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Impact on Change in Turnaround Management

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***Abstract:** A change leader looks for change, knows how to find the right changes and knows how to make them effective both outside the organization and inside it."From "Management Challenges for the 21st Century" by Peter F. Drucker Organizational change is the implementation of new procedures or technologies intended to realign an organization with the changing demands of its business environment, or to capitalize on business opportunities."*

Change usually involves the introduction of new procedures, people or ways of working which have a direct impact on the various stakeholders within an organization. The key to successful change management lies in understanding the potential effects of a change initiative on these stakeholders. Will employees be scared, resistant, pessimistic or enthusiastic about your proposed changes? How can each possible reaction be anticipated and managed?

With such widespread change occurring, handling all of the various issues that arise becomes a priority for a manager and naturally some are better at it than others. But keeping pace with the rate of change is fast becoming a necessity of modern management. If a change programme is not handled appropriately - despite the best of intentions - an organization is unlikely to achieve any of its desired goals or objectives.

I. Turnaround Management

A successful turnaround requires leadership that can inspire the stakeholders and manage all aspects of the process from start to finish. Some problems can be corrected by an in-house staff, but in a crisis situation, many businesses turn to the expertise of a turnaround manager, an objective third party who is trained in crisis management. The author will explain about the stages of turnaround management strategies.

Why the change in change?

As for coping with change, it has always been an accepted part of corporate strategy, but there has been an increase in recent decades in the issues that will impact upon organizational performance such as:

- globalization;
- "globalization";
- deregulation;
- privatization;
- mergers and acquisitions;
- movement of labor towards less expensive economic locations;
- advances in technology;

- empowering of consumers;
- changes in demand patterns.

It is widely accepted that change can be continuous or discontinuous. Because continuous change is gradual, you have more time to predict and plan, but the very nature of radical change requires a greater innovative responsiveness.

The challenge for today's organization is not so much to plan for change, but to learn to live with it, anticipate it, and where possible - capitalize on it.

Communication - the internal challenge

During times of change, uncertainty is rife and fears of the unknown a common factor. Employees do not always understand why this change is occurring and tend to be wary of moving away from the old. This is where internal communication can prove invaluable.

However, resolving to communicate your intentions effectively to employees is one thing, achieving it is another. Change is not just about how people act but how they think, and you will never be successful if actions are not the result of instilled belief in the new system / culture / product.

And creating such belief and understanding is fraught with many obstacles. Before even considering the specifics of internal transmissions, there are other concerns. There is no point assembling an impressive communication system when there are fundamentals within your organizational make-up that will render any strategy useless.

The following must be eradicated to ensure initial organizational health:

- decreasing productivity;
- increasing absenteeism;
- barriers to open communication;
- all decision making is at the top of the managerial pyramid;
- lack of employee commitment to the organization;
- low levels of motivation and morale;
- the reputation of the organization is ignored by employees;
- existence of unethical behavior;
- lack of goal setting;
- lack of mentoring;
- lack of development and training programs;
- lack of trust among employees.

Once this has been achieved, you must identify what employees:

1. Must know - Key job-specific information
2. Should know - Essential but desirable organizational information, e.g. changes in senior management.
3. Could know - Relatively unimportant or office gossip.

The power of informal structures

Bear in mind that today's flatter organizational structures and more casual employees means that identifying who belongs and who does not is increasingly difficult. In addition, organizations have both formal and informal communication structures. It would be unwise to ignore the power of the "grape vine". Instead, you should try and harness this channel. There will always be informal avenues of dissemination, but by recognizing these outlets, you will minimize the risk of inaccurate information passing

Similarly, there are pitfalls such as one-sided (usually downward) communications, suppression of information, mistakes being communicated, and intentional distortion. These must all be considered when formulating your structure. But despite the system you adopt, there is no excuse for transmitting baffling or convoluted information. Careful thought must go into what you are saying as well as how you say it. Have you thought of everything an employee may want to know? Will give the opportunity for questions to be posed? Are you being entirely honest and open?

Understanding is key

If employees understand the reason for the change, why the organization is committed to this change and what part they will play in ensuring success, they are more likely to support the initiative. It stands to reason that employees aren't going to support something just because somebody tells them that they should.

Internal communication should not be an afterthought or come second to external information. It plays an intrinsic part in establishing an effective organizational culture. Recently the corporate emphasis has been towards Customer Relationship Management, and whilst this is still critical to organizational success, we must recognize the emergence of another critical concept: Employee Relationship Management.

After all, an organization is nothing more than a group of employees. And it is what they do that makes a company successful.

Management Implications

Key concerns when communicating internally:

- **Communications must come from the top** - visible senior management commitment is a must of you want communications to carry the necessary authority.
- **Devise a communications system** - take into account formal and informal channels and try to incorporate the "grape vines" of your organization into the overall structure. Your system should be clear, concise and speedy in dissemination. Don't give the gossips time to distort information.
- **Monitor and evaluate your system** - continuous improvement is essential.
- **Be open and honest at all times** - in times of crisis or extreme change, do not try to smooth things over with half truths and false reassurances. Be honest. The chances are, employees will find out the truth (secrets never stay under wraps for long in the corporate world) and you stand not only to lose face, but also the trust of all involved.
- **Combine written and face-to-face communications** - this mix provides the best results and demonstrates your commitment to employee awareness.
- **Be relevant** - do not confuse employees with unnecessary facts and figures. Think what you would want to know if you were in their position and if you're still unsure then ask - communication is a two-way process!

