Turnaround strategy essay sample

Increasing global and domestic competition, the business environment tends to be more turbulent, more and more organizations have realized the importance of reforming its future competitive competence in order to succeed in a changing environment. In practice, no matter what companies' size are, they could easily get into trouble to survive, their performances are unexpectedly unacceptable to their shareholders, creditors etc. Of course, the reasons for a company could be innumerable，it may be the internal reasons or the external reasons, or both. " Through the SWOT analysis can provide a good overview of whether a firm's business position is fundamentally healthy or unhealthy" (Thompson&Gamble&Stickland, 2006: 85).

The strengths and weaknesses of a firm are the part of the internal environment of a firm and can be controlled by the firm. Whereas, the opportunities and threats are the part of a firm's external environment that are uncontrollable factors. Both weaknesses and threats can often pose serious risks and competitive disadvantage to the firm. Thus, the firm can easily get into turnaround situation. Once this situation occurs, managers must first be able to diagnose the symptoms of the firm. Then, managers must take a series of remedial actions to cure the firm's symptoms. Finally, managers must also evaluate whether its corrective actions are properly fitting for the situation, and ensure the firm return to growth again.

The concept of turnaround

" A " turnaround" can refer either to a business firm that faces financial disaster or action taken to prevent the occurrence of that financial disaster"

(Sloma, 1985: 11). All turnaround situations not only deal with transforming any struggling firm to a profitable one again, but also deal with those firms whose performance is seriously dissatisfied by the management. Particularly, those unacceptable performances refer to a company's financial performances.

" According to Sloma' statement, turnaround situation can be classified into four stages, which are cash crunch, cash shortfall, quantity of profit and quality of profit" (Sloma, 1985: 20). All of these four stages share two basic characteristics. First, the stages of turnarounds are unable to exist together. This is because the extent to which the financial difficulties are quite different, the time they need to change the embarrass situation should also different. Second, all stages of the turnaround situations may stem from the managers' selfishness. Because of their position in the company and ego, they are often unwilling to recognize the problems or to take the responsibilities. Thus, they may intentionally cover the truth and delay to deal with it. Unfortunately, the bad situations do not get better by themselves, but it will make the things worse.

In deed, most turnaround situations could be avoided, if managers can be able to identify those early-warning signals. This is because before the turnaround situation occurs, it normally has an incubation period. Unfortunately, rare managers can be ware of the problems at this stage. After that period, the firm will really enter into the turnaround situation.

" According to the statement of Bibeault (1982: 23), businesses decline for both uncontrollable external reasons and for controllable internal reasons.

However, most of business problems are generated by internal reasons” Therefore, in order to be ware of the warning signals prior to the turnaround situations taking place, managers must periodically monitor both external and internal forces.

“ Macro-environment can be defined as the larger societal forces that affect the micro-environment____ political force, economic force, social force and technological force”(Kotler & Armstrong, 2004: 107). Macro-environment presents the one of external environment, which influences the competitive environment. Through PEST analysis, it will give an overview of the whole business atmosphere.

The external forces should also include the competitive environment. Changes in competitive environment are likely to affect directly the performance of a given company. According to Michael porter, the nature of competitiveness in a given industry can be viewed as a composite of five competitive forces. The Porter’s five forces model not only help decision-makers to identify any particular industry’s potential profitability, but also help managers to assess how each force influencing companies.

All of above elements are companies’ external forces. They can both positively or negatively affect companies’ performance. “ A change in an external uncontrollable element will be felt by all businesses in an industry, but the impact these changes have on a specific business depends on the strength and stability of the management team” (Scherrer, 2003: Online).

As it mentioned above, the turnaround situation is usually caused by poor performance of internal elements, which mainly refer to the company’s various functional departments, such as operation, marketing etc. Through the value chain analysis, managers can gain an in-depth knowledge about which parts of value chain they have built cost advantages and which ones they have posed cost disadvantages. A cost disadvantage may be caused by many ways, such as poor productivity in operations, high distribution cost etc. A differentiation disadvantage may stem from poor quality R&D team or material selection etc.

