Organizational Decline and Turnaround Management

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Executive Summary

A panel of turnaround leaders, consultant, and academia responded to the theme on Organizational Decline and Turnaround Management. The panel members addressed the following issues:

- What are the causes of organizational decline?
- How do stakeholders respond to organizational decline?
- What are the turnaround challenges?

The salient features of the responses are as follows:

- There is a divide among the turnaround leaders regarding the causes of decline. Some view the decline purely as the result of the failure of management to anticipate and act appropriately in time. For others, the decline is caused primarily due to external changes.
- People in academia and consulting view the problem as a mix of the two. According to them, a complex mix of variables—organizational processes, structure, leadership, vision, and technologies—lead to organizational decline.

To safeguard against decline, organizations must carefully monitor:
- difficulties in adapting changes and rigidity of systems
- declining profitability
- shift in customer preferences
- working capital problems like inventory build-up; dumping products on dealers; and increasing receivables from customers
- inability to plough back into the business
- lack of vision and explicit direction for the future
- frequent labour unrest
- regular plant breakdowns.

The response of stakeholders to organizational decline becomes hostile. Often, financial institutions include compound interest and increase penal charges to secure their dues. The employees and union members tend to become aggressive owing to loss of credibility of management. Suppliers tend to evaluate the risk of their dues. Their hostility reduces if the management assures them of payment. Managers experience erosion of pride in their company. It leads to low individual initiatives.

The turnaround challenges include the following:

- Leadership that provides a vision, induces creativity, challenges the existing business assumptions, and shows willingness to take tough decisions.
- The support of financial institutions by way of loan restructuring. Industry is experiencing a definite shift in the approach of financial institutions and banks; they are now tending to support the turnaround effort.
- Gaining the trust of the suppliers to seek their support.

Internally, management needs to be concerned about:
- maximizing productivity of all resources and capacity utilization
- manpower rationalization
- stringent working capital management
- stretching the targets and making assets ‘sweat’
- streamlining systems
- investing in technology upgradation through internal generation
- financial restructuring in low interest cost regime.

KEY WORDS
Organizational Decline
Turnaround Management
Turnaround Leadership
Productivity
Stakeholders
Working Capital
Sunil Kumar Maheshwari (Faculty, IIMA): Organizational decline and turnaround management is emerging as one of the most important topics addressed by business education and research in recent years. Yet, globally, the threat of decline has been increasing in both manufacturing and service industries not only during the period of economic recession but also in the relatively prosperous years. In fact, there has been a sudden upsurge in the decline rate in the companies since 1995.

There is a growing concern among the policy makers, financial institutions, and corporate houses in the country to arrest the declining trend among the organizations. The frequently asked questions are:

- What are the causes for the firms’ decline?
- What are the actions taken by the firms to respond effectively to decline?
- What is the role of financial institutions, government, and other bodies in ameliorating the situation?

The causes of decline are identified along two lines:

a) external to the organization, and
b) internal to the organization. Environment has limited resources. Consequently, only the fittest survive. Organizations that fail to align with the environment decline. The lack of initiative arises primarily from inertial pressure which could be the result of sunken investment, specialized assets, bureaucratic control, internal political and cultural constraints, external restrictions, and managers’ commitment to status quo due to their longer tenure in the organization and in the industry.

Frequently, the lack of surplus resources causes excessive control and managerial paralysis leading to failure. Similarly, excessive surplus resources lead to complacency. Careful management under these conditions can prevent possible decline of organizations.

One of the most common reasons for organizational decline has been ‘one-man rule.’ Organizations which are prone to this policy have a high risk of being blind to many perspectives as no one is in a position to play the role of a ‘devil’s advocate’ while strategies are formed. Consequently, they are caught unawares owing to inadequate preparation for contingencies.

Organizations that are owned by large corporate houses are likely to be influenced by corporate offices before a decision is taken on turnaround or closure. Corporate offices that closely monitor the performance of the organizational unit will force the management of the declining organization to take quick action to ameliorate the declining conditions thus reducing the period of inaction. However, in organizations that have diffused power structure, the crucial time for early corrective actions gets lost.

