: Competitiveness and Globalization* 6th ed. Mason, OH: Thomson/South-Western, p. 39.

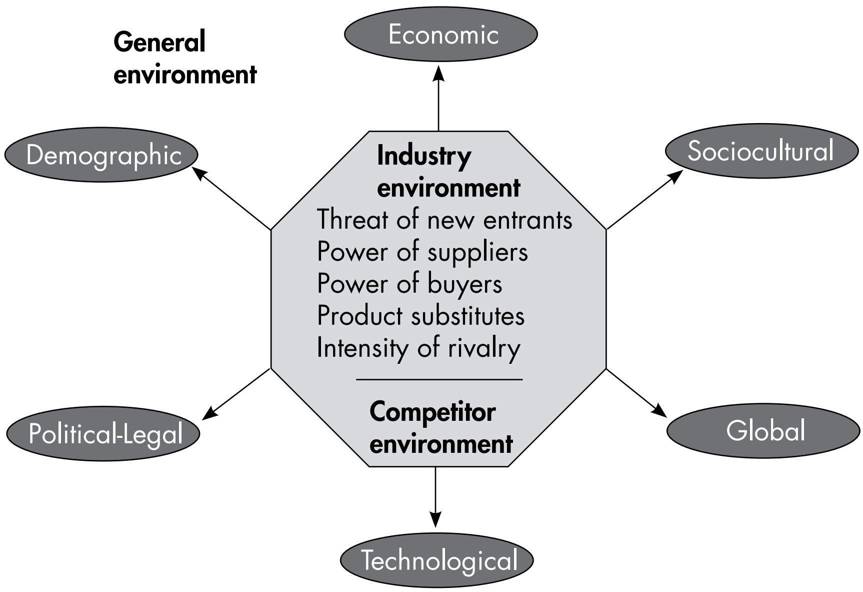


TABLE 2.1 External environment segment variables

Sources: Harvey, N.M. 2006. *The Development and Transfer of Core Competencies in Multinational Corporations*. PhD thesis. Rhodes University: Grahamstown, South Africa.

Hitt, M.A., Ireland, D.R. and Hoskisson, R.E. 2005. *Strategic Management: Competitiveness and Globalization* 6th ed. Mason, Ohio: Thomson/South-Western, p. 40.

Louw, L. and Venter, P. 2006. *Strategic Management: Winning in the Southern African Workplace*. Oxford University Press: Cape Town, p. 85.

The Economist. 2010. *Pocket World in Figures: 2011 Edition*. London: Profile Books.

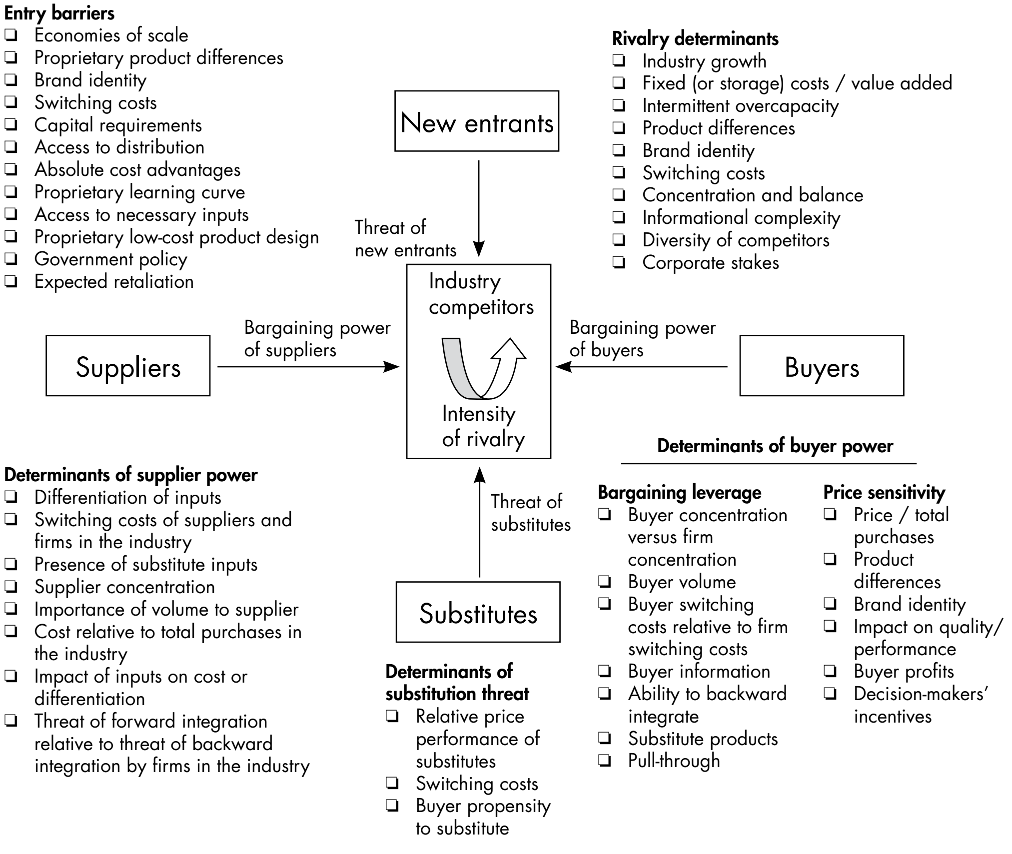
Segment	Variables	
Demographic	❑ Population size	❑ Ethnic mix
	❑ Population growth	❑ Income distribution
	❑ Age structure	❑ Education
	❑ Birth rates	❑ Health
	❑ Life expectancy	❑ AIDS
	❑ Immigration / emigration	❑ Unemployment
	❑ Geographic distribution	
Economic	❑ Gross domestic product	❑ Savings
	❑ Growth rates	❑ Government debt and spending
	❑ Interest rates	❑ Money supply
	❑ Inflation	❑ Exchange rates
	❑ Oil prices	❑ Trade deficits or surpluses
	❑ Employment / unemployment	❑ Official foreign exchange and gold reserves
	❑ Taxation policies	❑ Infrastructure
Sociocultural	❑ Languages	❑ Customs
	❑ Religions	❑ Cultural activities
	❑ Values and norms	❑ Work and career attitudes
	❑ Social structures	❑ Consumer activism
	❑ Press freedom	❑ Human development index
	❑ Sport	❑ Concern about climate change and environment