The following figure points out any value chain that consists of six primary activities, they are called supply chain management, operations, distribution, sales and marketing, services and profit margin. Another three basic activities give them sufficient support. They are called product R&D, technology, and systems development, human resource management, and general administration. All of activities within a value chain incur amount of costs and create a part of value on final products that will be received by customers.

The above diagram was taken directly from Thompson et al, 2006: 96.

When anyone of these internal elements poses a seriously competitive disadvantage over rivals, it may lead the company to a turnaround situation. However, these internal elements can be controlled by the company. Before the turnaround situation occurs, if managers constantly monitor these factors and benchmark them against other rivals, the turnaround situation may be possibly avoided.

3 . The key factors in turnaround success

In order to ensure the turnaround situation can be successfully completed, there are four key elements that are vital for any turnaround firms. They are reforming all aspects of old management, building a viable core business, having sufficient financial resources, improving motivation.

3. 1 Reforming all aspects of old management

In general, the management’s problem is the centre of internal problem. Thus, one of the critical matters is to correct management problem. First, the management style must be changed, in order to fit the turnaround situation. According to the statement of Bibeault (1982: 113), it includes four important aspects: use of hands-on management style, delegation of absolute authority of management by the board, introduction of tight controls, and emphasis on good “ people motivators”.

Second, the management must establish a strict control system to keep the turnaround process going well. Particularly, it refers to the financial resource of the firm. This is because the most obvious problem of turnaround firms is their financial trouble, when they intend to turn around their firms. They must precisely control the cash flow pipeline. To be effective, the control system must be sensitive and measurable. In other words, each person in the system must have a clear mind what should be done in time basis, and the performance can be quantitatively measured. Moreover, the communication and coordination among different levels or functional departments are also necessary.

3. 2 Building a viable core business

“ The most important is that the business has a sound core that can be saved; this means a salable product or service, a proven market, operating assets and a staff of capable personnel” (Scherrer, 2003: Online). The viable core of the business must be protected from the negative effects of both internal and external changes. In other words, managers must differently treat the viable core from the rest of the business. Therefore, managers must carefully cultivate the viable core by using various strategies. First, managers must consolidate its current competitive advantage to please the target market on one hand, and seek opportunities to expand the current markets on other hand. Second, managers must control the tempo of the expansion. Otherwise, the business may get out of control. If a turnaround firm blindly expands its businesses, it will lead to the business too broad to control. Third, a turnaround firm must avoid competing with strong competitors directly. Finally, the management must proactively divest some businesses or segments, which are not profitable.

3. 3 Having sufficient financial resources

For any turnaround firms, it is essential to have sufficient capital to implement the turnaround plan. Without adequate financial resources, the management can do nothing for the firm. However, the most serious problem for any turnaround firm is short of funds to operate. Thus, the turnaround management must confidently express its plan so that obtain the trust from both internal and external support. The external funds could be stemmed from the bank and the internal funds could also be obtained from divesting poor-performance businesses.

3. 4 Improving motivation

When a company is in turnaround situation, their employees' morale is often low. Employees are the most important asset for a company. The management must effective change the employees' attitudes so that they can optimistically face the difficulties and creatively contribute their efforts. Here, the effective leadership plays a vital role. " In turnaround situation, the leadership must adopt a positive attitude and transmit this to the rest of the organization" (Bibeault, 1982: 122). Turnaround situation can not be fixed out by one person, unless all of the employees at all levels in the organization make the big efforts toward the same direction.

4. Creating a remedial plan

In order to prepare a feasible plan, the management must first evaluate the critical aspects of the business as well as the external factors that may influence the corrective actions. At this evaluation stage, managers need to conduct a detailed viability analysis in order to prepare a suitable turnaround plan for the business.

