# CHAPTER – II

**REVIEW OF LITERATURE**

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REVIEW OF LITERATURE

2.1 Introduction

Research on turnaround in the past, especially in the western context (Slatter, 1984; Schendel et al. 1976; Davis 1993; Robbins and Pearce, 1992), has contributed a lot of insights into how a sick company could be turned around. Many question the generalisability of these findings across different organizational and environmental settings. (Bruton, Ahlstrom and Wan, 2001). The findings in the western context need not be applicable in other parts of the world and in different organizational forms. For instance, the turnaround strategies found successful in the west proved less effective in the South East Asian countries during the economic crisis in the second half of the 90’s (Bruton, Ahlstrom and Wan, 2003; Ahlstrom and Bruton, 2004). Besides, there is also reason to believe that the strategies adopted for the public and private enterprises differ, given the nature and context of their working (Walshe et al., 2004). So it is essential to take turnaround research into new domains which will clarify the vital elements of turnaround in different environmental contexts. The present study is an attempt to unearth the factors that explain the turnaround in the State Level Public Sector Enterprises of Kerala. Towards developing a theoretical framework for the study, the researcher has surveyed the available literature on Turnaround and its related topics. This chapter presents the literature which the researcher has reviewed.

The chapter is divided into two main sections. Section 2.2 discusses the concepts of Sickness and Turnaround Management. Section 2.3 deal with the three main aspects of turnaround which received considerable attention from the academicians, viz, turnaround response/ strategy content, the relevance of turnaround context and the turnaround process.

2.2 Concepts and Definitions

This section discusses the meaning and definitions of Sickness and Turnaround Management to develop a conceptual clarity regarding these two terms. With regard to
Turnaround, comparison was also made with similar concepts to place the meaning of Turnaround in the correct perspective.

2.2.1 Sickness - Meaning and Definition

Industrial sickness means different things to different people, depending on the stake they have in the affairs of a company. To a layman, a sick unit is one which is not healthy; to an investor, it is one which skips dividends; to an industrialist, it is one which is making losses and tottering on the brink of closure; to a banker, it is a unit which has incurred cash losses in the previous year and is likely to repeat the same in the current and following years (Nadkarni, 1983). As a consequence, there are numerous definitions of industrial sickness, some of which are rather vague, others are more clear-cut. (Falk, 2005; Biswasroy and Patro, 2006; Gupta, 1990). Since a detailed exploration of all such definitions is outside the scope of this chapter, we discuss here some definitions given by the statute and government authorities in India.

The prominent official, legal definition of sickness in India is stated in SICA, 1985 as “an industrial company (being a company registered for not less than five years) which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth and has also suffered cash losses in such financial year and the financial year immediately preceding such financial year”. SICA applies to both private and public sector companies, though the latter have been brought within the purview of the SICA only in 1991. The SICA’s definition of sickness, however, has been criticized primarily for identifying only terminally sick firms for which any reorganization or rehabilitation package would come too late (DPE, 2005). Second, the SICA may mistakenly declare non-sick firms as sick if companies fudge accounts to get shelter under the BIFR (Soni, 1999).

Another legal definition of sickness was found in the provisions of the Industries (Development and Regulation) Act, 1951 (IDRA, 1951), which devotes a whole chapter for the ‘Liquidation or Reconstruction’ of industrial undertakings. Reconstruction is recommended if a company is not in a position to meet its current liabilities out of its current assets (Chapter 18 FD (1) (a) of IDRA), but ‘public interest’ rules out winding it
up. As under the SICA, reconstruction under the IDRA goes along with provisions of financial assistance, suspension of legal proceedings, existing contracts and outstanding obligations (Chapter III-AB, section 18 FB). In fact, the obviously similar tenor of the relevant provisions in both laws gives rise to the question why a new law like the SICA with a whole new bureaucracy had to be established.

The Board for Reconstruction of Public Sector Enterprises (BRPSE) considers a CPSE as ‘sick’ if it has accumulated losses in any financial year equal to 50% or more of its average net worth during 4 years immediately preceding such financial year and/or a CPSE which is a sick company within the meaning of the Sick Industrial Companies (Special Provisions) Act, 1985 (DPE, 2005). The BRPSE considers a company as sick sufficiently earlier compared to a sick company as per SICA’s definition which requires complete net worth erosion.

Even the legal and official definitions have considerable differences in the treatment of what makes up sickness and it calls for a simple unambiguous definition of sickness.

Unlike the use of the term ‘decline’ in the west, the term ‘sickness’ is found popular in the Indian context (Manimala, 1991; Khandwalla, 2001; Gupta, 1983).

2.2.2 Turnaround Management – Meaning and Definition

Turnaround has been defined in many different ways. Generally speaking, turnaround is essentially a period of performance improvement following a period of performance decline. Turnaround is defined as the ‘reversal of a firm’s declining situation’ (Schendal, Patton and Riggs, 1976) or a recovery from a decline in performance (Khandwalla, 2001). In other words, it is “a process that takes a company from a situation of poor performance to a situation of good sustained performance” (Brandes and Brege, 1993). Turnaround management, therefore, is a management process that reverses a decline or sickness situation and denotes management actions taken to bring the firm back to sustainable good performance levels.
Though there is a general agreement regarding the broader meanings of the term sickness and turnaround, there is no unanimity in the treatment of what constitutes sickness/decline and what constitutes turnaround/recovery among the researchers. The term ‘decline’ represents a performance level lesser than Gross National Product (GNP) growth rate (Schendal and Patton, 1976) or industry average (Robbins and Pearce, 1992) or cut-off rate (Hambrick, 1983) or previous performance level. Also, there is no unanimity in the treatment of what constitutes ‘recovery’. ‘Recovery’ is often referred to as achievement of an enhanced performance level beyond industry average (Robbins and Pearce, 1992) or GNP growth rate (Schendal and Patton, 1976) or cut-off rate (Hambrick, 1983) or previous performance level. Such differences in the treatment of both ‘decline’ and ‘recovery’ cast a shadow on the generalisability of various findings. Such varied choices call for a simple but unambiguous definition of Sickness and Turnaround. Therefore, the present study adopts the definition given by Prof. Khandwalla (2001) which is very specific and clear. He states that “Turnaround is the recovery to profitability from a loss situation” (p. 73). According to this definition, recovery is essentially a period of profitability compared to decline, which is essentially a period of loss. The profit/loss is adopted as a measure of turnaround performance. However, as there are many concepts of profit like Profit before Tax (PBT), Profit before Interest and Tax (PBIT), Cash Profit, Operating Profit, Gross Profit, Net Profit, etc., it is essential to settle for one. In this context, the best way is to stick on to the most reported and accepted measure of company performance (Khandwalla, 2001, p. 74). For the SLPEs in Kerala, the Profit before any appropriations and prior period adjustments is a widely reported and accepted measure of performance (BPE, 2006) which is nothing but PBT (Profit Before Tax). This is also consistent with previous studies on turnaround (Hambrick, 1983; Shamsud et al., 1996), which uses PBT as a measure of performance.

2.2.3 Turnaround Vs Restructuring or Rejuvenation or Reorientation

The concept of turnaround is often used interchangeably with similar concepts like restructuring (Cherunilam, 2000), rejuvenation (Stopford and Baden- Fuller, 1990),
and reorientation (Tushman and Romanelli, 1985). The attempt here is not to deeply explore the similar concepts but to further clarify the concept of turnaround by placing its essential features in relation to similar concepts.

Turnaround does require a life-threatening crisis or a negative performance trend, which, if not corrected, will eventually lead to death. Restructuring and others do not require a declining or sickness situation but can incorporate such a situation. They can be effective tools in sick, stagnant and growing companies even with adequate profit. Therefore, measures or strategies of restructuring or reorientation or rejuvenation can be part of turnaround. However, it doesn’t mean that these are required only when the business is sick. So, what makes turnaround distinct from other similar concepts is the presence of sickness or decline situation and its focus in the reversal of sickness or decline. According to Hambrick (1985) turnaround strategies differ from other strategies because of the special conditions that turnaround situation imposes, i.e., limited available resources, poor internal morale, sceptical shareholders and urgency.