Global	❑ Global competitiveness ❑ Determinants of competitiveness ❑ Important political events ❑ World Trade Organisation (WTO) ❑ International Monetary Fund (IMF) ❑ Regional international trade ❑ Government intervention ❑ Tariffs, subsidies and quotas ❑ Trade agreements and blocs (EU, NAFTA)	❑ Exchange rates ❑ Country risk ratings ❑ Corruption perceptions index ❑ Economic freedom index ❑ Diverse economic, political and legal systems ❑ Diverse languages and cultures ❑ Time and distance complexities ❑ Sovereign debt
Technological	❑ Expenditure on R&D (% of GDP) ❑ Innovation index ❑ Technological readiness index ❑ New communication and transport technologies ❑ Internet	❑ Computers and telephones ❑ Product innovations ❑ Productivity improvements ❑ Patents granted and in force ❑ Government support
Political-legal	❑ Constitution ❑ Legal system ❑ Political parties ❑ Head of state and cabinet members ❑ Affirmative action / black economic empowerment ❑ Unions ❑ Labour Relations Act	❑ Law enforcement ❑ Educational philosophies and policies ❑ Foreign trade regulations ❑ Climate change ❑ Environmental protection laws ❑ Terrorism

The situation is even more complex when we consider Porter's five forces with regard to the industry environment, namely the threat of new entrants, the power of suppliers, the power of buyers, product substitutes and intensity of rivalry. See Figure 2.2.

Figure 2.2 Porter's five forces of competitiveness

Source: Porter, M.E. 1985. *Competitive Advantage*. New York: Free Press, p. 6.



Changes in one or more of the factors constituting the forces can be advantageous or disadvantageous to the companies affected. Consider the oil prices in the first half of 2008. Airlines, together with transport and chemical companies, were negatively affected, but alternative energy companies may have found it easier to attract investment and government support.

The competitor environment is the third major area in the external environment. A company should be interested in understanding the objectives, strategies, assumptions and capabilities of its competitors.[10] Any changes in these four dimensions will affect the company's understanding of the competitive environment, and hence its responses and actions.

Table 2.2 lists internal and external factors that can cause corporate decline. Many of these are interrelated in practice. Poor management is universally regarded as the leading cause of business decline.

Table 2.2 Causes of corporate decline

Source: Adapted from Slatter, S. and Lovett, D. 1999. *Corporate Turnaround: Managing Companies in Distress*. London: Penguin Books, p. 21.

	Internal factors	External factors
1.	Poor management	Economy
2.	Ineffective board of directors	Changes in market demand
3.	Uncompetitive product or service	Availability of finance
4.	Inadequate financial control	Technological change
5.	High cost structure	Government policy
6.	Outdated technology	Competition
7.	Lack of marketing capability	Commodity prices
8.	Excessive diversification	Social change
9.	Loose information systems	Environmental factors
10.	Poor acquisitions	Exchange rates
11.	Inappropriate financial policies	Sovereign debt problems
12.	Overtrading	Industry factors
13.	'Big' prospect or deal	Bad luck
14.	Organisational inertia and confusion	Strikes

In a logical progression from this discussion of some of the differences between normal management, turnarounds and corporate renewals, the next chapter gives a general overview of the stages and activities in managing a turnaround.

Notes

1 Goodman, S.J. 1982. *How to Manage a Turnaround*. New York: Free Press, p. 4.
2 The Economist. 2010. *Pocket World in Figures: 2011 Edition*. London: Profile Books.
3 Lee, K.Y. 2000. *From Third World to First: The Singapore Story. 1965-2000*. New York: Harper-Collins.
4 Slatter, S. and Lovett, D. 1999. *Corporate Turnaround: Managing Companies in Distress*. London: Penguin Books.
5 Bibeault, D.B. 1999. *Corporate Turnaround: How Managers turn Losers into Winners*. Washington, DC: Beard Books, pp. 158–159.
6 Slatter and Lovett 1999.
7 Soanes, C. and Stevenson, A. 2004. *Concise Oxford English Dictionary* 11th ed. Oxford: Oxford University Press, p. 1217.
8 Slatter and Lovett 1999 p. 7.
9 Slatter and Lovett 1999.
10 Hitt, M.A., Ireland, D.R. and Hoskisson, R.E. 2005. *Strategic Management: Competitiveness and Globalization* 6th ed. Mason, Ohio: Thomson/South-Western.

