Chartered Institute of
Management Accountants

Corporate turnaround

Topic Gateway series No. 59

Prepared by Jim Downey and CIMA

September 2009

About Topic Gateways

Topic Gateways are intended as a refresher or introduction to topics of interest to CIMA members. They include a basic definition, a brief overview and a fuller explanation of practical application. Finally they signpost some further resources for detailed understanding and research.

Topic Gateways are available electronically to CIMA members only in the CPD Centre on the CIMA website, along with a number of electronic resources.

About the Technical Information Service

CIMA supports its members and students with its Technical Information Service (TIS) for their work and CPD needs.

Our information specialists and accounting specialists work closely together to identify or create authoritative resources to help members resolve their work related information needs. Additionally, our accounting specialists can help CIMA members and students with the interpretation of guidance on financial reporting, financial management and performance management, as defined in the *CIMA Official Terminology* 2005 edition.

CIMA members and students should sign into My CIMA to access these services and resources.

Chartered Institute
of Management Accountants
26 Chapter Street
London SW1P 4NP
United Kingdom

T. +44 (0)20 7663 5441
F. +44 (0)20 7663 5442
E. tis@cimaglobal.com
www.cimaglobal.com

Definition

Corporate turnaround is defined as:

'The implementation of a set of actions required to save an organisation from business failure and return it to operational normality and financial solvency. Turnaround management usually requires strong leadership and can include corporate restructuring and redundancies, an investigation of the root causes of failure, and long term programmes to revitalise the organisation.'

(BNET Business Dictionary)

Available from: **http://digbig.com/5badnw**
[Accessed 6 August 2009]

Related concepts

Business process re-engineering; company rescue; cost reduction; debt restructuring; financial restructuring; insolvency.

Alternative concepts

Mergers and acquisitions; strategic alliances; joint ventures.

Overview

In 2008, the number of UK companies liquidating in one quarter topped 4,000 for the first time since 2002. Well-known brands such as Woolworths, XL Leisure, MFI and Silverjet became notable casualties of the 2008 economic downturn, and many more businesses were forced into a corporate turnaround situation to cope with severe financial difficulties.

An organisation's profitability and effectiveness can be affected by a variety of factors, which in certain circumstances can cause business failure. The UK Insolvency Helpline recently identified 65 of the most common reasons why companies fail. These included:

- failure to control costs ruthlessly
- failure to adapt the company's product to meet customer needs
- failure to build a team that is compatible and has the skills to finance, produce, sell and market
- tougher market conditions
- poor management
- over-trading.

The decline of a business' performance can take place over several years, although there are situations when an extraordinary internal or external event may suddenly place a business in peril. Examples of extraordinary events include: fraud, for example, Enron, WorldCom and Satyam; product failure; loss of funding; bankruptcy of a major customer or supplier; and natural or man-made disasters.

Typically, if a company is in the early stages of business failure, then it will show the following signs of financial distress:

1. A significant shortage of cash with borrowings at or close to the maximum.
2. Suppliers starting to push for faster payments.
3. Monthly accounts showing that the business is consistently losing money.

Often these signs are symptoms of underlying operational or strategic problems within the business. Unless these symptoms are quickly addressed and reversed, for example, through a corporate turnaround programme, the business may enter into a vicious circle of decline – ending in business failure and liquidation.

Application

The principal aim of any corporate turnaround is to remove the company quickly from any immediate danger of going into liquidation, and to focus on activities and tasks that restore corporate value.

In order to achieve this, there are six broad stages that a company in a turnaround situation will need to go through:

1. **Management change** – involves the board of directors or senior management recognising that change is necessary and then initiating a corporate turnaround programme.

   Often a company will bring in an external turnaround specialist or a new Chief Executive Officer (CEO) specifically to make the challenging and controversial decisions required to restructure the business. The advantages of bringing in an external specialist are that:

   1. They have significant turnaround experience along with proven turnaround techniques.
   2. They have no emotional 'baggage' associated with any of the company's previous business decisions and are not committed to the status quo.