The detailed viability analysis contains two general approaches. They are segmentation techniques and evaluation of available resources. According to Bibeault (1982: 209), there are four general rules of segmentation that is very useful in turnaround situation: the rule of three, Pareto's law, current/future analysis, and importance ranking.

The rule of three implies that managers need to divide the company into three categories, in order to determine which businesses or departments the company must kept, or divested, or kept a wait-and-see attitude to some of them. The purpose of this technique is to distinguish each division depending on its own importance, so mangers are able to allocate the limited resources on most important division more effectively.

The famous Pareto's law also points out the 80/20 relationship. Here, it does mean 20 percent of a company's product lines usually contribute 80 percent of the company's sales. This technique is to help an underperforming firm concentrating their energies on those segments that would produce the maximum profits.

Current/future analysis is used to identify the relationship between expenditure and asset, and to discern which ones are needed for current operations or future development. Undoubtedly, it is very necessary for underperforming company to understand what the most important things need to be addressed now, and what the less important things will be completed later.

Importance ranking is the last segmentation technique, which is used to provide a detailed expenses structure so that managers can be able to rank the importance of ex expense. Consequently, the management can not only concentrate its most energy on the most important items, but also can compare their actual cost-reduction performances with the target budget.

After that, the turnaround management must evaluate the available resources that can be customized and carried out the turnaround plan. It must include its financial strength, competitive position, human resources etc.

At the final step of evaluation stage, the various evaluation results must be integrated together in terms of the level of the company's turnaround situation, the internal and external variables etc. such an overall assessment can give the management more in-depth knowledge about the situation, so that the management can craft more effective strategy to revive the company.

Once the management has clearly defined the turnaround situation, it then needs to create a turnaround plan before the corrective action is undertaken. The objective of the remedial plan is to provide a proper solution so that the problems can be systematically fixed. " This usually consists of altering operations to respond realistically to the current internal and external environments of the business" (Scherrer, 2003: Online). More importantly, an effective turnaround plan can be used to win people's trust.

An effective plan generally has two important characteristics: simple and realistic. First, in order to save more valuable time to revive the turnaround firm, the plan must be simple. However, it dose not mean to discharge the duties carelessly. The plan must be clear and easily understood by turnaround team so that they can quickly take actions. Second, the plan must also be realistic. In other words, the plan must be appropriate for the situation and be able to cope with the complexities. In addition, in order to customize the plan more realistic, the line managers must also involve the planning process. This is because they deal with these works daily. They must understand the problems better than others.

5. The type of remedial strategies and implementation

There are three types of remedial strategies available for underperforming company: cost-cutting, revenue-generating, and asset reduction. Which one works the best, it largely depends on the company's own situation. According to the statement of Bibeault (1982: 227), it can be concluded in the following figure:

Cost-cutting

Revenue-generating

Asset- reduction

Percentage

Of break-even

60 to 80 percent

30 to 60 percent

Less than 33 percent

Additional

Condition

High direct costs and overheads, and limited financial resources

Strong financial position, otherwise, using asset-reduction together

Close to bankruptcy

5. 1 Asset- reduction strategy

There are two ways to achieve asset-reduction strategy: they are fixed-asset-reduction strategies and working-capital-reduction strategies.

5. 1. 1 Fixed-asset-reduction strategy

This strategy is to divest or sell some distress businesses, such as a product line, land and building, vehicle etc. the biggest advantage of this strategy is that the turnaround firm can collect amount of cash in the short period through the divestment. Whereas the biggest disadvantage of this strategy may cause low morale atmosphere in the company.

In order to make a right decision for divestment, there are some critical tasks that the managers must address them. “ The first step in implementing the divestiture is to prepare a prospectus which describes the operating unit being sold in an objective manner” (Slatter, 1984: 158). The prospectus should include the description of the production line, historical performance, market competition, and future performance. The purpose of a prospectus is to introduce all interesting aspects of the selling business and verify the business has huge potentialities to potential buyers. Thus, the quality of a prospectus may substantially influence the chance of a successful divestiture.