Chapter 3

Overview of managing a turnaround

Neil Harvey

The different stages of the turnaround process

This chapter gives a general overview of managing a turnaround as a framework for a turnaround or corporate renewal process. It covers the stages of a turnaround and the most important issues in each stage. Detailed examinations of areas and issues covered here are dealt with in later chapters by experts in their field, for example legal, financial, human resources, operations and marketing aspects.

We can segment the turnaround process into different stages. While Bibeault delineates just five stages, namely management change, evaluation, emergency, stabilisation and return to normal growth,[1] Slatter and Lovett envision seven stages, including:

- crisis management
- selection of management for the turnaround
- project management of the turnaround
- stakeholder management
- business plan development
- implementation of the business plan
- preparing and negotiating the financial plan (financial restructuring).[2]

These stages may overlap and work may be done on more than one stage at a time. I see the turnaround process as including the following stages:

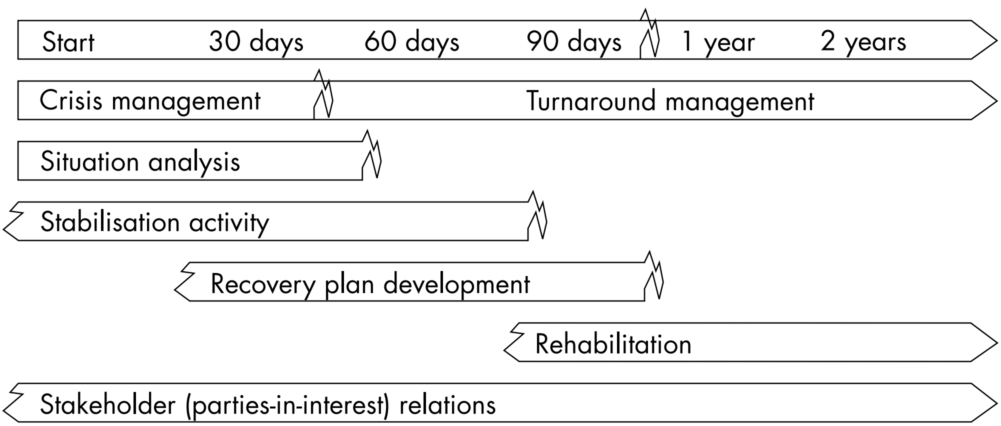
- *Stage 1*: Recognising the need for a turnaround
- *Stage 2*: Rapid appraisal of the situation
- *Stage 3*: Crisis management and emergency actions
- *Stage 4*: Stabilisation phase
- *Stage 5*: Detailed analysis and development of a recovery plan
- *Stage 6*: Rehabilitation or 'return to normal'.

There are two additional categories of activities that encompass all six stages. They are the management of stakeholder relations, as well as implementation and delivery or 'getting it done'. Stakeholder relations and implementation are crucial for the success of turnarounds.

The above six stages and two additional categories are partly illustrated in Figures 3.1 and 3.2. These were derived from MorrisAnderson Ltd, a leading US turnaround corporation. The time-flow chart depicts typical turnaround and crisis management situations.

Figure 3.1 Time-flow chart

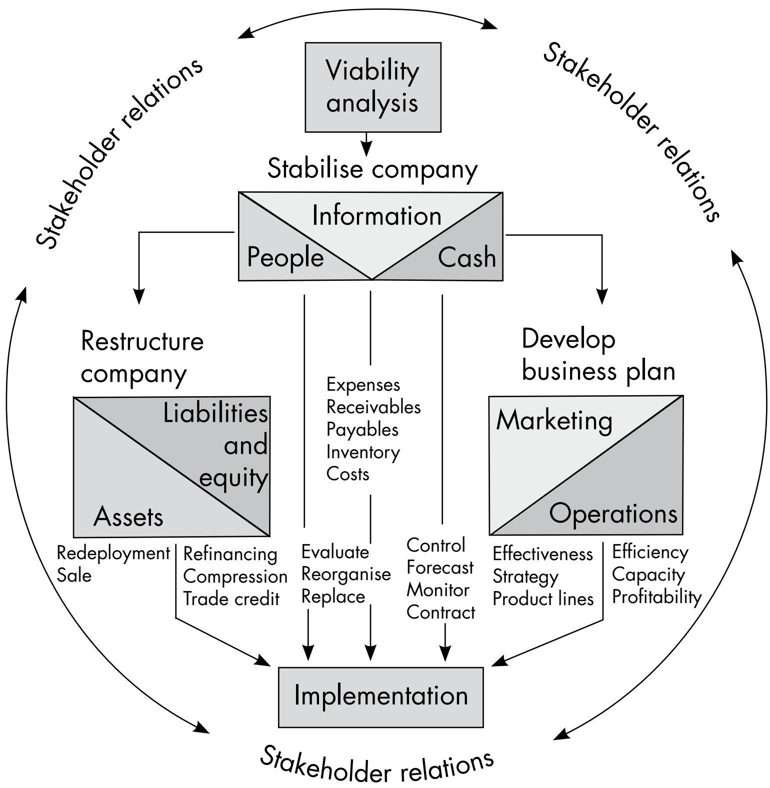
Source: MorrisAnderson. 2008. Diagram attributed to Dan Morris, founding partner, in 1987.