3. They are not part of the organisation's hierarchy and are therefore often able to challenge the company's management more freely.

Steps may also be taken at this stage to remove any senior managers who might obstruct the turnaround effort – this might include the CEO, CFO and weaker board members.

2. **Business review** – the company must quickly identify the underlying problems causing the current situation and understand the business' chances of survival. This includes a thorough assessment of:

    - **Strategy** – does the organisation have a clear and deliverable strategy that sets out the focus for the organisation? Is the business tackling the right markets?
    - **Operations** – is the focus on what really matters? Which products, customers and channels create or destroy value? Are the products or services being provided in the most effective possible manner and at the lowest possible cost? Is there waste in the organisation's processes?
    - **Finances** – what is the organisation's cash position? Does it have sufficient lines of credit or access to funding? Is there reliable information on the organisation's performance and financial situation? Does the business have effective budgetary control? Is the business managing its working capital?
    - **Infrastructure/people** – does the organisation have sufficient flexibility to response to changes in market conditions? Does it have the right departmental structure? Is the organisation over staffed? Does it have the right people with the right skills?
    - **Commitment and capacity to change** – is there a clear mandate for change that is driven through the organisation? Is the organisation capable of dealing with the significant (and often painful) adjustments that may be needed?

    As with any recovery, prevention is better than cure, and an early diagnosis of the root causes of the problem can be critical to saving the organisation.

3. **Business restructuring plan** – the next stage is to identify appropriate strategies and develop an achievable recovery plan with detailed functional actions**.** Typically, this will include action to:

   - restructure outstanding debt obligations
   - reduce operating costs
   - improve management of working capital
   - enhance product pricing and customer mix
   - streamline product lines
   - accelerate growth of high potential products.

   The plan must then be communicated to all key stakeholders in the business, including the board of directors, the management team and employees, to ensure buy-in.

   Communicating the plan with external parties, such as the bank, key suppliers and creditors will be critical to gaining credibility and restoring confidence in the business.

4. **Implementation** – at the emergency stage, companies must do whatever is necessary to survive. This may include:

   - making redundancies
   - eliminating departments
   - drastically reducing all non-essential costs.

   Positive cash flow is critical and must be established as quickly as possible. Cash will often be required to implement the turnaround strategy and this must also be sourced without delay.

   Often, unprofitable business units or operations are sold as a means to raise cash. Operations that cannot be sold within a reasonable timeframe may be liquidated.

5. **Stabilisation** – once the business has stopped haemorrhaging, overheads have been cut and loss making operations have either been divested or liquidated, the main focus is on improving the efficiency and effectiveness of the remaining business operations.

   To ensure long-term survival, the company must increase profitability and its return on investment while ensuring the smooth operation of existing facilities.

This is often the hardest stage for an organisation to achieve successfully. Improving return on investment is typically more challenging than removing loss-making operations or cutting costs.

6. **Embedding the change** – the final stage concentrates on embedding the turnaround, with the company gradually returning to financial health. Management behaviour and reward and compensation systems need to focus employees on profitability, return on investment and value creation.

To achieve long-term sustainability and growth, the organisation may also need to:

- develop new markets, new products or strategic alliances with other successful organisations
- improve customer service or enhance product quality
- secure long-term financing and strengthen its balance sheet, shifting the emphasis from cash flow management to strategic financial management and control.

Finally, the organisation will need to rebuild morale and develop a confident, positive corporate culture that focuses on continuous improvement, lean thinking and long-term profitability.

Leadership skills

When faced with a corporate turnaround situation, it often takes considerable management skill to reinvigorate a distressed business. While competent process and financial analysis are both important to success, strong people and change management skills become essential in a turnaround.

Turnaround leaders need to be able to:

- articulate clearly the company's direction and rationale for the turnaround, even if the final outcome cannot be known
- convey a sense of calm, control and confidence to all stakeholders
- listen and be prepared to accept any suggestions that may assist the turnaround, wherever they come from within the organisation
- be both firm and flexible in managing implementation of the turnaround
- replace any under-performing individuals quickly
- motivate staff and rebuild morale lost as a result of the situation
- assure staff that tough decisions are made fairly and that people who are affected will be treated with due care and consideration.