2.3 Turnaround Response, Context and Process

Turnaround research has been largely focused on functional content or turnaround response, i.e., what is actually done during turnaround attempt. Past research also suggests that success of turnaround also depends on the context in which it was undertaken and how well turnaround responses are matched to the specific circumstances (Walshe et al., 2004). Researchers also developed some stage theories of turnaround that could explain the turnaround called turnaround process. So, an attempt to unravel the mystery of turnaround requires attention to be paid to content, context and process elements (Pundit, 2000) of turnaround. The following section reviews literature relating to turnaround content/response, turnaround context and turnaround process.

2.3.1 Turnaround Response / Strategy Content

Review on corporate turnaround literature (Balgobin and Pandit, 2001, Pandit, 2000; Schendal et al. 1976) reveals that researchers have given greater emphasis to
strategic content/turnaround response (what is actually done). It owes a lot to the strategic management perspective adopted in most turnaround studies.

**Strategic Management and Turnaround Management**

Strategic management perspective assumes that the decline is the outcome of faulty strategies or wrong implementation of an otherwise sound strategy. However, it can be cured by an appropriate turnaround strategy. This perspective emphasizes the importance of strategy in saving a sick company from death.

Turnaround strategies differ from ordinary strategies, as they are dependent on the special circumstances that a turnaround situation imposes. Many researchers (Hambrick, 1985; Arogyaswamy et al., 1995) argue that the turnaround situation differs from other strategic situations due to the limited available resources, poor internal morale, sceptical shareholders, and urgency. Arogyaswamy et al. (1995), in their review of prior research, identified the special conditions in a turnaround situation, which include an erosion of external stakeholder support, deteriorating internal firm climate and decision-making processes, and inefficient asset-cost utilization. These special conditions imposed by the turnaround situation impact the selection of strategies/actions to improve firm performance. Here, an attempt is made to present the strategy content literature to develop deeper understanding on how various turnaround actions/strategies are selected and implemented to enhance firm performance.

**Strategic and Operating Strategies**

Strategic turnaround strategies are the grand, long-term initiatives such as diversification, vertical integration, new market share thrusts and divestment (Chowdhury and Lang, 1994), greater R&D, introduction of new products, redefining the business, diversification, vertical integration and divestment (Schendel et al., 1976). Here, the firm may seek to compete in a new manner in its existing industry or to enter new industries (Bruton and Rubanik, 1997). Hofer (1980) identified two ‘strategic’ strategies, namely, product market refocusing strategy and dramatic market share-increasing strategy.
Operating turnaround strategies/ actions are short-run tactics including cost-cutting and asset reduction (Schendel et al., 1976; Hofer, 1980; Chowdhury and Lang, 1996) revenue-generation (Hofer, 1980; Chowdhury and Lang, 1996) and efficiency improving (Schendel et al., 1976). Operating strategies are also called ‘Efficiency’ strategies as the primary focus of this strategy is efficiency improvement, i.e., it continues to do what it has done in the past, but does it more efficiently (Bruton and Rubanik, 1997).

**Entrepreneurial and Efficiency Strategies**

Hambrick and Schecter (1983), by abandoning the strategic/operational dichotomy, first introduced the concept of ‘Entrepreneurial’ and ‘Efficiency’ strategies. Both of these strategies were found significantly associated with successful turnaround. Entrepreneurial strategies are market-oriented. They focus either on resource acquisition or revenue generation (Cameron, 1983) or on changes in market niches (Hambrick, 1985). Efficiency strategies are treated as a means of improving efficiency. They include cost-cutting and asset reduction. Efficiency strategies are suggested to precede entrepreneurial moves. According to Hambrick and Schecter (1983), there are two entrepreneurial and two efficiency strategies. Their entrepreneurial strategy contains revenue-generating and product market-refocusing strategy. Efficiency strategy includes both cost-cutting and asset reduction strategy. It can be presented as follows:
Unlike Schendel et al. (1976), Hambrick and Schecter have given a strong endorsement of efficiency strategies in turning around firms in mature industrial-product business. Their research has also added a new dimension to turnaround literature by the use of multiple variables to represent a strategy, also called ‘gestalts’. Cluster analysis revealed three turnaround types, two of which they had anticipated and one they had not. They showed that 28 out of 53 turnaround firms practised what is called ‘piecemeal productivity’, the one they had not anticipated, involving greater capacity utilization and higher employee productivity. 19 firms seemed to practise ‘selective product/market pruning’ involving liquidation of receivables and inventories, reduced borrowings, cut in marketing expenses, push on higher productivity and quality, relatively premium-priced goods and reduced capacity utilization, signifying a shift to profitable niches by abandoning the fat. The third cluster consisting of only 6 firms, was labelled ‘asset and
cost surgery’. This turnaround seems to be secured by sharp cuts in R&D, divestiture of old plants and equipment, liquidation of receivables and inventories, strong push for higher productivity and capacity utilization signifying a low-cost market position. One drawback of Hambrick and Schecter’s (1983) study is that they did not study the causes of the firm’s declining situation.

**Retrenchment and Recovery**

Retrenchment denotes a strong emphasis by the firm on cost and asset reductions. Researchers have consistently found that firms attempting turnaround almost always pursue cost cuttings and asset reductions to improve performance ((Schendel et al., 1976; Schendel and Patton, 1976; Hofer, 1980; Hambrick and Schecter, 1983), which seem to undermine their importance in the turnaround effort. Research up to 1990 appreciated the role of retrenchment as part of turnaround, but failed to thoroughly investigate the value of retrenchment in the turnaround process. Researchers (Schendel et al., 1976; Schendel and Patton, 1976; Hofer, 1980;) have described retrenchment activities as only a tactic or component of a short-term operating plan. Consequently, Robbins and Pearce (1992) investigated the value of retrenchment in turnaround.

Retrenchment is a term used to describe a wide range of largely short-term actions taken to stabilize the organisation, to stem its losses and to deal with the immediate problems which have precipitated the crisis (Walshe et al., 2004). Pearce and Robbins (1993) define retrenchment as the ‘deliberate reduction in costs, assets, products, product lines and overheads’ of the firm. They argue that ‘retrenchment’ increases the chances of successful turnaround and is an essential first step in the turnaround process (Robbins and Pearce, 1992).

Robbins and Pearce (1992) argue that retrenchment seeks to stabilize declining performance by reducing costs and unprofitable assets. The two objectives of retrenchment are to ensure survival and to generate positive cash flow. Strategies under retrenchment include liquidation, divestment, improving operational efficiency, product elimination and head-count cuts.
In the post-retrenchment period (or recovery phase), the firm may choose either an ‘efficiency’ recovery strategy or an ‘entrepreneurial’ recovery strategy. Firms whose decline is caused primarily by internal problems tend to choose an ‘efficiency’ strategy, while firms whose decline is caused by external causes tend to follow an entrepreneurial strategy. The degree of retrenchment depends on how severe the firm’s decline is; asset surgery is likely in deep declines and cost retrenchment is likely in less severe declines. Retrenchment is found more fruitful for firms in deep decline than in less severe declines.

In a replicated study using the same data, Barker and Mone (1994) found that retrenchment could improve performance only for firms in deep decline. When the severity of decline was controlled, they found that retrenchment did not improve performance. Hence, retrenchment as a base strategy for all declining situations is questionable.

**Decline-Stemming Strategies and Recovery Strategies**

Arogyaswamy, Barker and Yasai-Ardekani (1995) have given another division of strategies. According to them, firms attempting a turnaround pursue two distinctive strategies: decline-stemming strategies that reverse the consequences of decline and recovery strategies that yield a defensive competitive position for the firm. Decline-stemming strategies address the consequences of decline, viz., erosion of external stakeholders’ support, growing internal inefficiencies, and deteriorating internal firm climate and decision-making processes.