Note that the periods depicted in Figure 3.1 extend significantly for heavily regulated or public companies. Similar, if not greater, extensions are applicable to municipal corporations and companies in chapter proceedings. Other factors that influence time periods include the degree of direct or indirect control granted, size, complexity and the quality of information available.

The industry or sector involved is yet another factor that influences time periods. One can change the product line of a corner bakery in days. Revising the product line of a vehicle or pharmaceutical manufacturer could take years. Turning a country around would obviously take longer. As mentioned in Chapter 1, Collier, formerly director of research at the World Bank and now Professor of Economics at Oxford University, conducted extensive statistical research and concluded that it takes 59 years on average to turn around a failing state.[3]

Figure 3.2 Crisis management turnaround flowchart
Source: MorrisAnderson. 1987. Diagram attributed to Dan Morris, founding partner.



Stage 1: Recognising the need for a turnaround

This may appear trite or self-evident, but if organisations recognised warning signals and problems earlier and more easily, there would not be so many in need of a turnaround. People and management sometimes have an amazing capacity to fool themselves or to avoid facing up to issues. A crisis is, therefore, often the trigger in recognising the need for a turnaround. Recognition may also come from dissatisfaction with below-average performance or even from far-sighted management anticipating problems before they arise. Bibeault describes this recognition as the organisation's moment of truth:

> At the point where a company reaches its moment of truth and decides to make fundamental changes, it has gone from absolute decline to positive turnaround.[4]

Stage 2: Rapid appraisal of the situation

It is crucial to assess the seriousness of the situation and the potential viability of the organisation as quickly as possible. The availability of reliable information will often determine the speed at which this can be done. Another essential part of the rapid-appraisal plan is to meet with key stakeholders, especially customers, suppliers and key employees.

While value judgments and intuition may be necessary depending on the situation, estimates of cash flow expectations are usually crucial in determining how much time is available to rescue the business. I have found that a quick *viability analysis* centring on whether the troubled company has *potentially competitive products or services* can be valuable and time saving. I generally like to see both product line and customer profitability analyses done at this stage if at all possible. I have found this to be a key to success in the majority of turnarounds I have worked on – Komatsu Southern Africa and Conlog (Consolidated Logic, an electronics company) are relevant examples.[5] In both these cases, the rationalisation of customers and product lines was largely responsible for successful turnarounds. The companies concentrated on bigger and more profitable customers and products, and discontinued unprofitable customers and products or made them more profitable through, for example, value engineering of the products and price increases. The Pareto 80/20 rule seems to apply far more often than not.

Slatter and Lovett believe that the viability of an organisation depends on the combined effect of six major factors:

- Causes of decline
- Severity of the crisis
- Stakeholders' attitudes
- The organisation's historical strategy and internal environment
- The external and industry environments
- The cost-price structure.[6]

When I have not succeeded in leading a turnaround, I consider the reasons to be either an unmanageable variable or a lack of expertise in and knowledge of the industry. It may not be possible to do a full viability analysis during the rapid appraisal, but at the very least a turnaround practitioner should attempt an analysis of Slatter and Lovett's causes of decline, the severity of the crisis and cost-price structure, as well as a quick-study viability analysis centring on the potential competitiveness of the product or service in question. After working in management for more than 30 years and teaching strategic management and turnaround management for 10 years, I have come to the conclusion that the product or service is the most important element in strategy: 'It's the product, stupid.' If the product or service is not competitive, then the organisation will spend additional funds on advertising and/or cutting prices, probably to no avail.

Bibeault states that the four principal keys to a turnaround are:

- new and competent management with full authority to make all the required changes
- an economically and competitively viable core operation
- 'bridge' capital from external and internal sources to finance the turnaround
- a positive attitude and motivated people so that the initial turnaround momentum is sustained.[7]

One should also start to evaluate the strategic alternatives to a turnaround – sale, merger or closure, or any combination of these. Can the business be saved? Would the investment of management and capital to do so be justified? What is the best alternative? The evaluation should ideally be continued in more depth and detail during Stage 5: Detailed analysis and development of a recovery plan. Circumstances may, however, necessitate a serious evaluation of the alternatives at this early stage.

Stage 3: Crisis management and emergency actions

The actions an organisation takes here will depend largely on what was uncovered in the rapid appraisal of the situation. The severity of the situation, as well as the time and money available to resolve it, will be key factors. There could be turbulent and chaotic conditions.

Evaluating, reorganising and, where necessary, replacing key managers and people are important activities, the success of which will largely determine the outcome of the turnaround. In the USA and the UK, organisations have appointed a new CEO in the vast majority of successful turnarounds. This is believed to give credibility to the turnaround process.