The best turnaround leaders are those that can deal with broad strategic issues while managing day-to-day operations. They can take either a 'hands on' or high level strategic approach, as the situation requires. They also assist stakeholders to understand problems, articulate a vision of the future and motivate staff to achieve the required outcome.

Finance role in turnaround

Finance has a key role to play in assisting the turnaround effort. Usually, when business performance declines, the demand for financial information increases significantly. Senior managers, banks, creditors, venture capitalists and shareholders all start to ask questions.

Finance can assist stakeholders by providing key statistics on the business' performance, as well as identifying the main drivers causing the decline.

By substantiating and explaining urgent and critical issues to key stakeholders, Finance can help the organisation to regain its credibility, which will buy some time for the emerging solution.

If an external turnaround specialist or new CEO is appointed, Finance will be pivotal in ensuring that they are quickly apprised of the situation – providing correct, relevant and timely information. Finance also needs to reassure the turnaround management team that it understands the business and is well placed to serve its needs.

By responding early to problems, Finance can demonstrate that it is part of the solution. However, if Finance reacts too late or provides inaccurate and out of date information, it may be seen as part of the problem and end up being restructured, with the CFO replaced.

Successful turnarounds

A successful turnaround could be as simple as surviving a downturn with financial performance only just acceptable to the company's various stakeholders. In other cases, the recovery could lead to the firm achieving sustainable, superior performance, which in turn could enhance its competitive position in the marketplace.

Companies that come out of turnaround are often stronger in terms of management, operations and responsiveness to market conditions. Having been through massive change during the turnaround, they are better able to plan, manage and respond to changes in their business environment.

Of course, not all companies achieve successful turnaround programmes in this way. Some businesses may succeed in eliminating their losses, only to find that they are unable to attain an acceptable return on investment ongoing. Where this occurs, managers may decide to sell the business to a company that does have the resources to achieve superior returns. While this may not have been the intended outcome of the turnaround programme, the turnaround may still be deemed a success. Indeed, under new ownership the business may well prosper and achieve even better results.

Turnarounds can be an uncertain and worrying time. The key to success is ensuring that the organisation focuses on achieving immediate results, with senior management adopting a short-term, results-oriented leadership style that creates momentum and a catalyst for change.

Case studies

The Thinking Managers website
Available from: **www.thinkingmanagers.com**
[Accessed 6 August 2009]
This website has a wealth of case studies on corporate turnarounds, including:

Jarvis
Available from: **http://digbig.com/5badnr**
[Accessed 6 August 2009]

Compaq
Available from: **http://digbig.com/5badns**
[Accessed 6 August 2009]

ICI
Available from: **http://digbig.com/5badnt**
[Accessed 6 August 2009]

References

Deloitte. (2005). *Case study: The 10 stages of a turnaround*
Available from: **http://digbig.com/5badnj**
[Accessed 6 August 2009]

Farr, R. *Corporate failure: how to spot the warning signs,* CIMA Insight, February 2005
Available from: **http://digbig.com/5badnk**
[Accessed 6 August 2009]

Heller, R. (2009). *Turnaround: the leadership of John Harvey-Jones*
Available from: **http://digbig.com/5badnm**
[Accessed 6 August 2009]

Lynch, R. *Rising corporate failures increase economic gloom.* The Independent, 7 November 2008

Pandit, N.R. Manchester Business School. *Some recommendations for improved research on corporate turnaround.* M@n@gement, 2000, Volume 3, Number 2, pp 31-56

Platt, H.D. (1998). *Principles of corporate renewal.* Michigan: The University of Michigan Press

PricewaterhouseCoopers. Health Service Procurement Review, Winter 2008. *Managing in a downturn: public sector change in a volatile market*