There are three broad alternatives for the future of declined organizations: they could be closed, sold, or revived without a change of ownership. The highly integrated firms prefer to turn around their units rather than closing or selling them. This is because the big corporate houses can provide technical, financial, and managerial help to such organizations for their revival which is important for the overall functioning of the group. However, in the loosely integrated organizational units of a corporate house, there is likely to be a longer managerial inaction.

The various stakeholders in an organization respond to decline through:

- disengagement
- reduction in quality of participation
- bargaining for more favourable exchange of relationships
- denigration via rumours
- denigration via confrontation.

Such reactions enhance the chances of closure of an organization. Hence, management of relationship with stakeholders outside the organization becomes an important task of turnaround management. However, in subsequent stages of decline, when the initial efforts prove to be futile, these managers lose credibility. This necessitates a change of leadership at the top characterized by a benevolent autocratic behaviour and vision which would help in producing positive results to turnaround efforts. Essentially, these leaders will have to convince all the stakeholders that decline is temporary and controllable. This process would reduce the hostility of different stakeholders.

The turnaround leaders need to take action in the following areas for an effective revival of the companies:

- personnel changes
- diagnosing and troubleshooting
- stakeholder or people-management
• operations management
• management systems and structure
• financial management
• strategic management.

Changes in the product-market domain and cost reduction are common in most of the turnaround efforts. People reduction has also been one of the common measures of reducing cost in the recent past. Organization of farewell ceremonies in such declining organizations has been found to be useful as they provide emotional support to the people leaving the organizations. Such ceremonies are also used for motivation, information dissemination, external stakeholder acceptance, impression management, and guilt management.

One of the biggest challenges for the revival of the declining companies is to improve operations without much investment in plant and equipment. Because of a lack of available funds, the fullest exploitation of the creative ability of the organization becomes a necessity. The operations management efforts for reducing the cost and improving the quality include initiatives such as stretched targets and suggestion forums.

Financial management requires negotiations with the financial institutions for support during crisis when they are actually hostile towards the management. These institutions require convincing arguments from credible sources that the management is serious about the turnaround process and that the institutions’ interests are best served by supporting the revival initiatives.

Finally, strengthening the organization’s position to avoid a slippage into losses again remains the main challenge for any revived organization.
decline is when the company’s market share is allowed to decline unchecked over a period. By definition, the entity is facing a shrinking core and the inherent cost of doing business automatically becomes excessively high. This, in turn, pushes up the cost of production per unit of the product making it an unviable proposition to keep producing and selling in a small market much below the capability of the manufacturing plant. The first step which needs to be undertaken is to revisit the marketplace and understand how the product is being viewed by the entire downstream value chain. In fact, the very definition of the product or the business needs a hard re-look. This does not take away the need for structural changes to be put in place; what needs to be understood is that the structural changes themselves are not and should not be the starting point.

Regarding the people aspect we can easily see that in a declining organization, the company pride is greatly diminished and the individual initiative seems to be at somewhat lower levels resulting in problems relating to idea generation and information flow. However, this itself can get triggered by the financial and market situation which may not be good. Hence, the people factor generally should not be perceived as the starting point of decline except perhaps for what the senior leadership team might have done. The omissions and commissions of the senior leadership resulting in bad corporate governance can definitely trigger a downswing. However, once the process of de-motivation has set in the organization, it is imperative that an intensive and extensive communication process is set in place. People need to be constantly told about the strengths of the organization to bring back their self-esteem and pride in the organization. It is easier said than done since it is a cultural issue and the pessimist in any case will have a field day predicting doom for the organization at every available opportunity. A systematic process of communication appropriately targeted at different levels and functions can revive the confidence and put the people back on the rails.

Often, the operations of the organization are not just working at sub-optimal levels but the company facilities appear to be run down. Overall cleanliness and quality standards seem greatly diminished and manufacturing equipment is repaired only after the breakdown. No asset is perhaps more valuable to a manufacturing organization than its physical plant and machinery. When a company’s manufacturing facilities are operating at very low levels of its capacity, it is perhaps the most potentially crippling situation for the firm sending clear signals that it is in need of a turnaround.