Decline-stemming strategies constitute the first stage in their turnaround model and can be either internal or external in direction. External strategies stop the erosion of stakeholder support and renew the trust in top management. Internal strategies create efficiency and stabilize the internal climate and decision-making process.

For turnaround to sustain, firms require successful implementation of Recovery strategies. Recovery strategies are the management actions and policy changes that seek to eliminate or cope with the cause of the firm’s decline in order to enhance turnaround performance to acceptable levels.
Bibeault’s (1982) suggested some important turnaround factors that contribute to Turnaround such as instituting tight controls, changing people’s attitudes, understanding business better, absolute control to management, and visible leadership.

Slatter (1984) identified 10 categories of turnaround elements. The most widely used elements were asset reduction, change in management, financial control, cost reduction, debt restructuring and improved marketing.

Khandwalla’s study (1989) of 10 Indian turnaround attempts revealed ten categories of turnaround action consisting of both internal and external focus actions. The internal focus actions were top management changes, credibility building actions by the new management, attempts by new management to control finances and operations, mobilization of staff for turnaround, coordinating activities, quick pay-off projects and quick cost reductions. The external focus actions were negotiation with external stakeholders, neutralization of external pressures, revenue generation and asset liquidation for generating cash.

Hegde (1982) quoted in Manimala (2005) suggested seven turnaround elements which includes an outside turnaround agent, heavy lay offs, rapid shifting of product or plant portfolios, emphasis on technological updating through greater or more focused R&D, selective strengthening of management systems, stronger commercial orientation in the marketing function, and stronger profitability orientation in the production function.

Manimala (1991) in his study of 28 western turnarounds identified 24 turnaround strategies. They are: changes in staff patterns, positions and numbers especially in reduction of staff; leadership/ownership change; financial restructuring; rationalization of product mix; market orientation and focus on quality and customer service strategies; organizational restructuring; tie up with other companies including mergers, acquisitions and takeovers; information dissemination throughout the company; reducing excessive dependence upon a single product, market, or sector; massive (re)training of employees; public relations and liaison including those with government and even competitors; financial incentives for managers/employees, reduction of overhead costs; introduction of
new systems and procedures; focus on the core business; building a new culture; redefining the business/evolving new strategies and customer service; reduction of inventories; change in corporate identity/image; decentralized planning and strategy making; increasing R&D activities; changes in the managerial cadre/professionalism; engaging outside consultants; modernization of plant and machinery.

In a later study, Khandwalla (1992) identified two categories of turnaround elements, foundational and strategic elements. Foundational elements are used by more than 60 percent turnarounds. They include product mix changes, changes at the top, marketing related actions, restructuring, cost reduction measures and plant modernization. The strategic elements include the use of staff motivational devises such as incentives, garnering support of stakeholders, participation of lower level managers in turnaround-related diagnosing and problem solving, increased HRD, formal diagnostic work, mass lay offs and creation of organisation wide consensus on core values and required changes. According to him, turnarounds differ because of strategic elements and similar because of foundational elements.

In a study covering 120 turnaround cases, Khandwalla (2001) considered 10 turnaround building blocks by grouping various turnaround actions. They are asset-cost surgery, tighter controls and financial mending, restructuring and staff empowerment, actions for operating excellence, cost shedding, product market refocusing, transformational changes, managerial overhaul, strategic shift and sales push. It was found that turnarounds differ mainly because of asset-cost surgery, tighter controls and financial mending, restructuring and staff empowerment, actions for operating excellence, and cost shedding. The two turnaround building blocks, strategic shift and sales push differ moderately. Less difference was found with regard to the remaining building blocks of product market refocusing, transformational changes and managerial overhaul.

The review points out that the emphasis on strategies led many to suggest universal prescriptions of various turnaround interventions (Walshe et al., 2004). However, there is no unanimity among the researchers about the successful turnaround
strategies. Studies differ as to what strategies make up successful turnaround. The difference might be because of difference in the context in which the strategies were implemented. The suggestions based on strategies could be misleading unless they take a comprehensive outlook that addresses not only the content but also the context perspective.

2.3.2 Turnaround Context

The turnaround process and content, if seen in isolation, could be misleading unless due attention is given to the context in which they are undertaken. Past research has isolated a few context variables that could play a crucial role in turnaround. They are discussed below.

Causes of Sickness

Schendel and his colleagues (Schendel et al., 1976; Schendel and Patton, 1976) first introduced the relevance of ‘cause’ element in the selection of appropriate turnaround strategies. They distinguished between downturns resulting from poor strategy (Strategic) and poor operation or poor implementation of an otherwise sound strategy (Operational). If the decline was caused by operating problems, the cures chosen were also of an operating nature. If the decline was caused by strategic problems, the cures chosen were of a strategic nature. They have shown that 39 out of 54 firms that formed part of their study declined due to efficiency problems and the remaining 15 owing to strategic failure. Though operational problems dominated decline, turnarounds were more frequently associated with strategic moves, i.e., 25 strategic turnarounds against 15 strategic downturns, and 29 operational turnarounds against 39 operational downturns. Subsequently, the cause of decline is accepted as a major determinant of turnaround strategies (Manimala, 1991; Bibeault, 1982; Robbins and Pearce, 1992; Khandwalla, 2001; Barker and Barr, 2002).

The causes of decline are often dichotomized into internal and external - whether they originate inside or outside the firm (Bibeault, 1982; Khandwalla, 2001; Ford, 1985; Robbins and Pearce, 1992; Barker and Duhaime, 1997). It is argued that the firm’s
strategy may have been inappropriate for the given environment faced by the firm (external), or that the firm was implementing its chosen strategy inappropriately (internal). Research on turnaround consistently found that management actions / strategies needed to address the causes of decline (Schendel et al., 1976; Hofer, 1980; Robbins and Pearce, 1992). According to this view, strategic solutions should be used for solving external, strategic problems and operating solutions for internal, operating problems of firms facing decline. So, the firm needs to understand the principal cause of its decline since its response needs to address the problems that created decline.

The studies on sickness in the western and Indian context have brought out the major causes of industrial sickness. Bibeult (1982) found that internal factors accounted for about 70 percent corporate sickness whereas external factors contributed only to 10 percent, with the remaining 20 percent were caused by a mix of both internal and external factors. Manimala (2005) tried to summarize the major causes of sickness based on the 28 western cases he studied. The external causes are changes in the particular industry, the economy as a whole and in the general environment. The internal causes were:

- Continuance with production orientation resulting in poor quality of goods, poor customer service, wrong positioning of the product and excessive dependence on one product, one region or one market.
- Strategy of growing too fast through unrelated diversification resulting in lack of synergy, and cultural incompatibility.
- Poor management of finances resulting in high leverage, delays in collection, undercapitalization, etc.
- Wrong personnel policies resulting in overstaffing, poor employee relations, lack of adequate training of employees and promotion and retention of incompetent managers.
- Authoritarian and conservative attitudes of top management.
- Technological obsolescence
- Uncontrolled and non-focused R&D activities.
- Poor management of inventories
- Structural inadequacies
- Inadequate information systems
- Conflicts among stakeholders.

Manimala further opined that external factors, in fact, denote management’s failure to adapt according to environmental changes and hence, they are basically internal problems.

Other Indian studies (Agarwal, 1979; Prasad, 1982; Ramaswami, 1981; Khandwalla, 1989; Manimala, 2005) have also isolated many important causes of industrial sickness. The important external causes identified were transition from sellers’ to buyers’ market, inflation, import-export policies of the government, excise duties and taxation policies, slow economic growth, recession and lack of demand, raw material shortage and supply problems, power shortage, changes in the international market conditions, technological changes, procedural delays at the government level and delays on the part of financial institutions. The prominent internal causes were mismanagement or corrupt management, lack of professional orientation among top management, infighting within the ranks of management, weak board of directors, too much centralization of management, wrong choice of technology, poor financial management, poor cost control, inadequate marketing, disturbed industrial relations, dishonesty of entrepreneurs, disturbed industrial relations, uneconomic wage levels, surplus work force, underutilization of capacity, faulty production programme, lack of modernization, and mismanagement of personnel function.