Second, the business must be correctly valued. “ management will obviously look at different methods of valuing the business, such as net asset value, net asset value adjusted for the fair market valuation of property, future discounted cash flow, historical earnings etc”(Slatter, 1984: 158). In order to strive for greater benefit for the company, management also needs to thoroughly prepare it for negotiation, such as price range, payment methods etc. Moreover, in recovery situation, all the information must be kept in secret. Otherwise, if the potential purchasers know the business must be sold, the buyers will possess very strong bargaining power.

Finally, managers must identify who may be those prospective buyers, and negotiating teams should involve at this phase to facilitate the divestiture.

5. 1. 2 Working-capital-reduction strategy

This strategy emphasizes on three aspects: reducing inventory and debtors, and extending creditors. First, inventory can be classified into three groups: raw- material inventory, WIP inventory, and finished-goods inventory. For accounting's perspective, inventory presents current asset, it usually makes up 40 to 50 percent of the company's total revenue. When turnaround management undertakes reducing raw-material inventory, the following possible ways may be taken.

If possible, management can stop the purchasing contract with current suppliers, so that amount of financial resources can be saved for other use.

If the invoices have not sent by the suppliers, management should consider returning those goods to the suppliers.

If necessary, management should evaluation its current and potential suppliers based on quality, price, delivery, reliability, and dependability. Thus, management may be able to select the most preferable suppliers and collaborate with them to reduce inventory cost by implementing JIT.

Management could also sell the surplus raw materials to other companies. Although the selling prices may be much lower than ordinary market prices, it can generate cash quicker.

When turnaround management undertakes reducing WIP inventory, management must strive for improving its operation efficiency by searching better manufacturing methods and designing more efficient layout.

When turnaround management undertakes reducing finished-goods inventory, marketing department should pay lots of efforts to promote sales. The simplest way to promote sales is to offer lower price for the target market so that it will possibly alleviate a cash-flow crisis.

Second, reducing debtors is also an important path to turn an underperforming company around. There are three steps that management can follow:

Management should first conduct credit analysis. " It is very important to check the creditworthiness of one's major customers and one's overdue accounts at an early stage"(Slatter, 1984: 166). Through this analysis, management is able to discern the overall credit structure and prepare a settlement for each group of customers.

Then, management needs to negotiate with those customers to find an optimal settlement. If necessary, the company may stop placing order to customers whose reputation is not trustful.

Finally, if the negotiation is unsuccessful, management must take the third step to sue that company. Although, this is the worst way to solve the problem, it is actually a choice for a turnaround company.

Third, management can also persuade the suppliers extending creditor and continue supplying. Or management can mortgage some idle properties to the suppliers in order to offset the previous bills.

5. 2 Revenue-generating strategy

If a turnaround company is going to use this strategy unless it has less financial problem. " One major revenue-generating strategy was identified as commonly used in turn around situation: marketing improvement strategies," (Slatter, 1984: 221).

For marketing improvement strategy, it includes several issues: making better pricing strategy against rivals, effective using promotion mix, pay attention to new product development, and product line rationalization. First, price is an important element of marketing mix. Pricing changes can be classified as proactive pricing changes and reactive pricing changes. In general, if a company wants to increase the price, unless it can provide more important value to target customer and the total profit will be also gained; contrarily, a company wants to cut the price, if the gains in additional unit sales are enough to offset the impact of lower prices and thinner margins per unit sold. However, price changes should cause fluctuation of demand. The turnaround company may not be able to cope with such fluctuation. Hence, a turnaround company must carefully deal with the issue of price changes.

According to Kotler and Armstrong (2004: 386), they developed a model for a company to react rivals' price changes:

Note: present " no " presents " yes"

The above diagram was taken directly from Kotler & Armstrong, 2004: 386

Second, for a turnaround firm, management must effectively use promotion mix to communicate with target audience. Management must first concentrate its efforts on target customer who are the most profitable. Then, management should use the combination of direct marketing and personal selling to reach the most cost-effective outcomes. Although these two communication tools are the most expensive ones, customers can be highly targeted. Hence, it will substantially reduce promotion costs and yield a satisfied result.