Slatter, Lovett and Barlow state that while there is a wide range of leadership styles among turnaround executives, virtually all:

- quickly develop clear, short-term priorities and goals
- exhibit visible authority
- set expectations and enforce standards
- are decisive and implement their decisions quickly
- communicate continuously with all stakeholders
- build confidence and trust by being transparent and honest
- adopt an autocratic leadership style during crisis stabilisation.[8]

They identify five key leadership tasks for stabilising a crisis:

- Grab the control levers (establish controls, set targets, measure results, continuous vigilance).
- Take tough decisions.
- Maintain visible leadership.
- Deliver quick wins.
- Deal with dissent.[9]

The emphasis should be on seeking those significant actions that will make the most difference. This often means that the CEO must stem the cash flow haemorrhage by taking control of cash disbursements and approving all purchase orders. Working capital management, with actions to collect debts more quickly and pay creditors later, is crucial. As an example, if a bank will lend 80% against debtors but 50% against stock, stock can be sold at cost to improve cash flow, even though it will adversely affect profits and equity.

One should also check and obtain legal advice on whether the company has been trading recklessly under insolvent conditions according to the Companies Act.

What is required for survival may be very different from the requirements of a normal ongoing successful business. I remember that when Dick Goss was group managing director of SA Breweries in the 1970s, he advised me that ‘when very survival is at stake, the business should *make*, *sell* and *count*. All the other activities like HR, PR, strategic planning and marketing can be unnecessary luxuries under such conditions.’ One would also need to decide *what* to make, sell and count and *to whom* to sell.

The product line and customer profitability analyses referred to in the rapid situation appraisal are crucial. I have found that a good way to reduce costs is to make an exhaustive list of all the possible savings. This is because certain cost-saving opportunities may not seem worth it or may become subject to special-case pleas when viewed in isolation. Similarly, opportunities should appear more meaningful when seen as part of an exhaustive list and are therefore more likely to be decided on and implemented. Value analysis, where one compares the cost of a product or activity with the function of that product or activity, can be a valuable cost-reduction technique.

In addition, crisis management can include negotiations with stakeholders such as shareholders, banks, creditors, management, employees, unions and customers.

Stage 4: Stabilisation phase

Slatter and Lovett regard crisis stabilisation as the critical factor in any successful recovery situation.[10] The turnaround leader secures a short-term future for the organisation and thus creates the time space within which it can formulate and implement survival strategies and plans.

The crisis management stage has hopefully stemmed the haemorrhaging so that the troubled organisation is at least cash neutral. Profit break-even often takes longer as margins, and hence profits, may be sacrificed to facilitate short-term cash flow.

The stabilisation stage is usually characterised by less ‘fire fighting’, turbulence and chaos and more ‘normality’ than the crisis stage.

> During the surgery [*or crisis*] stage, corporate executives concentrated on cash flow and survival. During stabilization, the emphasis shifts to a three-pronged strategy: first, concentrating on profitability in addition to cash flow; second, running existing operations better; and third, repositioning the company to provide a sound platform for medium-term growth … Everything is examined in more detail, and this puts strain on the longer term systems requirements. At this point the company makes investments in running its current business better. Of particular concern is the main core business of the company that must be protected, cultivated and purified. It is the core that will finance the turnaround and provide a platform for the future.[11] [*Words in italics added by author*]

Slatter and Lovett emphasise the importance of predictability and communication with stakeholders in the stabilisation stage:

> … a key feature of crises is that they come as a surprise, and consequently, they shake external stakeholders' confidence in the ability of management within the company ... It is vital that stakeholder confidence be rebuilt, and that can be done through the crisis stabilisation phase by ensuring that all promises made are adhered to even when this involves making full disclosure of difficulties … nothing helps stability more than a period of management delivering what they promise.[12]

Turnaround practitioners must make adequate provision for restructuring costs and write-downs. Some turnaround practitioners make extremely conservative provisions in the hope that these will not only provide a contingency against unexpected problems, but will also leave an amount to be written back to future profits. I believe that an appropriate strategy is to make conservative provisions, but not to the extent of losing credibility. Contingency provisions should be clearly identified as such.

Stage 5: Detailed analysis and development of a recovery plan

I have classified this as a distinct stage although some turnaround experts include it either in the crisis management stage or in the stabilisation stage. In practice, it often occurs in both stages – you do it as soon as you can, but only when you can do it properly.

Slatter and Lovett note that very sick companies have serious problems that can be tackled only through fundamental, holistic plans. They have almost never encountered a turnaround plan that was too drastic. The chief danger, they counsel, is doing too little too late.[13]

It is crucial to have a framework and checklist for gathering the necessary information to provide a detailed analysis leading to the recovery plan. Porter and Ohmae are the strategic gurus to whom I usually refer for this purpose.[14] Whichever framework or guru's work you use, it is important to understand the industry or sector in which the troubled business operates and how the business stacks up against this. How is money made or lost in the industry? Table 3.1 sets out the Slatter and Lovett framework of generic turnaround strategies.

TABLE 3.1 Framework for achieving a successful turnaround

Source: Slatter, S. and Lovett, D. 1999. *Corporate Turnaround: Managing Companies in Distress*. London: Penguin Books, p. 77.

Seven key ingredients	Generic turnaround strategies
Crisis stabilisation	❑ Taking control ❑ Cash management ❑ Asset reduction ❑ Short-term financing ❑ First-step cost reduction
Leadership	❑ Change of CEO ❑ Change of other senior management
Stakeholder support	❑ Communications
Strategic focus	❑ Redefine core business ❑ Divestment and asset reduction ❑ Product-market refocusing ❑ Downsizing ❑ Outsourcing ❑ Investment
Organisational change	❑ Structural changes ❑ Key people changes ❑ Improved communications ❑ Building commitment and capabilities ❑ New terms and conditions of employment
Critical process improvements	❑ Improved sales and marketing ❑ Cost reduction ❑ Quality improvements ❑ Improved responsiveness ❑ Improved information and control systems
Financial restructuring	❑ Refinancing ❑ Asset reduction

Table 3.2 is the table of contents of the turnaround plan for Conlog, an Anglo American company, in July 1996. It illustrates many of the aspects that should be covered, but is by no means exhaustive.