Biswasroy et al. (2006) have found that delay in project implementation, improper management, financial indiscipline, underutilization of capacity, diversion of funds and labour problems are the internal causes contributing to sickness. The external causes contributing to sickness are recessionary trend, changes in the fiscal and monetary policies of the government, non-availability of raw material and shortage of power.

A Reserve bank of India study quoted in Morris (1982) identified that about 52 percent of the units went sick because of mismanagement, 23 percent by market
recession, 14 percent by faulty initial planning and technical defects, nine percent by power and raw material shortage, etc., and two percent by labour problems.

A study covering 120 turnaround cases (Khandwalla, 2001) suggested eight categories of external causes contributing to sickness. They are recession, intensified competition, adverse government actions/policy changes, sharp increase in bought out costs, adverse political situation, infrastructural problems and adverse technological changes. The internal causes identified were complacency, lack of planning, bad industrial relations, lack of professionalism, ill-timed or inappropriately executed expansion/diversification, lack of responsiveness to market, poor coordination and internal conflict, bureaucratic management, poor functional management, bad customer service, reckless acquisition, and corrupt management.

Both Indian and western studies pointed out the dominance of internal causes in company sickness over external causes. Though differences exist with regard to many causes of sickness, researchers have near unanimity with regard to poor management or mismanagement as the main reason for industrial sickness.

**Triggers**

Declines do not automatically lead to turnaround action (Stopford and Baden-Fuller, 1990). For turnaround to begin, it requires certain triggers that are likely to force management / government to seriously pursue turnaround attempt. Certain events, like financial crisis involving salary cuts or salary break, are likely to generate an organization-wide consensus regarding the need and urgency of pursuing turnaround. In some other cases, a threat of closure or ownership change may induce an array of organization wide actions to improve performance. A change in top management may also lead to new initiatives at the enterprise level to achieve turnaround.

Grinyer et al. (1988) found that decline does not automatically lead to sharp-bending actions but the latter require triggers. The new chief executive is cited as the most prominent trigger for change by 55% of firms that participated in the study. This is followed by recognition by management of problems (35%), intervention by external
bodies (30%), change of ownership or threat of change in ownership (25%) and perception by management of new opportunities (10%). Their study also found links between the various causes of decline and events triggering sharp-bending changes. If the causes of decline were external, the triggering event tended to be an intervention by external institution e.g. financial institutions, stock market authorities. Actions in response to poor management seem to get induced by the new executive and/or change or threat of change in ownership.

Past researchers are almost unanimous in proposing that declining firms’ CEO or top managers be removed or replaced to initiate a turnaround attempt (Bibeault, 1982; Grinyer and Spender, 1979; Slatter, 1984; Nystrom and Starbuck, 1984; Mueller and Barker, 1997; O’Neill, 1986). Such top-level changes occur when the internal factors are perceived to be the major cause of firm sickness (Bibeault, 1982). Advocates of CEO change argue that actions/strategies that led the company into decline were shaped by the decisions of the firm’s leadership. Those who lived with them do not change such decisions and strategies easily. They are likely to be more resistant to changing the current strategy, owing to their identification with the strategies. They are more likely to attribute the causes of firm decline to external factors as a cover to protect their self-esteem and they do very little internally, which might cause further deterioration of crisis. In this context, top management change is the most effective way of breaking down an organization’s natural inclination to persist with prior strategies that led the company into decline (Nystrom and Starbuck, 1984). Newly appointed managers will feel little connection with the organization strategy, and will be in a better position to objectively judge the firm’s performance problems. Researchers also have reported that top managers’ perception regarding the causes of decline shifted from external focus to an internal focus, as top managers were replaced (Hedberg et al., 1976; Starbuck et al., 1978; Barker and Barr, 2002). Moreover, the CEO and/or new key top-level managers are likely to bring with them new skills and expertise to run the organization. Recent empirical studies also found support for the association of CEO or top management change and successful turnaround (Barker and Patterson, 1996; Mueller and Barker, 1997) but not without dissent (Arogyaswamy et al., 1995; Daily and Dalton, 1995;
Bruton et al, 2003). This difference in empirical studies raises some important questions, i.e., whether turnaround really requires a leadership change or only a change in leadership style/quality or a change of both leadership and leadership style, an issue not specifically explored in the past turnaround research. Improvements/changes in leadership quality can happen even without leadership change. A change in the management style may be enough to bring about the required changes in the organizations. In other words, any change in management without significantly improving the quality of managing and decision making may not improve firm performance.

Many studies in the Indian (Manimala, 1991; Khandwalla, 1983-84; Hegde, 1982; Morris, 1982) and western (Bibeault, 1982; Slatter, 1984;) context reported mismanagement or poor/faulty management as a primary cause of firm decline. Among the Indian studies, there is almost near uniformity that the major cause of sickness is management failure (Manimala, 1991). An RBI study on sickness covering 378 units, published in the early 1980s, quoted by Morris (1982), estimated that about 52% of these units fell sick due to mismanagement. The reports of various committees and task forces that studied the performance of SLPEs in Kerala also cited mismanagement as the primary reason for the dismal performance of this sector (GOK, 1998; ERC, 2001; SPB, 1990; SPB, 1997) and suggested various measures to counter it. Management-level changes in SLPEs in general manifest themselves in different forms like new appointments at the CEO level and/or new appointments at the middle level, strengthening the board with new skills and expertise, professionalisation of top management team, additional functional autonomy from government and ensuring a sufficient tenure for the CEO. Such changes at the top level may result in the improvement of leadership quality, top management commitment, quality of decision and risk taking, and understanding between the Board and the CEO. Hence, changes at the top level are likely to bring lots of improvements within the organisation which would eventually improve the performance of the company.
Stakeholders

‘Stakeholder’ refers to any individual, group or institution that may affect or be affected by the business activities (Freeman, 1984). They are government, trade unions, employees, customers, suppliers, share holders (owners), creditors, general public, etc. In the Public Sector context, government assumes the role of both regulator and owner. However, unlike private institutions, PEs are exposed to controls by Parliament/State legislature, administrative departments, the Minister concerned, government officials, Planning Board, Audit departments (CAG), Vigilance agencies, etc.

Stakeholder management is a critical element that contributes to firm performance, especially during the turnaround attempt (Hambrick, 1985; Arogyaswamy et al., 1995). During decline, the firm experiences an erosion of stakeholders’ support, and whatever support remains comes only at an increased cost. Managing stakeholders’ interests may be the most challenging job for the top management during turnaround. In the public sector context, the top management needs to maintain good ties at the government level. Support of the Minister in charge, government officials and politicians may be extremely important even to rope in other stakeholders, e.g., banks and financial institutions. Unless enough attention is given to stakeholders, they may withdraw their support, which can eventually lead to firm failure. The more effective the stakeholder management, the more the support they give during turnaround attempt.

Sickness Severity

Hofer (1980) first introduced the severity of decline as a contextual variable influencing the selection of appropriate turnaround strategies. He identified two strategic solutions, namely, ‘product-market refocusing strategy’ and ‘dramatic market share increase strategy’, and four ‘operating’ strategies, namely, ‘revenue-increasing’, ‘cost-cutting’, ‘asset reduction’ and ‘combination strategy’. Hofer found support for the strategic-operational hypothesis: strategic cures for strategic problems and operating cures for operating problems. Hofer’s main contributions were the inclusion of severity as an important element in the selection of strategy and its relative importance in the
selection of cost and asset reduction (efficiency strategies). According to him, the choice of ‘operating’ strategy depends on how close the company is to its break-even point.