Turnaround management

A successful turnaround requires leadership that can inspire the stakeholders and manage all aspects of the process from start to finish. Some problems can be corrected by an in-house staff, but in a crisis situation, many businesses turn to the expertise of a turnaround manager, an objective third party who is trained in crisis management.

Companies with revenues less than $200 million most often need renewal. They have the most frequent incidences of decline and the most need for a turnaround. The majority of these businesses are privately held, and managers usually are unaware of the early segment of internal or external decline. They have become accustomed to existing in a growing or stable environment and do not cope well with adverse changes. They consider change in environment to be a hostile event and therefore to be avoided. When changes are ignored they become crises.

To begin with, the turnaround analysis of the current condition of the business and its viability is performed. Then the necessary changes are made such as: eliminating unprofitable products, divesting losing dividends, and eliminating useless or unused assets. When these steps are complete, the business begins to recover, and the remaining products, divisions and assets can return a profit to the shareholders. The cash generated from the changes is used to implement the turnaround plan. The management negotiates with banks, creditors, and then lawyers to obtain bridge capital or refinancing which is necessary for success. This is used not only to finance the process, but also to reestablish positive relationships with vendors and other stakeholders. Realistically, creditors become allies when they have positive results.

For the turnaround team to be effective they must be given total control of the business by the board of directors or the majority of shareholders in a privately owned corporation. During a turnaround, the turnaround team is granted authority to act immediately. Although this may seem extreme, the turnaround team must have total authority to act quickly in order to save the business. Without this authority, actions would be delayed and each step taken would be subject to question. This would result in a situation where the turnaround manager would be just another CEO, and the business would continue to deteriorate. It is the turnaround team's authority that allows it to bring together the employees and stakeholders of the business as a team.

The turnaround team serves as the CEO during the turnaround process. Incompetent managers (i.e. managers who allowed existing problems to grow to crisis proportions) are dismissed, and the turnaround team works with the remaining management as the turnaround team. Salvaging existing management is less expensive than hiring a new management team, and when the turnaround is over there is a competent team in place to manage the business. The turnaround team members that are not necessary for the future growth of the company are dismissed.

II. STAGES OF THE TURNAROUND PLAN

The length of time necessary to complete a successful business turnaround varies. Basically, there are five stages to the turnaround process. These stages and the time required to complete each stage are listed below:

Stage 1. Analysis of the situation: one week to one month.

Stage 2. Creation of a plan: one to two months.

Stage 3. Implementation of the plan: six months to one year.

Stage 4. Stabilization of the business: six months to one year.

Stage 5. Return to growth of the business: one to two years.

III. Analysis of the Situation

There are numerous financial ratios that have predictive power but are often rewarded by management as accounting busy work. The turnaround manager uses these ratios to generate a picture of the company that indicates the ability of the business to survive.

The most useful of these ratios during the turnaround process are the following:

- Working capital to total assets;
- Retained earnings to total assets;
- Earnings before interest and taxes to total assets;
- Market value of equity to book value of total debt; and
- Sales to total assets.

These ratios are especially useful when reviewed for a period of at least three years. The business will begin to establish a pattern within the ratios, and deviation from the pattern should be quickly corrected. Mature businesses should reach a point where the ratios are consistent from year to year. When an inconsistency is noticed, it is important to find the cause.

When the ratios are extremely low, it usually indicates a need for bridge capital. However, most banks will not be willing to commit additional funds unless the turnaround plan is valid and based on realistic projections of a business's ability to support itself after the turnaround.

IV. Creation of a Plan

The purpose of the turnaround plan is to present solutions for the fundamental problems revealed in the analysis stage. This usually consists of altering operations to respond realistically to the current internal and external environments of the business. The turnaround plan is a document outlining these changes and solutions, and can be used to build stakeholder confidence and guide the turnaround process.

The turnaround process can take several forms, but there are three that are most commonly used. By understanding the available turnaround options, you can choose the one that best meets your company's crisis needs.

1. A strategic turnaround redefines the business. The may involve changing markets and redefining product lines.
2. An operational turnaround changes the operations of a business. This can mean cost-cutting, revenue generation and asset reduction.
3. A financial turnaround restructures the financial operation of a business. The objective is to use the financial strength of the business as an asset and to restructure the business to take advantage of this financial strength and restructure the business.

V. Implementation and Stabilization

Two major elements of the early phase of the turnaround process are reorganizing the business's finances and analyzing its customers. Financial restructuring requires time, but this investment of time will help stop the business's decline. The turnaround process begins by recreating a budget and then strictly enforcing financial accountability. Standard costing estimates are replaced by actual costs, and the use of contribution margins reveals the products that contribute most to the fixed costs of the business. Bottom-up budgeting (i.e. budgeting as a function of costs, not as a percentage of sales) is needed to determine the actual costs of running the business and as an accountability tool to keep management within absolute financial boundaries.