Table 3.2 Conlog turnaround plan

Source: Anglo American Industrial Corporation. 1996. *Strategic Plan for Conlog* (Consolidated Logic). Johannesburg: Amic Board Papers.

1. Introduction
2. Market and industry
   - 2.1 History
   - 2.2 Political, social, legal and economic environment
   - 2.3 Markets:
     - Size
     - Growth
     - Segments
     - Customers
     - Consumer behaviour and profiles
     - Shares
     - Forecasts
   - 2.4 Distribution channels
   - 2.5 Sources of supply and value chains
   - 2.6 Competition
   - 2.7 Financial performances of sector and competition
   - 2.8 Opportunities, threats and risk
   - 2.9 Economics and key factors for success
   - 2.10 Norms, standards and nuances
3. Conlog
   - 3.1 History
   - 3.2 Financial review competition
   - 3.3 Management
   - 3.4 Organisation and personnel
   - 3.5 Marketing and sales
   - 3.6 Facilities
   - 3.7 Sourcing and manufacturing
   - 3.8 Service
   - 3.9 Information technology
   - 3.10 Contracts
   - 3.11 Legal
   - 3.12 Other

4. Analysis of Conlog
    4.1 Introduction
    4.2 Market positioning versus competition
    4.3 Products, price, distribution and terms versus competition
    4.4 Financial performance versus competition
    4.5 Cost structure versus competition
    4.6 Sales, capital employed, marginal profit, ROCE and cash flow by:
        – market segment
        – division
        – customer
        – product line
        – product
        – facilities
        – function
        – geographic area
    4.7 Management
    4.8 Strengths and weaknesses versus competition
    4.9 Current objectives, plans and strategies
    4.10 Potential competitive advantages
    4.11 Summary and conclusions
5. Alternatives
6. Conclusions
7. Recommendations

The sections I usually consider most important in a detailed analysis are:

- 2.9 Industry economics and key factors for success
- 2.10 Industry norms, standards and nuances
- 4.3 Products, price, distribution and terms versus competition
- 4.4 Financial performance versus competition
- 4.6 Sales, capital employed, marginal contribution, profit, ROCE and cash flow by:
    – market segment
    – division
    – customer
    – product line
    – product
    – facilities
    – function
    – geographic area.

What sections to emphasise in an analysis depends mostly on the situation. It may be possible to focus on only a few, but I have found that it usually pays to be thorough if you have the time. I have seen some people learn more about an industry in an intensive month of analysis than others familiar with the industry have in decades.

The analysis should include in-depth discussions with major customers, suppliers, key employees and other stakeholders. Table 3.3 lists some of the questions I have found valuable in the detailed analysis and recovery plan development stage.

As mentioned in Stage 2: Rapid appraisal, the strategic alternatives should be evaluated.

Table 3.3 Questions for analysis

1.	What are the economics, value chains and key factors for success in the sector?
2.	What are the 'average' performances in the sector, for example ROCE, ROI, gross margins and operating profits to sales? What do outstanding competitors achieve?
3.	In what aspects is the organisation underperforming?
4.	Why is the organisation underperforming?
5.	Are there inherent competitive advantages or can they be created? (Here, the initial study on the competitiveness of the product or service outlined in Stage 2: Rapid appraisal of the situation, comes into play.)
6.	What is the realistic potential of the organisation?
7.	Will the required financial and resource investment be adequately compensated by future performance?
8.	What actions can be taken to stabilise the organisation in a crisis? Examples include management changes, selling assets and closing loss-making operations.
9.	Can the product or service be competitive?

Stage 6: Rehabilitation or 'return to normal'

The final stage of a turnaround concentrates on development and revenue growth. If management has learned its lessons, it will position the organisation in faster-growing, high-margin markets. To facilitate revenue and profit growth, an organisation must:

- improve marketing effectiveness
- selectively add new product lines
- develop additional markets
- increase selling effectiveness
- improve customer services
- improve operations processes and efficiencies.[15]

The balance sheet is often restructured in this phase. See Figure 3.2 from MorrisAnderson above.