Third, adjusting products structure is needed to please profitable customers. Meanwhile, management needs to divest some of the product lines that are yield low profit margins. This would keep the business profitable on one hand, and may generate amount of funds on other hand.

Fourth, management should also pay attention to new product development. The faster technologies forcing plenty of substitute products springs up, and when a company's product life cycle has reached at the mature stage, they must undertake to update its current products. This is because customers' buying behavior and needs can be influenced by external factors, such as competitor's advertising. The management should always identify these changes and be able to customize better products delivering customer satisfaction.

In addition, the turnaround company can choose the following way to growth its business at later stage. Diversification to related or unrelated businesses, strategic alliance, and vertical integration, all of them are available to undertake.

5. 3 Cost-cutting strategy

Very often, a company falls into a turnaround situation, because of its value chain incurs much higher costs without any obvious differentiation attribute on its products. This symptom will inevitably pose a competitive disadvantage over rivals. Consequently, the company will suffer a financial crisis. “ Cost-reduction strategies are likely to encounter considerable organizational resistance, particularly those strategies involving redundancies”(Slatter, 1984: 166). As it mentioned above, value chain analysis can be a good technique for organizations to identify its cost structure and cost disadvantages. In general, the total cost can be divided into four categories: supply chain cost, operation cost, marketing and logistics cost, and the overall manpower cost.

The major costs incurring in supply chain activities includes material costs. In order to reduce material costs, management must improve its buying practices. The most important activity of buying practice is to precisely evaluate both current and potential suppliers. Although price is an important element for a turnaround firm, the purpose of the evaluation is to reduce the total costs incurring in the buying activities.

Management should also consider reducing material costs by using substitute materials. If available, the company can obtain a number of benefits from it. First, the substitute materials may reduce the total costs of ownership. Second, because of the material may be more convenient to operate, it may result in lower manufacturing costs. Third, it may increase the quality of final products and feature as well. All of these reasons should enhance the attractiveness of final products in the market place. Company may be able to deliver more value to target customer and yield higher customer satisfaction.

Operations activities are at the center of the overall value chain activities. Increasing productivity is a key issue of operation management. High productivity can be derived from better machineries and manufacturing methods, effective process design and layout as well as skilled workers. An underperforming firm often does not have too much money to replace its machinery. However, it is possible to use the rest of the methods, which cost less money.

A company usually uses the specific blend of advertising, sales promotion, public relation, personal selling, and direct marketing tool to communicate with target customers. Logistics activities also incur customer service costs, warehousing cost and transportation costs.

Overspending on promotion is waste. Whereas under spending on promotion ignores the effects of promotion on sales. Corrective setting the total promotion budget can help firms to receive a cost effective market efforts. Particularly, for those underperforming firms normally encounter financial crisis. “ The most logical budget setting method is the objective-and-task method, whereby the company sets its promotion budget based on what it wants to accomplish with promotion” (Kotler & Armstrong, 2004: 107).

Reducing transportation and warehousing costs is not difficult. It can have a similar approach with reducing operation costs. However, as these costs decrease, it should cause production costs increasing. “ The point to remember is that manufacturing and distribution costs are interdependent and that the balancing of inventory-carrying costs against production costs is the key management decision”(Slatter, 1984: 166). In addition, management also needs to leverage the relationship between reducing service costs and customer satisfaction.

A two-stages model for turnaround

According to Arogyaswamy, Barker & Yasai-Ardekani (1995: 493), they presents a model proposing that turnaround firms exhibit two classes of response to decline:(a) decline-stemming strategies that reverse the dysfunctional consequences of decline, and (b) recovery strategies that position the firm to better compete in its industry. The relationship of these two stages can be simply deemed as: the first stage is the prerequisite of second stage. The foundation conditions for recovery form an important link between these two stages.