Table 2.1

<table>
<thead>
<tr>
<th>Closeness to BEP</th>
<th>Suitable Operating Strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Just below the BEP</td>
<td>Cost cutting</td>
</tr>
<tr>
<td>Moderately below BEP</td>
<td>Revenue increasing strategies</td>
</tr>
<tr>
<td>Far Below the BEP</td>
<td>Asset reduction strategy</td>
</tr>
<tr>
<td>Extreme case</td>
<td>Combination strategy</td>
</tr>
</tbody>
</table>

*Source: Compiled by the author on the basis of Hofer (1980).*

Hambrick and Schecter (1983) suggested Capacity utilization and Market share as an alternative to Hofer’s break-even point to measure decline severity. According to them, asset/cost surgery was pursued primarily by businesses with low capacity utilization; selective product/market pruning was undertaken primarily by businesses with relatively high capacity utilization; and the piecemeal strategy was followed primarily by businesses with high market share.

Robbins and Pearce (1992) take a similar view where they suggest that the nature of retrenchment depends on how deep the decline is. Asset surgery or asset retrenchment is likely in deep declines, and cost retrenchment is likely in less severe declines. So, retrenchment is taken as an essential first step in all turnaround situations. But the treatment of retrenchment as a base strategy in all turnaround situations is questioned. When their study was replicated using the same data, Barker and Mone (1994) found that retrenchment contributed to performance gains only in deep declines. They found that performance did not improve when the severity of decline was controlled. Thus, retrenchment made sense only for firms in deep decline. Retrenchment as a base strategy in all decline situations is, therefore, doubtful. Another approach to measure turnaround
situation severity is resource availability (i.e. underutilized or additionally available human resources and available financial resources). The flexibility to strategic choice depends on the resources available to the sick firm. If available resources are low (relative severity is high), flexibility to alter strategy is limited, since neither human resources nor slack financial resources are available for use. When the available resources are high, relative severity is low because the firm has the flexibility to change strategies and is in a better-off position to achieve turnaround (Arogyaswamy, Barker and Yasai-Ardekani, 1995).

**Firm Size**

Firm size is likely to influence the selection of strategies being pursued during turnaround. Big firms have increased capabilities for change because they have market power, greater resource stockpiles, and specialized structures that can be used to exploit opportunities (Barker and Barr, 2002; Ramanujan, 1984). However, others (Bruten et al., 2003; Khandwalla, 2001) also argue that large size increases complexity and to bring about any significant changes requires firms to implement changes throughout the organisation. This will make change time-consuming and difficult for large firms.

Small firms have greater flexibility and may require little effort and resources to introduce changes. However, smaller firms often lack resources to undertake major strategic reorientations. This restricts the firm’s ability to introduce changes during turnaround attempt and consequently to reap the benefit of improved performance. In this context, it is worth exploring whether size influences the selection of strategies and the subsequent changes in performance.

**2.3.3 Turnaround Process**

Researchers (Grinyer and McKiernan, 1988; Robbins and Pearce, 1992; Bibeult, 1982; Khandwalla, 1989; Manimala, 1991; Hambrick, 1985; Arogyaswamy et al., 1995) have proposed many process models and theories to describe successful turnaround as something taking place in a number of stages or phases. Some earlier models (Hambrick, 1985; Grinyer and McKiernan, 1988; Robbins and Pearce, 1992) assume that these
phases occur sequentially one after the other and rather independent of one another. Later models (Arogyaswamy et al., 1995; Balgobin and Pandit, 2001) tried to look at turnaround as a series of overlapping and interdependent phases rather than a sequence of independent phases. So, now we look at turnaround process as a series of complementary, parallel (overlapping) and interacting stages rather than a few consecutive phases operating independently. These stage theories and models help us to understand the possible linkages and appropriate actions at the right time at the right place. The review below will give an understanding of various turnaround process models available in the literature.

Grinyer and McKiernan (1988) studied 25 UK cases of ‘sharp-bending’, companies that underwent transitions to a much higher performance from a stagnating performance level relative to their industry rivals. Though ‘sharp benders’ are not typical turnaround cases, their insights seem to enhance our understanding of turnaround. According to them, sharp-bending seems to begin with a dramatic crisis, a situation caused by internal dissatisfaction over the gap between corporate aspirations and realized performance. This gap may arise on account any of the several internal and external factors. Next, the organizations may undertake a wide array of options that produce results. To begin with, it analyses operational problems function-wise and then initiates cost cutting. If these actions do not bring the desired result, then the firm may go for modest changes of strategic nature. If these two steps are found inadequate, then the firm may seek radical changes including major changes in technology, market served, etc. Grinyer et al. (1988) found that appropriate level of response to achieve sharp bend was operational, followed by administrative and strategic.

Donald Bibeault (1982), in an exploratory study based on descriptive statistics derived from a survey of 81 companies and over 100 interviews with business leaders involved in corporate turnarounds, has proposed a five-stage model of turnaround (see figure. 1). The study covers 81 US-based conglomerate type organizations that achieved turnaround during the 1970s.
The first two phases of the proposed turnaround process are predominantly preparatory stages while phases three to five are action phases. The time frame for the different stages varies.

The management change stage, the top management recognizes the performance decline and decides to respond appropriately. According to Bibeault (1982), in about seventy percent of turnaround situations, mismanagement is cited as a reason for performance decline. Under-performing members of the top management team are regularly replaced in the management change stage. The replacement of top managers is compulsory if they are either directly responsible for the mismanagement or if they are unable to take necessary internal actions to achieve firm turnaround. Thus, replacement of CEO depends on the perceptions of top management regarding the causes of decline—internal or external. Internal causes are considered controllable within the firm and are usually the result of inappropriate management. In contrast, uncontrollable external causes can be political or economic in nature, and might impose constraints on management actions. As the responsible leader, the CEO is replaced especially if internal reasons are perceived to be the cause for the performance decline. However, if the cause of decline is clearly external, the change of management may not occur. Even if the cause of performance decline is internal, the change of management may not happen, if the CEO happens to be a major shareholder of the company.

In the evaluation stage, the viability of the company is assessed and a turnaround plan is developed with priorities. The focus is primarily on ensuring firm survival through
liquidity management. To develop a turnaround plan, the top management has to gain sufficient understanding of the turnaround situation, the turnaround cause and organizational conditions, to determine where the turnaround efforts need to be focused. In the initial period of turnaround, the realistic target is to solve 80 percent of the relatively easily solvable problems rather than get bogged down with the 20 percent of more difficult problems. The turnaround plan, consequently, is based on the top management’s prioritization of turnaround actions in the given context.

In the emergency stage, the focus shifts from problem recognition to action. The most important goal at this stage is to ensure the firm’s survival by focusing on liquidity. Retrenchment of assets and costs is the clear focus, as retrenchment is a short-term activity to increase liquidity by reducing cash outflow and enhancing cash inflow. Firm management, therefore, has to ‘stop the bleeding’ (Bibeault, 1982:99) by cutting costs. Actions taken to reduce cash outflows include personnel lay-offs and plant or department closings. Two assumptions underlie the retrenchment activities: Firstly, the personnel are seen as a cost factor rather than a source of competency. Secondly, the short-term focus on liquidity is governing the actions. Thereby, the long-term recovery strategy is neglected for a focus on short-term liquidity assuming an inability to increase cash inflow in the short-term.

Depending on the availability of time and monetary resources, retrenchment activities might be more or less extensive. Accordingly, the emergency stage may or may not be a harmful experience for the organization. If enough time is available in the emergency phase, the firm should try to divest plants and unprofitable business units through sales to strategic or financial buyers. Only if it is impossible to timely find a potential buyer, the closing of parts of the business and disintegration of resources is unavoidable for short-term liquidity considerations.

The retrenchment in the emergency phase leads the firm to concentrate on business segments that achieve good profits or segments with promising gross margins. As a result of asset and cost-cutting moves, many organizations come out of the
emergency stage with reduced revenue capacities and diminished resources, but with stabilized liquidity and greater focus on core business.