> The turnaround becomes a turnaround at that point in time when your financial partners begin to treat it as such ... when your financial partners begin to treat the company as a customer again, rather than the bank feeling like it's the customer, that is the point in which the turnaround has been effected.[16]
>
> …
>
> Dramatic profit improvement, unless sustained for a period of time, does not mean that a company has turned around. The euphoria of quick results must be followed by the reality of successfully implementing strategies for two or three years. Besides generating profit, a company must rebuild its position in the marketplace, make the right strategic moves, and motivate its people to complete the turnaround cycle.[17]

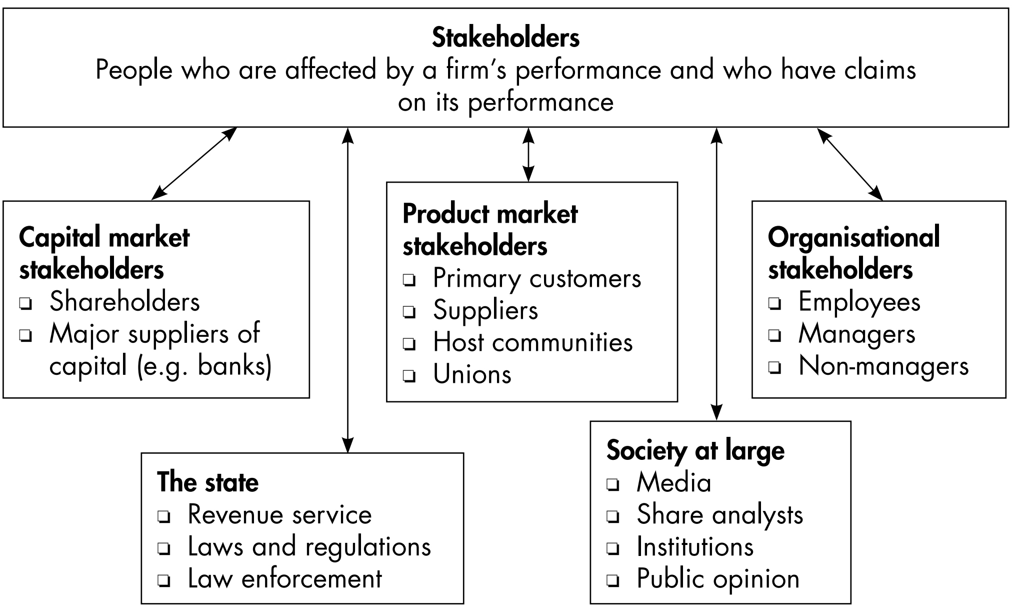
It would seem that a company has been successfully turned around when it consistently earns investment returns in excess of the average for its sector, but this may not necessarily be the case. The potential of the turnaround candidate could be different. Well managed, it may, on the one hand, have the potential to earn only below-average returns or, on the other hand, clearly outperform its competitors over time.

Management of stakeholder relations

Figure 3.3 illustrates the stakeholders. I have added the state and society at large to the original three categories portrayed by Hitt, Ireland and Hoskisson.

FIGURE 3.3 Stakeholders

Source: Adapted from Hitt, M.A., Ireland, D.R. and Hoskisson, R.E. 2005. *Strategic Management: Competitiveness and Globalization* 6th ed. Mason, OH: Thomson/South-Western, p. 24.



One has to work at managing stakeholder relations at all stages of the turnaround process. Success, and sometimes survival itself, depends on it.

Who the most important stakeholders are depends on the situation, the timing and which stakeholder appointed the new CEO or the consultant overseeing the turnaround. Banks or creditors, and not necessarily the board or shareholders, may decide this in critical situations. An organisation may have to persuade banks and creditors that they would be better off if it survives rather than being liquidated. The organisation will certainly not survive if its customer base is rapidly eroded.

In my experience and judgment, however, the most important stakeholder group is almost always the few top managers selected to manage the turnaround. No one else is going to accomplish it.

Shuchman and White stress the importance of public relations in managing stakeholder relations. They emphasise the need for communication in troubled times, and advocate courage and tenacity:

> The worst attitude is to become introverted and behave like an ostrich, burying your head in the ground to hide from the world. During troubled times you may often feel like saying 'Help! Stop the world; I want to get off!' But at all costs you must fight on. The survival of your business depends on your ability to keep your head when times get tough.[18]

Shuchman and White believe that press releases work – simple, succinct notices sent to the local and industry press announcing good news about an organisation will be read and noticed.

Implementation and delivery or 'getting it done'

The work done during the turnaround process will largely be in vain if there is no implementation. I believe it crucial to identify key managers and employees, and provide them with sufficient incentives and security to facilitate the implementation. Each person should have a list of clear and specific goals with due dates and how goal achievement will be measured or assessed. These goals should, if possible, be written on one page or be contained to a single video screen! Ideally, these goals should be 'negotiated' unless the situation is so crucial that authoritarian leadership is required for a time. One must have goals that are both achievable and 'stretching'. There is also a widespread belief that there should be no more than five major priorities.

Bossidy and Charan recommend follow-up and follow-through, together with quarterly performance reviews that should conclude with an agreement on what is to be done. There should be contingency plans and the assumptions likely to be the most vulnerable should be checked thoroughly. In a time-pressured turnaround, reviews and follow-up may have to be done far more frequently, sometimes daily on crucial issues.[19]