The diagram was taken directly from Arogyaswamy et al, 1995: 498

At the first stage, the figure points out that two uncertainties influence the turnaround firm using decline-stemming strategies. First, the severity of decline is determined by three consequences of decline: unstabilization of internal climate and decision processes, loss of shareholder support, and loss of firm efficiency. Second, it points out that the demand for decline-stemming strategy is determined by the level of available slack resources. The lower level of available slack resources leads to the turnaround firm highly demands for decline-stemming strategy, vice versa.

Step one

In order to produce foundation condition for recovery strategy, the first step is to improve on those three consequences of decline, which cause the severity of decline:

First, management must obtain shareholders' support. They should positively influence the external shareholders to continually participate the company's reviving plan. In other words, the external shareholders will not join the firm unless they perceive the benefits from the participation.

Second, the firm must fully utilize its resources, competences, and capabilities to increase operation efficiency. Increase efficiency allows declining firm reinforcing its market position, alleviating financial crisis, and reducing its total costs.

Third, management must also stabilize the firm's internal climate and decision processes. Employees are usually panicky when their company falls into turnaround situation. " if the firm must down-size, the employee uncertainty causing many of the firm' internal problems can be reduced if top management maintains open channels of communication with employees” (Gilmore&Hirschhorn, 1983, cited by Arogyaswamy et al, 1995: 503). Moreover, management should also promulgate a number of human resource policies in order to retain talented employees, such as early retirement etc.

All of three elements are interconnected. Each of them has a “ leverage effect”. Hence, they must be carefully evaluated and improved. Otherwise, anyone of them may cause the turnaround action failure.

Step two

Once the foundation condition for recovery strategy is produced, the management should undertake recovery strategies. In order to successfully plan and implement recovery strategies, another two elements are needed to supplement the foundation condition:

First, management must identify the reasons of a firm’s decline. It could be an industry-based decline or a firm-based decline. “ Industry-based decline occurs when a firm’s industry shrinks in size or munificence” (Arogyaswamy et al, 1995: 507). This type of decline is often caused by macro-environment changes. Thus, it leads to a number of firms reduce their performances. Whereas, firm-based decline results from the firm’s internal problem or losing position in its competitive environment. “ Therefore, a major source of firm-based decline may be unanticipated industry structure changes that redefine the source of competitive advantage in the industry”(cf. Barney, 1991; Schumpeter, 1934 cited by Arogyaswamy et al, 1995: 507).

Second, it is also necessary to verify the turnaround firm's competitive position. It must be kept in mind that the reasons of losing competitive position are related to causes of decline.

Once these two issues have been identified, management then can craft an appropriate recovery strategy. According to Arogyaswamy et al (1995: 509), they developed six kinds of recovery strategies for different situation based on firm's competitive position and cause of decline.

Cause of decline

Firm-based Industry-contraction-based

The diagram was taken directly from Arogyaswamy et al, 1995: 509

7. Checklist of turnaround situation

Has the firm qualified the turnaround situation?

What are the symptoms of turnaround?

Has the management diagnosed the severity of the turnaround?

Has the management evaluated the internal and external variables?

Has the management found the reasons causing the decline?

Has the management checked all available resources that will be used to turnaround actions?

Has management chosen the most appropriate strategy for the situation?

Has the management created a realistic plan for turnaround?

Has the management communicated the plan to the overall organization?

Has the management properly implemented the turnaround plan?

Has the management monitored the performance?

8. Conclusion

In today's business environment of both internal and external changes, every organization needs an appropriate turnaround strategy to resist the turbulent business environment. As it discussed above, when a company encounter the turnaround situation, management must correctively diagnose the firm's symptoms. Then, they need to carefully plan it and be able to find effective solution to implement. The two- stage turnaround model provides a systematic way that companies can follow the right path.

A successful turnaround strategy re-ignites growth while leveraging the organization's core competencies, sustains that success in an often turbulent and unpredictable future and implement a realistic solution that creates a platform for long-term corporate health and success.

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