Another typical situation is when the company is having a hard time generating cash. Managing a business for cash is often through reprioritizing projects, altering inventory and in-stock positions, making purchasing arrangements with suppliers, practising value engineering on existing products and facilities and modification of processes.

In almost every turnaround situation, there is a division, product line, operating facility or a ‘corporate project’ that is losing money or draining cash at an accelerated speed. For a variety of reasons (sometimes political), these situations remain unaddressed while vital functions are dramatically under-funded. The turnaround team must apply the tourniquet and immediately stop the continuous outflow of cash. Therefore, ‘stopping the bleeding’ is the first step towards getting a handle on the situation and setting a new tone within the troubled company. No corporate asset is more precious than cash. While undertaking a turnaround, the strict cash management policies must be implemented whereby all the expenditure over a certain level must be authorized by the controller, the executive-in-charge of the functional area, and the CEO or the individual presiding over the turnaround.

The turnaround team must talk to everyone in the firm who can supply the needed information and should take notes on the thoughts and perspectives of the management ranks. It should ask the question: “if you did not have to worry about what any of your bosses thought, what would you do to fix the business?”
The answers will indicate the clarity and apparent distance from the plans that are actually being implemented. The same exercise must also be conducted with key retailers, suppliers, and other stakeholders. The extraction or generation of critical data requires a skill that is foreign to many high-powered managers—the ability to listen to others. In the zeal to show themselves as the saviour of the business, the natural inclination is to espouse the turnaround strategy almost immediately only to find out later that initial plans must be modified because of the emergence of new data. This critical shift in strategy can have an adverse effect on the psyche of the company and can lead employees to believe that they are either ‘victims’ or ‘culprits.’ It is critical for the turnaround team to disarm this syndrome by enabling everyone feel that their input is valuable and will be viewed with a non-judgmental eye.

Once the turnaround team has gathered the facts about the company, it is time to determine who is going to play on the team. Many people cannot shed the emotional baggage of having worked in the declining business environment and will forever doubt the new team’s (or any team’s) ability to turn the business around. Such people should be dealt with immediately in order to create a proper environment for a fresh thinking required to revive a troubled business.

Alternatively, existing managers who are committed to the new cause are one of the most valuable assets any turnaround team can have. These individuals are the archives for the company; they understand the procedural issues involved in getting things done and provide the experience base that is specific to the firm so that previous mistakes are not repeated by unsuspecting new managers.

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It is important to create a venture-team environment whereby traditional inter-departmental barriers are broken and the cross-flow of information is facilitated and encouraged. But, in this case, a high degree of commitment on the part of all the employees is essential. Unhappy or unsupportive workers are like a virus and their negative attitude can be especially contagious to tired, frustrated, and vulnerable co-workers.

The time is now ripe for creating a master plan that will guide the company out of its trouble and into calmer waters since the turnaround team has been assembled and has the necessary information along with the vision, direction, and a clear understanding of the parameters and time frame associated with the task.

The playbook is the master plan that the organization will use to execute the turnaround. It also lists the critical checkpoints that must be a part of the overall plan. Unless every individual in the company understands what he or she is supposed to do, the plan cannot succeed no matter how well conceived it is.

Perhaps the most valuable asset in successful companies is the ability of the people at all levels to use their knowledge, creativity, and experience to generate ideas. These companies set up systems that encourage, if not demand, the personnel at all levels to submit topical ideas on a regular (often weekly) basis. Idea generation enables everyone in the firm to believe that he or she has a direct voice in determining the organization’s future and also helps in uncovering hidden ‘jewels’ within the company.

Ideas that are ultimately implemented should be rewarded and the initiator or inventor, the co-workers involved in the execution, and the individual’s boss who helped to direct and/or carry out the plan should all be compensated. It is amazing where ideas come from and how close some of them are to the needs of the consumer or the target audience that the firm is trying to reach. Another benefit is that the ideas generated internally by employees in functional areas related to the manufacturing process tend to be very cost-effective and, in many cases, improve the firm’s overall economies of scale.