With the containment of negative cash flows, the firm enters the stabilization phase. In the stabilization stage, the strategic orientation shifts from short-term survival, retrenchment and liquidity management, to long-term sustainability, and acceptable return-on-investment. Profitability takes priority over cash flow, and management systems get renovated, especially in the control systems.

If the company survives the stabilization phase with controlled profit growth, it enters the return-to-growth stage. In this phase, the emphasis is on internal and external development and growth. The company initiates planned exit from unprofitable or futureless businesses and shift its focus to high potential businesses.

Internal development concentrates on revenue growth, new marketing initiatives, new ways to broaden the base of the existing business, and options to increase the market penetration.

External growth can potentially be achieved through an acquisition in the core business segment financed through funds from disinvestments. In order to achieve corporate growth, new products may be added, new markets penetrated and developed, selling effectiveness increased and customer services improved.

The executives put in charge of turnaround might have led the company through traumatic retrenchment experiences, and as a result they might not be suited to lead the company in the return-to-growth stage since they might be incapable of creating a positive internal atmosphere. In such cases, as Bibeault (1982) suggests, a replacement of the turnaround management may be adopted for long-term growth of the company.

The turnaround process ends if the perception of the company leaders is that the company has undergone a turnaround.

Moreover, Bibeault (1982) points out important restructuring options in a turnaround situation. These options include the exit from the current industry by way of sale or merger with a competitor, the potential to realize growth (and market share) in the
core segments through acquisitions, and the ability for the turnaround firm to acquire financial resources through divestment of business divisions. The point is also clearly made, that divesting a business is clearly preferable over retrenchment of the business, since the divestment allows the firm to realize financial resources rather than building up obligations from the retrenchment process and disintegrating resources.

Bibeault’s study (1982) covers 81 conglomerate-type organizations in the US during the 1970s, and the process elements he proposes largely resemble turnaround process adopted by these conglomerate-type organizations. Reviewing the companies that Bibeault (1982) analyzed includes large organizations such as Electronic Associates, Johnson & Johnson, etc. and underlines the notion that this turnaround process is particularly oriented at the business set-up of large conglomerates. These findings may have limited use in other types of business units or cultural environments.

Apart from this, Bibeault (1982) neither explicitly considers the negative effects of retrenchment nor does he assess interdependencies between the early-liquidity driven phases of the turnaround process and the later growth-driven phases.

In a theoretical contribution, Hambrick (1985) suggests a three-stage process model of turnaround by incorporating the peculiar turnaround contingencies. Hambrick argues that a turnaround situation differs from other strategic situations due to the limited available resources, poor internal morale, sceptical stakeholders and urgency. Since these conditions are special to turnaround situation, they influence all stages and actions of turnaround.
A low level of resources, according to Hambrick (1985), is part of the turnaround situation. Banks are usually reluctant to infuse more funds in a declining firm. Consequently, one of the major challenges for the turnaround manager is to work with the available limited resources to achieve firm turnaround.

In addition to limited resources, the turnaround manager is confronted with low internal morale and dissatisfied personnel, which are consequences of the initial decline. With an increasing crisis situation, a growing number of highly skilled and educated employees leave the firm to work in a more stable environment. When crisis deepens, poor morale, internal strife among personnel, and lack of confidence among employees further deteriorate the organizational resources and competencies (Hambrick and D’Aveni, 1988).

Organizations largely depend on interrelations with stakeholders such as suppliers, creditors, distributors, franchisees, and unions. In times of performance decline, the
survival of the firm is partly dependent on the support of stakeholders and their confidence in firm survival. If firms suffer from declining performance, stakeholders withdraw their aid especially if they have better and more viable alternatives. The withdrawal of stakeholder support increases transaction costs for the firm (e.g. suppliers withdraw credit, banks increase interest rates), which further deteriorates resources and contributes to the severity of the turnaround situation. Hence, the turnaround process needs to incorporate stakeholder management so as to ensure continued stakeholder support.

For Hambrick (1985), urgency is the result of the lack of time in the turnaround situation due to the low (financial) resource base, deteriorated internal morale, and decreased stakeholder support. Accordingly, timely actions and fast decisions are crucial to firm survival. Moreover, urgency has implications for the way in which strategic decisions are made, the substance of those decisions and the sequence of actions.

According to him, turnaround process consists of three action phases: Crisis, Stabilization and Rebuilding (see figure 2.3). In the crisis phase, Hambrick (1985) argues, a firm faces a survival-threatening situation. Correspondingly, the focus in the crisis phase is on liquidity and stopping cash outflows to avoid bankruptcy and to create a solid cash flow position. To create positive cash flows, retrenchment steps such as closing down or divesting plants, and reducing headcounts might be inevitable. Hambrick (1985), however, warns about the potential negative effects of retrenchment on internal morale and stakeholder support.

If the survival of the firm is secured as a result of liquidity and cash flow-enhancing actions taken in the crisis stage, the firm enters the stabilization phase. In the stabilization phase, the primary aim is to get “breathing room” (Hambrick, 1985, p. 10). Attention in the stabilization phase is directed towards increasing margins, fine-tuning the production mix, targeting high-return market segments, and increasing the organizational efficiency to build up resources that can subsequently be used to lead the firm to growth. Control and information systems should be installed or improved. Management actions remain operational in the stabilization phase.
Finally, in the rebuilding stage, management attention shifts from operational issues to reconstructing the firm. In this phase, entrepreneurial activities such as new product development, marketing campaigns, and asset renewal and expansion can be started or accelerated. The rebuilding phase is similar to a general strategic management situation, once the impacts of the characteristics of a turnaround situation, i.e. limited resources, poor internal morale, sceptical stakeholders and urgency of decisions, have gradually diminished and ultimately vanished.

Hambrick’s (1985) major contribution is the recognition of the contingencies that impact the turnaround process, which conceptually makes strategic management clearly distinct from turnaround management. Hambrick’s (1985) model gives a deeper understanding of the stages in the turnaround process when studied in relation to its contingencies. The effects of retrenchment, for example, turn out to be positive only if assessed solely in the light of liquidity and cash flows. If internal morale and stakeholders are considered, the overall effect of retrenchment can become negative. Correspondingly, the conclusion of Hambrick (1985) concerning retrenchment strategies is that they should only be pursued carefully, also taking into account the negative effects of fall in internal morale and stakeholder support. However, he seems to focus more on the action phases with lesser weight for the recognition-oriented aspects.

Hambrick (1985) also fails to explain the interrelations that exist between different phases. It is assumed that the rebuilding phase deals with ordinary strategic management issues rather independently of earlier phases in the turnaround process. If valuable resources are retrenched in the crisis phase, however, they will be lacking in the rebuilding phase. Accordingly, subsequent researchers have questioned the assumption of independence between the turnaround process phases (Arogyaswamy, Barker and Yasai-Ardekani, 1995).

Robbins and Pearce propose a model of the turnaround process (Robbins and Pearce, 1992; Pearce and Robbins, 1993; Robbins and Pearce, 1993; Pearce and Robbins, 1994), which is derived partly from the preceding work of Bibeault (1982). Robbins and Pearce found that turnaround management literature up to the 1990s had appreciated the
existence of retrenchment as part of the turnaround process, however, without thoroughly investigating the importance and value of asset and cost-cutting strategies. Consequently, Robbins and Pearce investigated in their research the value of retrenchment in turnaround situation.

Robbins and Pearce (1992; 1993) argue that retrenchment is not only a measure to enhance the liquidity position of a firm but much more an efficiency-increasing action. If costs are reduced and inefficient assets are sold off, the overall/average efficiency of the assets increases.

Robbins and Pearce proposed a two-stage turnaround process model, viz., retrenchment and recovery. They argue that turnaround efforts shall focus on retrenchment since retrenchment and not strategic renewal is found to be the predominant determinant of successful turnarounds (Robbins and Pearce, 1992; Pearce and Robbins, 1993).