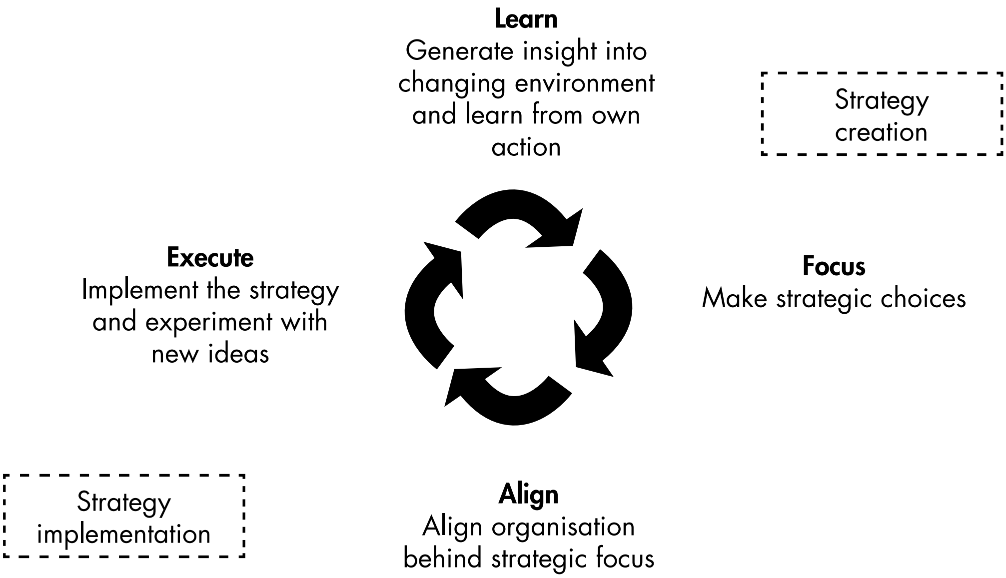
They believe that execution is a discipline and a system that has to be built into an organisation's strategy, goals and culture. An organisation in trouble will in all probability not be in this situation, which will be a great challenge for the new management.

It is generally better to hold more meetings than usual, but to keep them short. Rapid and continuous feedback to management and employees, especially of successes, is a key motivator in these circumstances. I have found that the need to follow up continuously is far greater than is the case with a normal business. Be prepared to be flexible if conditions change.

Another source of information for implementation is Pietersen's strategic learning concept. The essence of strategic learning is a process with four linked action steps, namely learn, focus, align and execute. These action steps build on one another and are repeated, as the fifth step if you will, in a continuous circle of learning and renewal. The key is to think cycle, not straight line. The challenge is to repeat the process over and over so that the organisation learns continuously from its own actions and from scanning the environment, and then modifies its strategies accordingly.

Figure 3.4 The strategic learning cycle

Source: Adapted from Pietersen, W. 2002. *Reinventing Strategy: Using Strategic Learning to Create and Sustain Breakthrough Performance*. New York: John Wiley & Sons, p. 8.



The final stage of the strategic learning cycle is implementation and experimentation. Pietersen states that 'it is a misnomer to refer to the final step alone as implementation'.[20] This is because the entire strategic learning process – learn, focus, align and execute – is a challenge of implementation. As stated above for Bossidy and Charan, this would have to be accomplished in a situation with time and consequence pressures.[21]

In conclusion, the need for turnarounds comes not only from crises, but also from anticipation of change and dissatisfaction with below-average performance. The key factor in successful turnarounds is early recognition of the need for a turnaround. Turnarounds can take time, depending on the sector and state of the organisation. Sufficient action should be taken in the first year to reach the stabilisation phase and obtain stakeholder confidence and support.

Notes

[1] Bibeault, D.B. 1999. *Corporate Turnaround: How Managers Turn Losers into Winners*. Washington: Beard Books.

[2] Slatter, S. and Lovett, D. 1999. *Corporate Turnaround: Managing Companies in Distress*. London: Penguin Books.

[3] Collier, P. 2007. *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*. New York: Oxford University Press.

[4] Bibeault 1999 p. 93.

[5] Harvey, N. 1999. Bulldozers don't wear shoelaces. *Professional Management Review*, December 1999: 80; Harvey, N. 2000. Conlog. *Professional Management Review*, May 2000: 18, June 2000: 40 and July 2000: 18.

[6] Slatter and Lovett 1999.

[7] Bibeault 1999 p. 93.

[8] Slatter, S., Lovett, D. and Barlow, L. 2006. *Leading Corporate Turnaround: How Leaders Fix Troubled Companies*. San Francisco: Jossey-Bass, p. 10.

[9] Slatter et al. 2006 p. 98.

[10] Slatter and Lovett 1999.

[11] Bibeault 1999 p. 103.

[12] Slatter and Lovett 1999 p. 12.

[13] Slatter and Lovett 1999.

[14] See, for example:
Ohmae, K. 1982. *The Mind of the Strategist*. New York: McGraw-Hill.
Ohmae, K. 1991. *The Borderless World: Power and Strategy in the Interlinked Economy*. New York: HarperCollins.
Porter, M.E. 1980. *Competitive Strategy*. New York: Free Press.
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Porter, M.E. 1990. *The Competitive Advantage of Nations*. London: Macmillan.
Porter, M.E. 1998. *On Competition*. Boston: HBS Press.

[15] Bibeault 1999.

[16] Taube 1978 cited by Bibeault 1999 p. 108.

[17] Bibeault 1999 p. 108.

[18] Shuchman, M.L. and White, J.S. 1995. *The Art of the Turnaround*. New York: American Management Association, p. 253.

[19] Bossidy, L. and Charan, R. 2002. *Execution: The Discipline of Getting Things Done*. New York: Crown Business.

[20] Pietersen, W. 2002. *Reinventing Strategy: Using Strategic Learning to Create and Sustain Breakthrough Performance*. New York: John Wiley & Sons, p. 210.

[21] Bossidy and Charan 2002.