The credibility of the turnaround team rests with its ability to motivate the organization by creating a feeling of victory and by conveying that troubled times are behind and better times are ahead. During the turnaround process, many employees would be required to put in long hours to help execute plans and programmes they may not necessarily agree with. In effect, the members of the organization should get committed to the plans created and directed by the turnaround team.

It is important for the success of the project that specific measurable criteria for evaluating the progress be agreed upon before executing the plan. It is up to the turnaround team to ensure that a majority of those objec-
tives are met within the turnaround process.

There is nothing like success to convert anxious employees into devoted zealots. Only when all members of the organization begin to see clear signs of progress and achievement of the stated business goals will they feel that the plan is sound, viable, and on track. The tension and fear within the troubled company will gradually dissipate and will be replaced by a new entrepreneurial spirit.

Finally, no turnaround story is ever complete. After the revival phase, one has to bring in necessary robustness to ensure that the organization does not fall back into the same trap. The surest way of ensuring this is by instituting a process of business excellence in the organization at the earliest and getting fully guided by the letter and spirit of the principles enshrined in such a process. This will especially facilitate an approach whereby all the stakeholders’ needs could be simultaneously addressed and balanced. Without such an approach, any turnaround effort today will remain inconclusive. Efforts will have to be directed towards making total quality management a way of life in the organization through a well-structured process of deployment and continuous measurements to check the effectiveness of the process. In a fiercely competitive market scenario, the approach of everyday being a new day is the only approach which can bring about consistent success and growth without which the old glories can take the organization back to complacency and possibly towards disaster.

Pradip Chanda (Chairman, MMS India Private Ltd.): In any business, there are three key drivers of success: vision, resources, and organization. They determine the stage of lifecycle a corporation is in.

Growth requires fuel by way of monetary and managerial resources and a prudent growth plan can attract both. Stagnation is the result of the inability to access more resources as the investing community and the management talent pool lose confidence in the firm’s ability to grow—a reflection of its stakeholders’ perception of the firm’s game plan. Decline is the result of resource crunch. Turnaround is mandated when the resource crunch becomes severe. Renewal is the phase in which the firm re-establishes its ability to attract fresh resources and post a successful turnaround. And, finally, when the renewal is visibly successful, the firm is ready to get back on to the path of growth.

It is obvious that remaining stagnant is not an option available to the management of any corporation. Growth is imperative to generate necessary resources to remain competitive, especially when new entrants and substitutes threaten to erode its base.

In environments where government intervention provides artificial and unsustainable factor advantages, corporations often get by without making these investments. Bajaj Auto and Hindustan Motors are two clear examples. Both were in a ‘stagnation’ mode when the environment changed. Hindustan Motors is rapidly declining towards a point of no-return whereas Bajaj seems to have got its act together just in time.

Clarity of vision plays a major role at such times. If the investment decisions are made without a clear understanding of the life cycle phases, they can destroy the corporation’s core strengths. For example, Metal Box, a packaging company, flush with cash in the late 1960s, decided to branch out into manufacturing ball bearings, a non-core business that sucked up so much cash that the company could not be saved from bankruptcy.

Glaxo Consumer Products preferred to return extra cash from the business to its shareholders in the 1990s. This might have appeared to be a better decision than Metal Box’s at that point of time, but the management’s inability to find new avenues of investment for growth led to the company’s subsequent exit from the consumer products business.

More recently, Hindustan Lever has returned some extra cash in the business to its shareholders. And its top line has grown by a mere six per cent in the last five years. A case of losing its way? Perhaps not, as recent strategy initiatives of the company suggest that the company management is well aware of the challenges ahead.

When a corporation reaches the turnaround phase, one of the issues for debate is whether an Anglo-American model of turnaround is the correct one or whether businesses based in India, and indeed much of East Asia, should develop a separate model.
Harsh short-term measures such as large-scale retrenchment and divestment of unproductive assets, the cornerstones of the American model, are always more attractive to the turnaround manager. Our interaction with many CEOs heading potentially bankrupt companies indicates that they had the desire to have freedom to employ this model, no matter what industry it is or how big or small the firm is. There is no doubt in any of these CEOs’ minds that the American model produces results more quickly. All are, however, aware of the high social costs of such turnarounds and very few are mentally prepared to take the responsibility for the trauma such strategies could cause. As a result, corporations in most Asian and European countries have adopted more ‘humane’ turnaround models. In many cases, arcane laws such as the Industrial Disputes Act 1947 (IDA) requiring that prior government permission be taken before implementing any plans to rationalize, standardize or improve manufacturing processes, have forced corporations into diverting valuable resources to pay large worker compensations to enable restructuring. For example, Telco is reported to have spent Rs 2.4 billion on voluntary retirement schemes, a sum that could have launched a number of medium-sized companies!