**Figure 2.4: A Model of the Turnaround Process by Robbins and Pearce (1992)**

Source: Robbins and Pearce (1992)
Turnaround situation severity is included as a contingency in the turnaround process model, which was drawn from Hofer (1980) who found in a case study of 12 poorly performing firms that a link existed between turnaround situation severity and the degree of cost and asset reductions necessary to achieve turnaround. However, conditions of stakeholder support and internal morale are not explicitly modelled.

Similar to Bibeault (1982), Robbins and Pearce (1992; 1993) also argue that the two main objectives for a firm in a turnaround situation are survival and attainment of positive cash flows. To achieve positive cash flows, the distressed organization has to engage in typical retrenchment activities, lowering cash outflows and improving the liquidity position through liquidation, divestment, product elimination, and head count cuts (retrenchment phase). These actions are based on the assumption that in the short run cash inflows from operations cannot be increased and a situation of low liquidity can only be resolved through lowering cash outflows. In the recovery phase, the aim shifts to growth and development. Measures to accomplish organizational growth and development are acquisitions, new products, new markets and increased market penetration.

In the retrenchment phase, the firm seeks to stabilize the declining performance and weak liquidity and cash flow position by cost and asset reduction. If a satisfactory performance level is reached, companies can return to growth in the core business, but might still decide to divest in other business areas. The firm is at a decision point between the two stages (Robbins and Pearce, 1992; Pearce and Robbins, 1993): Either the organization can pursue recovery maintaining the pre-existing strategy in a retrenchment-reduced form or change the strategic orientation. Robbins and Pearce (1992) argue that independent of the decision to change the strategic orientation, retrenchment is universally an appropriate reaction in a turnaround situation. They propose two major turnaround strategies: either an operating/efficiency turnaround in which the pre-existing strategy is maintained and the turnaround is achieved through asset and cost reductions, and a diminished resource base or strategic/entrepreneurial
turnarounds in which retrenchment is the foundation for an altered strategic orientation for the return to sustainable growth.

Robbins and Pearce (1992) tested their two-stage turnaround process model and found retrenchment to be an integral part of the turnaround process. They investigated 32 publicly held textile manufactures during the period 1976-1985, and found retrenchment activities during the turnaround attempt to be positively related to turnaround success.

Firms encountering severe turnaround situations needed to pursue cost retrenchment as well as asset retrenchment. Firms facing less severe situations sufficiently reacted by retrenching costs. Cost and asset retrenchment together resulted in the highest average level of turnaround performance. Based on their empirical findings, Robbins and Pearce (1992) derive their process model and conclude that retrenchment can be considered a core element in the turnaround process. Robbins and Pearce (1992), similar to Bibeault (1982), model the turnaround process from a financial/liquidity perspective without explicitly taking other contingencies into account.

Thus, they find a high utility for retrenchment activities, but negative effects of retrenchment are neither modelled nor considered. Especially the proposition that retrenchment in itself can be a strategy to achieve turnaround, and that accordingly strategic renewal is less important than retrenchment, has invited strong oppositions in subsequent studies (Arogyawamy, Barker and Yasai-Ardekani, 1995; Barker and Mone, 1994; Barker and Duhaime, 1997).

Retrenchment is, therefore, taken as an inevitable response to firm inefficiency (e.g. Bibeault, 1982; Robbins and Pearce, 1992; Pearce and Robbins, 1993; Robbins and Pearce, 1993; Pearce and Robbins, 1994). However, prior research indicates that declining firms face severe problems in addition to inefficiency, such as dysfunctional decision-making processes (D’Aunno and Sutton, 1992), deteriorated firm climate (Hambrick 1985; Cameron, Whetten and Kim, 1987) and reduced stakeholder support (Hambrick, 1985). Such contingencies are overlooked, making the retrenchment argument win little acceptance later.
Arogyaswamy, Barker and Yasai-Ardekani (1995) in their theoretical contribution tried to address the key criticisms of earlier models of turnaround. Preceding process models were criticized for being linear, sequential and unable to explain the interdependencies of turnaround process stages and the complexity of the process.

**Figure 2.5: Two - Stage Contingency Model of Firm Turnaround by Arogyaswamy, Barker and Yasai-Ardekani (1995)**

Consequences of Decline

The two-stage integrative model proposed by Arogyaswamy, Barker and Yasai Ardekani (1995) argues that the turnaround firm will undergo the following pattern of events and actions. Initially, the firm’s performance declines as a result of either misalignment with the firm environment, environmental hostility, or a mixture of both. If the decline is not turned around, it will lead to three consequences: erosion of external stakeholders’ support, growing internal inefficiencies, and deteriorating internal firm climate and decision-making processes. A declining firm fails when a combination of these consequences exhausts the firm’s financial resources and causes creditors to withdraw their support from the firm.
Stage I – Decline-Stemming Strategies

If the above three consequences remain unattended, they may cause the firm to fail or dissolve. In order to avoid failure, the authors propose that turnaround firms take decline-stemming strategies that reverse or contain the three consequences of decline. Decline-stemming strategies constitute the first stage in the turnaround model and can be either externally or internally directed. Externally, they stop the erosion of stakeholders’ support, and renew their confidence in the top management. Internally, they create efficiency and stabilize the internal environment of the firm. Decline-stemming strategies must also be sensitive to the resource needs of various recovery strategies in stage II (feedback loop). However, two contingencies influence initial decline-stemming strategies: firstly, the severity of the performance decline, and secondly, the level of organizational slack available at the time of the turnaround attempt.

The severity of the decline influences the extent to which erosion of stakeholder support, inefficiency and deteriorating internal morale threaten the survival of the firm. The effect of turnaround-situation severity on decline-stemming strategies depends on the level of slack resources available. Organizational slack is defined as available manpower and/or financial resources. In situations of low organizational slack, firms facing severe performance decline are most vulnerable and as a result these firms are expected to pursue decline-stemming strategies more intensely. High available slack may, on the other hand, reduce the need for decline-stemming strategies. As slack can absorb variability in firm performance, it can protect the firm at least temporarily against dysfunctional effects of decline.

The first aim of the decline-stemming strategy is stakeholder management. The strategy seeks to change the image that the stakeholders have of the firm in a way that either increases or at least maintains their support.

The second aim of decline-stemming strategies is to eliminate inefficiencies. Increased efficiency by definition allows declining firms to better utilize their assets and cost structures, which stabilizes the competitive position of the firm to some extent by lowering costs, improving cash flows and reducing risk of insolvency in the short run.
Increased efficiency may be the result of retrenchment, downsizing the firm, increased sales, or a combination of the three. The methods used to increase efficiency in declining firms may vary, depending on what recovery strategy is chosen by the management.

The last goal of the decline-stemming strategy is stabilization of the internal climate and decision processes. Arogyaswamy, Barker and Yasai-Ardekani (1995) argue that firms can avoid the mechanistic shift in structure and decision processes, if the top management enforces decentralization in structure, experimentation and free flow of communication. They also suggest that employee involvement counters the mechanistic shift and helps to maintain a positive internal climate. Additionally, uncertainty among employees due to expectation of downsizing measures can be reduced, if the top management maintains open communication during the turnaround attempt.

**Stage II – Recovery Strategies**

The outcome of stage-I creates a conducive atmosphere for recovery. Successful recovery strategy in stage II is built on the foundation laid by successful decline-stemming strategies in stage-I (e.g. stakeholders’ support, increased efficiency and stabilized internal environment). Since, decline-stemming strategies deal with only the three consequences of decline, any progress achieved in stage-I is likely to be short-lived as it leaves the basic causes of decline largely unattended. So stage-II requires more elaborate recovery strategies that address the basic causes of firm decline.

Recovery strategies are management actions and policy changes that seek to eliminate or cope with the causes of the firm’s decline in order to enhance turnaround performance to acceptable levels. Successful recovery strategies take into account the cause of decline as well as the firm’s competitive position in the industry.