During the initial stages of the turnaround process, the turnaround manager uses cash flow analyses and financial projections on a frequent basis to help reorganize the accounting system. In some crisis situations, the cash flow analyses and final projections may have to be made daily. Later, when stability has been achieved cash flow projections can be made quarterly. Working the cash flows will help with development of an operating plan for the business. A quality-operating plan is required by most lenders, and the time line and the amount of cash inflow the plan generates will determine the methods a business can use to survive. It is necessary to use financial projections of cash to make a reasonable determination of how to dispense it.

Analyzing the business's customers is another essential part of the turnaround process. To determine which customers are profitable, the turnaround manager consults the customer classification and aging of accounts receivable. These two sources will reveal the less productive accounts - such as those that order infrequently or those that delinquent in payment - and allow the management team to focus on the profitable customers. This analysis will provide customer profitability.

Other turnaround strategies include the following:

- Revenue generating. Prices are decreased while sales, advertising and market penetration are increased. Customer profitability decreases in the short term to increase cash flow. This is a short-term strategy only.
- Productivity/market refocusing. Products markets and customers are analyzed for profitability, and channels of distribution are analyzed for efficiency. This scrutiny may indicate that business has reached the limits of growth in its products and markets and needs to expand into other areas.
- Cost-cutting. Costs are reduced, including administrative marketing and research and development.
- Asset reduction. Unnecessary or obsolete assets are eliminated. Usually these assets look nice on the balance sheet but produce no revenue stream, only costs for maintenance. For example, excess inventory is sold at or below cost. Inventory that does not sell is a liability not an asset. The cost of excess inventory may approach 15 percent of assets. Inventory costs include warehouse, throughput, maintenance, plus the actual cost of the inventory.
- Combination of any of the above.

Which strategy to use and at what time determines a turnaround success? It may be that an initial strategy requires cost cutting and then is superseded with a revenue-generating strategy. Strategies may be combined and used in various sequences. Using the inappropriate strategy can be a terminal error. Several guidelines apply to most turnaround situations:

1. Mature businesses use retrenchment and efficiency strategies, not product/marketing refocusing.
2. Businesses with low-capacity utilization should pursue cost-cutting strategies.
3. Businesses with high-capacity utilization should pursue cost-cutting strategies.
4. Businesses with high market share should pursue revenue-generating strategies and product/market refocusing.

The strategy used and the timing of that strategy determine the success of a turnaround. Strategies may be combined and used in various sequences (e.g. an initial strategy may require cost-cutting, and then be superseded by a revenue-generating strategy) but using the inappropriate strategy can be a terminal error. The unique requirements of your business and the turnaround situation will determine the strategies to be used.

VI. Conclusion

Return to growth

The success of a business is never guaranteed; to remain successful, a company must be constantly monitored and maintained. Changes in internal and external business environments can negatively affect success and, if left unchecked, can lead a business into a state of decline.

To achieve a successful turnaround, business decline must be acted upon as soon as warning signals are identified. Problems must be analyzed and a turnaround plan must be developed and implemented in a timely and efficient manner. The unique needs of the business and the nature of the turnaround situation will determine the strategies to be used. Key elements of a successful turnaround include competent management, the cooperation of company stakeholders and sufficient bridge capital to carry out the turnaround plan.

A management turnaround can save a failing business by revitalizing it. After a turnaround has been completed, the business will be stronger, have better operations and possess an experienced, capable management team.

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Author(s) Profile

Dr. S. Gomathi has obtained a doctoral degree in the field of Human resource management in 1992 at the age of 26 years from Alagappa University, Karaikudi, Tamilnadu as a first full time research scholar. She was born on April 9th, 1966 in Tiruchirapalli. She was the first one to receive the stipend for her Ph.D programme based on merit.

At present, she has 24 years of teaching experience, inclusive of 23 years of teaching P.G. students. She made an active contribution in creating Four doctorate candidates successfully enhancing her research contribution.

She is a popular and friendly speaker, trainer in most of the premier educational Institutions and corporate and in other Public forums. She is specialized in stress management techniques, emotional intelligence, Knowledge management, balanced score card and other Psychological subjects and other OB&HRM Subjects.

She has authored a book on essentials of Entrepreneurship in 2003, and is a recipient of lot of honors as best teacher, best paper presenter in conferences and also research awards continuously for more than 5 years.

Guided more than 200 projects in MBA and other mini projects of Interest. Completed a consultancy project for ITCOT in 1999 and As a single individual organised an AICTE Staff development programme for other engineering colleges in Tamilnadu which was sponsored by AICTE in 2004.At that time served as the head of the department for 9 Months in the Department of Management studies in Vellore Institute of Technology.

She has visited countries like Malaysia and Singapore in 1993.Her hobby is regular exercising at Gym and hearing music and doing yoga and meditating for half an hour in the morning as well in the evening