Another point of debate is the leadership required to steer a company through the turnaround phase. Studies across the world have identified the induction of a new CEO as an essential ingredient in successful turnarounds. This is universally true for the American models of turnaround. Unfortunately, this is easier said than done in family-managed corporations in India. Recent studies have established that the owners’ resistance to distance themselves from the management is a pan-Asian phenomenon reflecting family and social values very different from the American management mindsets.

The vision or focus of the turnaround CEO is another point of debate. Often, turnaround managers lose sight of the necessity to prepare for the renewal phase. Hence, one comes across a number of instances where companies that have come out of the woods have gone back to a state of decline after a brief period of resurgence.

It is often argued that the CEO’s leadership style rather than his skills and expertise militates against the qualities required to go through a consolidation phase after the turnaround. That is because his focus impacts on the organization and its ability to raise resources.

Turnaround managers ask for and frequently get total authority from the board to take quick decisions. As a result, they often end up shooting from the hip with little time spent on collecting and analysing data and arriving at conclusions after careful consultations that a good business demands. Such practices are unlikely to be appropriate in the post-turnaround phase.

Too intense a focus on the turnaround phase also leads a company into a strategy trap that turnaround managers are forced to adopt in under-performing and sick companies. In most turnarounds, managers are perforce occupied with managing the details and instead of being driven by a well-articulated vision, strategies evolve as the repairs to the corporation gain momentum. And, to a large extent, the strategies adopted are a mix of what Mintzberg and Waters define as entrepreneurial and imposed strategies.

Entrepreneurial, because the grand plot for the turnaround is deliberately kept as a personal and partially articulated vision of the turnaround manager; the turnaround manager unfolds the strategy step by step as the organization develops its capabilities to meet immediate objectives and goals and gets ready to tackle the demands for sustainable growth. This approach provides the turnaround manager the flexibility to exploit new opportunities, wherever they come up, with utilization of the company’s assets as the only discriminating determinant.

Imposed, because the turnaround manager is forced to work with limited resources at hand. Under his direction, the company is more likely to find customers for what the company can make, rather than make what the customer wants. The environment would also dictate his decisions on wide ranging issues. If the political and social climate discourage manpower rationalization, the turnaround manager will opt for manpower intensive technology. If relocation of the manufacturing facilities is not an option, the turnaround manager will focus on a product range that is likely to give him a regional advantage. If building brands is too expensive, the turnaround
The strategy trap in the mind of a turnaround manager can have far-reaching consequences for the company. Too great a focus on products and efficiency in traditional functions makes the company vulnerable to duplication and substitution.

The signs of sickness manifest themselves in many ways and could be different for different types of industries and businesses. The most common are:

- inability to adapt to change
- declining profitability
- shift in customer preference
- working capital problems like (a) inventory build-up; (b) dumping products on dealers; (c) increasing customer outstandings
- inability to plough back into the business
- no clear plans for the future
- frequent labour unrest
- regular plant breakdowns.

Organizational decline is usually gradual. Lenders, dealing agencies, and investors become aware of the symptoms. Payment delays resulting into defaults is a common occurrence. The management is unable to read the signs and, unfortunately, takes too long to react. When realization finally dawns, precious time would have already been lost. The situation would have deteriorated far beyond expectation. Good performers would have taken flight; those left behind would rationalize to themselves that the problems are for the others and not for them. Effectively, the organization drifts along without any clear directional leadership. In such a situation, drastic measures pay rich dividends. The best approach is to change the person at the top and empower the new incumbent to take bold decisions with single-minded determination. The selection has to be carefully made or the organization could be pushed into a worse crisis.