The cause of performance decline directly influences the effectiveness of various recovery strategies. Organizational decline research proposes that the causes of a firm’s decline can either be based in an industry contraction or because of poor firm-specific adaptation to the internal and/or external environment (Cameron et al., 1988).
Decline as a result of industry contraction occurs when the industry as a whole shrinks. The contraction reduces the number of firms in the industry, and most firms suffer from performance decline as they all compete for a reduced resource base (Whetten, 1987).

In contrast, firm-based decline occurs when the firm is not sufficiently aligned with either its external or internal environment, and consequently performs worse than the average firm in the industry. Most effective recovery strategies for firms in the given competitive position and cause context are given in the following figure.

**Table 2.2**

<table>
<thead>
<tr>
<th>Firm’s competitive position</th>
<th>Cause of Decline</th>
<th>Industry – Contraction based</th>
<th>Firm-based</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strong</td>
<td>Long-term Industry Decline</td>
<td>Incremental strategy changes that expand industry position through investments that exploit existing resources and capabilities</td>
<td>Strategic reorientation leveraging existing resources and capabilities with the latent value (few firms by definition)</td>
</tr>
<tr>
<td></td>
<td>Cyclical Industry Decline</td>
<td>Incremental strategy changes that hold industry position and strengthen historic resources and capabilities</td>
<td></td>
</tr>
<tr>
<td>Weak</td>
<td>Long-term Industry Decline</td>
<td>Scaling back firm to viable customer segments. Strategic reorientation if viable customer segments dictate new resources and capabilities. Otherwise, incremental strategy changes</td>
<td>Strategic reorientation creating new resources and capabilities</td>
</tr>
<tr>
<td></td>
<td>Cyclical Industry Decline</td>
<td>Incremental strategy changes that hold either hold industry position or scale back those to those customer segments which most value the firm’s resources and capabilities.</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Arogyaswamy, Barker and Yasai-Ardekani (1995)*
For firm-based declines, they propose recovery strategies involving strategic reorientation. Few firm-based declines have strong competitive positions and such firms may focus largely on exploiting the firm’s existing but under-utilized resources and capabilities. On the other hand, firms that have weak competitive positions may pursue recovery strategies intended to build new resources and capabilities.

The stages in the turnaround process are interdependent rather than sequential. The interdependency between both types of strategies, decline-stemming and recovery, means that they need simultaneous consideration. However, it also means that success of only one activity is not sufficient for turning the firm around. Initial or ongoing success either of the decline-stemming or of the recovery strategies creates conditions that facilitate success in the other stages.

The process model by Arogyaswamy, Barker and Yasai-Ardekani (1995) comprehensively incorporates relevant turnaround contingencies, and reconciles much of the preceding work on decline and turnaround. This turnaround process model differs from other models by integrating different views on the turnaround process into one model: Efficiency-oriented ideas of Robbins and Pearce (1992) on retrenchment are combined with stakeholder and internal perspectives stressed by Hambrick (1985). Arogyaswamy, Barker and Yasai-Ardekani (1995) stress the interconnectedness of the three consequences of decline and also the difficulties that firms may have to face while implementing decline-stemming strategies. The authors argue, for example, that the implementation of retrenchment plans without considering all organizational consequences may lead to reduced employee morale and commitment, increased employee alienation and withdrawal of the most talented and skillful employees. Retrenchment may create incremental or short-term efficiency gains and liquidity relief. However, in the long run, such one-sided decline-stemming strategy may accelerate the deterioration of the firm’s internal climate and decision process resulting in the dissolution of the firm. Accordingly, the authors go beyond the liquidity argument and address the negative impact of retrenchment that might seriously deteriorate the internal climate making sustainable turnaround difficult.
Manimala (1991) proposed a five-stage model based on the analysis of 28 cases from the developed countries. His stages include (1) Preparatory stage, (2) Arresting the sickness, (3) Reorienting the business, (4) Institutionalizing the process, and (5) Growing further. The Strategies in each stage are given below in Table 2.3.

### Table 2.3
A Model of turnaround Stages and Strategies

<table>
<thead>
<tr>
<th>Stages</th>
<th>Strategies</th>
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| 1 Arresting sickness | ▪ Credibility building by the turnaround agent  
                        ▪ Mobilization of the organization  
                        ▪ Reprieve from external pressures  
                        ▪ Cost cutting/cost controls  
                        ▪ Staff reduction, especially in non-productive areas  
                        ▪ Quick pay off projects and actions  
                        ▪ Asset reduction  
                        ▪ Inventory reduction |
| 2 Reorienting     | ▪ Redefining business  
                        ▪ Change in corporate identity/image  
                        ▪ Rationalization of product mix to eliminate loss making ones and to focus on core business.  
                        ▪ Modernization of plant and machinery  
                        ▪ Shift from production orientation to market orientation  
                        ▪ Tie-up with reputed companies for marketing  
                        ▪ Focus on quality and customer service  
                        ▪ Debt/capital restructuring  
                        ▪ Organizational restructuring  
                        ▪ Changes in the management cadre  
                        ▪ Financial incentives for managers/staff  
                        ▪ Training and retraining of employees  
                        ▪ Information dissemination  
                        ▪ Public relation and liaison |
| 3 Institutionalizing | ▪ Culture building through continued training, seminars, focused programmes, slogans, rituals etc.  
                        ▪ Introduction of new structures, systems, and procedures including communication and coordination mechanisms |
| 4 Growth          | ▪ Introduction of new products  
                        ▪ Entry into new markets, especially international  
                        ▪ Related diversification  
                        ▪ Focusing and strengthening R&D  
                        ▪ Mergers and acquisitions |

Source: Manimala (1991)
Manimala’s (1991) preparatory stage includes Bibeault’s (1982) first two stages, top management change and evaluation. However, he doesn’t claim chronological distinctiveness and seems to admit the concept of overlapping stages. He has also given strategies normally associated with different stages of turnaround, which are given below.

Khandwalla (1992), in his study of 42 turnarounds, identified actions in relation to three stages of turnaround: initial phase, middle phase and final phase. His initial phase actions include personnel changes especially at the top, disciplining the staff, communication downward to co-opt the staff into the turnaround, roping in stakeholders, control-seizing and cost-cutting. Middle phase actions include incentives and other staff motivation techniques, attempts to weld the organization, revamping the plant and vigorous marketing. Long-term strategic actions like diversification and product mix changes including new products are relatively final phase activities. Khandwalla’s classification of turnaround stages provides clues as to the timings of various turnaround actions but he remains largely silent on the exact nature and purpose of actions at each stage.

2.4 Conclusion

Turnarounds are of increasing relevance. With the far-reaching economic reforms introduced in 1991, Public Sector Enterprises in India are exposed to global competition. Since then, PEs have faced problems that they never had experienced under the protective environment. These changes have put many PEs in trouble. Simultaneously, individual PEs along with government departments got actively involved in the process of turnaround. The SLPEs are an important component of Public Enterprises system in India. Unlike central Public Sector Enterprises, SLPEs are owned and managed by State governments. Their functioning heavily depends on the policies of respective State governments and often on the policies of the Central Government. There is a dearth of knowledge regarding the functioning SLPEs and the incidence of sickness among them looks quite extensive. The insights regarding the turnaround attempts especially in the SLPE context could be a powerful tool in the hands of policy makers and practitioners to ward off sickness engrossed in the PEs in general and the SLPEs in particular. The
review of literature, in a nutshell, pointed out that the research on turnaround in India is rather scanty except for a few studies in the form of Case studies (Khandwalla, 1989; 1992; 2003; Manimala, 1991). These studies have contributed lots of meaningful insights about the turnaround of sick companies. However, no specific studies relating to turnaround of the SLPEs of Kerala have been conducted and the present study is likely to bring out the critical factors of SLPE turnaround in Kerala. The insights could be of immense use to SLPEs in other states, which form a major constituent of Public Sector Enterprises system in India. The next chapter will give a comprehensive picture of PEs in India and more specifically the working SLPEs of Kerala.
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