Simister, P. (2009). *Business turnaround*
Available from: **www.squidoo.com/business-turnaround**
[Accessed 6 August 2009]

Sullivan, J. *CRO's people skills are one key to success.* Turnaround Management Association, 27 August 2008

Available from: **www.turnaround.org/Publications/Articles.aspx**
[Accessed 6 August 2009]

Turnaround Management Association. (2009). *Corporate renewal industry overview.* Available from: **http://digbig.com/5badnp**
[Accessed 6 August 2009]

The UK Insolvency Helpline. *The 65 most common reasons for business failure.* Available from: **http://digbig.com/5badnq**
[Accessed 6 August 2009]

Further information

CIMA members can obtain articles on this topic from the Business Source Corporate database, which can be found in the CIMA Professional Development section of the CIMA website. **www.cimaglobal.com/mycima** [Accessed 7 August 2009]

Articles

Filatotchev, I. and Toms, S. *Corporate governance and financial constraints on strategic turnarounds.* Journal of Management Studies, May 2006, Volume 43, Issue 3, pp 407-433

Genn, A. *The makings of a corporate turnaround.* Long Island Business News, 2/7/2004, Volume 51, Issue 28, pp 23a-33a

Maheshwari, S.K. *Turnaround excellence: six studies of corporate renewal.* The Journal for Decision Makers, July/September 2007, Volume 32, Issue 3, pp 149-151

Tourtellot, Peter L. *Successful corporate turnarounds: operational expertise makes the difference*. Journal of Private Equity, Fall 2004, Volume 7, Issue 4, pp 68-71

Books

Bar-or, Y. (2008). *Leveraging people for a corporate turnaround: leadership and management guidance for organizational change*. Ellicott City, MD: The Light Brigade Corporation

Nueno, P. (1993). *Corporate turnaround: a practical guide to business survival*. London: Kogan Page

Slatter, S., Lovett, D. and Barlow, L. (2006). *Leading corporate turnaround: how leaders fix troubled companies*. Chichester: Jossey-Bass

Slatter, S. and Lovett, D. (1999). *Corporate turnaround: managing companies in distress*. London: Penguin

Sloma, R. (2000). *The turnaround manager's handbook*. Frederick, MD: Beard Books

Sutton, G. (2001). *The six month fix: adventures in rescuing fallen companies*. Hoboken, MD: John Wiley and Sons

(2001). *Harvard Business Review on turnarounds*. Boston, MA: Harvard Business School Press

CIMA Publications

Duda, G. *True tales of a turnaround specialist.* CIMA Insight, January 2009
Available from: **www.cimaglobal.com/insight**
[Accessed 7 August 2009]

Farr, R. *Corporate failure: how to spot the warning signs*. CIMA Insight, February 2005
Available from: **www.cimaglobal.com/insight**
[Accessed 7 August 2009]

Leading in a downturn
CIMA website section with many useful resources and links to further information. Available from: **http://digbig.com/5badpk**
[Accessed 7 August 2009]

Websites

Global Turnaround

International magazine for company rescue and insolvency specialists, providing news, articles, resources and links to other related web content.
Available from: **www.globalturnaround.com**
[Accessed 7 August 2009]

INSOL International (International Association of Restructuring, Insolvency and Bankruptcy Professionals)

Worldwide federation of national associations for accountants and lawyers who specialise in turnaround and insolvency.
Available from: **www.insol.org**
[Accessed 7 August 2009]

The Institute for Turnaround
Non-profit, independent professional body for turnaround practitioners.
Available from: **www.instituteforturnaround.com/default.asp**
[Accessed 7 August 2009]

Turnaround Management Association UK
The UK licensee of the US based Turnaround Management Association. The website allows executives and professionals from all disciplines to exchange information, ideas and knowledge about the turnaround industry.
Available from: **www.tma-uk.org**
[Accessed 7 August 2009]

First published in 2009 by:

Chartered Institute of Management Accountants
26 Chapter Street
London SW1P 4NP
United Kingdom

Printed in Great Britain