This new leader must have the ability to think differently, take bold decisions and, above all, be well-informed to take calculated risks. The
promoter and other members on the board of directors must necessarily back him to the hilt. Being given a free hand also presupposes accountability. More often than not, the ‘command and control’ style of management needs to be adopted if results are to be achieved.

Strategizing and careful planning is very important. Organizational strengths and weaknesses have to be carefully assessed. Planning has to be flawlessly executed and team effort is a must. Many a time, the core team emerges from the existing personnel itself. Any organizational gaps need to be plugged. But, this can take time and, in any case, should not hold back the revival effort.

Each team member must be clear of what is expected of him and his team. Clear, precise, and unambiguous communication is most critical. This must emanate from the top so as to eliminate rumours from persons down the line. Freedom to perform within the overall given set of core objectives is essential. Frequent progress monitoring is necessary.

Problems are to be faced head-on and not deferred. By deferring them they do not disappear; instead, they remain, grow, get compounded and finally end up thwarting progress.

While the goals set need to be accomplished, often, with change of circumstances, the strategy may need to be altered to suit the situation. Quick reactions with flexibility of approach are needed.

Some of the other important aspects for eventual revival are:
• improving labour relations (do not underestimate the need to carry the workmen with you to succeed in all the initiatives that get implemented)
• maximize productivity of all resources
• managing working capital stringently
• maximizing capacity utilization
• leveraging strategic plant and operations and making assets ‘sweat’
• war on costs
• streamlining systems through extensive computerization
• ploughing back internal generations.

The leader needs to adopt the ‘command and control’ style akin to that of General Patton, the legendary commander of the US forces in World War II. Speed, simplicity, and boldness are the required ingredients. This style requires the team to take hard decisions in the interest of the organization, act quickly, and work with a less than perfect organization that will be comfortable with simple solutions. In this war for revival, survival of the company is the goal. To achieve this, strong action with determination is required.

In a turnaround situation, the team must pledge to strive for success. A strong message should reverberate throughout the organization emphasizing the need for careful planning, teamwork, pride in the company, its people and products, self-motivation, and discipline.

It has been proved that, with a well-thought out plan of action, if people are given every opportunity to succeed, they will. If they are given goals they understand, they will meet them. If the bar is set high, they will raise themselves.

The efforts of the management should have the support of different stakeholders. They also need to be committed to making the attempts at revival succeed.

Most often, the lenders turn creditors and work only to secure their dues, including compound interest and penal charges. Their support by way of loan restructuring is critical. Over the years, there has been a definite shift in the approach of financial institutions and banks. They are now more supportive of the turnaround effort once convinced of its seriousness. They have defined internal norms and procedures whereby they recover principal dues and offer concession in the interest. They also grant the requisite extension of time to meet these revised obligations. The area in which they are unrelenting is in giving additional credit facilities to facilitate improvement in the operations. Accounts get frozen, non-fund limits are withdrawn, and retention is imposed whereby the cash flows get impacted.

The help from suppliers during these difficult times is the oxygen that is needed to keep the operations go-
ing. Gaining the trust of the suppliers is all important. Even in such times, the supplier must feel that the management at the top is responsive and honourable in its approach. The company must demonstrate that the supplier’s dues are safe in spite of the inevitable delays in settling them. A management that can be trusted will get the cooperation of its suppliers. There have been instances where suppliers have acted as company’s bankers where the management has systematically built high credibility among them.

Implementing a turnaround though difficult is achievable. The ingredients have to be right and the effort has to be in sync with most of the players involved. But, the most crucial element in the whole process is the management team and its playing captain.

If one wants to do a ‘Patton’ to revive an ailing organization, he should by all means opt for the command-and-control model of leadership and let the critics be damned!2

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1 ibid.

I have dedicated my life to this struggle of the African people. I have fought against white domination and I have fought against black domination. I have cherished the ideal of a democratic and free society in which all persons live together in harmony with equal opportunities. It is an ideal which I hope to live for and to achieve. But, my lord, if needs be, it is an ideal for which I am prepared to die.

Nelson Mandela