CHAPTER VI

TURNAROUND STRATEGIES

Introduction

Turnaround implies that the units continue to exist. It indicates a durable increase in the previously sick units' capacity for normal growth and normal profitability. It is sustainable recovery;

"sustainable recovery involves achieving a viable and desirable business strategy, supported by an adequate organisation and control structure ----- sustainable recovery requires the firm to develop sustainable competitive advantage".(1)

Turnaround is not achieved merely when the financial results look up. It will be achieved when the unit has acquired the managerial, structural and strategic capability to hold its own in a competitive world.

"......a company has not really turnaround unless it has achieved a solid basis of future growth".(2)

A full turnaround would be a situation where the profitability has approached industry levels and has stabilised at least at these levels. An incomplete turnaround is a situation indicating rapid improvement in relative profitability from a situation of decline but is still below the industry levels. Turnaround will be easier if there is a single cause of sickness as compared to a situation in which a number of causes are responsible for the malady.
Essential turnaround strategies on which there has been considerable research in the context of private sector enterprises, have considerable applicability to PSEs as well. Hence, it is useful to look at these strategies. There are turnaround cases in PEs also and the strategies adopted could have relevance for drawing general conclusions.

The behaviour of the public sector enterprises, particularly, the loss-making and sick ones, differs from that of their private sector counterparts by an essential feature, viz., the absence of "hard" budget constraints. The low priority assigned to profitability and the lack of minimum profitability targets, combined with the de-facto assurance that losses would be covered by budgetary appropriations or non-Plan loans from the Government., have taken away the initiative from public enterprises to reduce costs and improve the efficiency of their operations. Many of the public sector enterprises would qualify as "sick" as their losses have completely eroded their equity. They have been financially sustained by the Government through re-capitalisation, subsidies and financial restructuring. There are some spectacular examples of turnaround in PEs. The Hindustan Copper had lost about Rs. 30 crores in 1982-83 but broke even next year, despite a fall in the price of copper in 1983-84. Bharat Aluminum Corporation (BALCO) reduced
its losses from about Rs. 53 crores in 1982-83 to Rs. 21.5 crores in 1984-85 without raising its prices. Burn Standard, which was losing some 30% on sales until 1978, broke even 4 years later. (3) Bharat Heavy Plate and Vessels, and Richardson and Cruddas, both lost heavily in 1978-79 but turned profitable the next year. (4) But these enterprises could not sustain the pace of growth and have turned sick again. The average period of turn round from a situation of sickness to self-sustaining health is around 4 years.

**Turnaround Strategy**

An effective strategy to combat sickness is to heed early warning signals about the deteriorating health of the enterprise. "Deep sickness is more difficult to cure than a minor dip." (5) Enterprises are in difficulty because they fail to take the "right action in time and impair or eliminate their future forever...... the earlier the recognition, the higher the probability of survival." (6) According to British and American studies, (7) following are the early symptoms of decline:

i) "Decreasing profitability, especially decreasing profit to sales or decreasing deflated profit to investment, ratios;"

ii) Decreasing real (i.e. deflated) sales, rapid increase in debt, decreasing liquidity particularly decreasing working capital, paralytic management i.e. management with slow responses to enquiries, unfavourable market developments, lack of planning and strategic thinking and declining real reinvestment." (8)
The remedies will differ according to the cause of sickness. It will also be necessary to find out whether the enterprise sickness' is an industry level phenomenon or a unit level phenomenon with some tentative reasons such as declining margins or increasing costs or worsening capital structures.

**Turn Around Stages:**

A turn around is likely to proceed through several stages viz.:

i) Diagnostic stage;

ii) Emergency phase; and

iii) Normalisation phase.

Diagnostic stage is the first phase in which the causes of sickness are identified if the unit appears to be salvageable and the initial turn around strategy is evolved to control the sickness. The second phase is the emergency phase in which emphasis is on the survival and mobilisation of the staff for turn around. Attempts are made to establish credibility of the management, financial control, quick cash generation and cost reduction, layoffs and stoppage of unprofitable products and negotiations with financial institutions are undertaken. The third stage is normalisation phase in which attention is paid to normalise profitability by undertaking profitable expansion and diversification, development of new markets and professional system of management.
Experience suggests that on an average, it takes about 4 years to go through these turn around phases. The strategic issues of expansion and diversification take a back seat during the early phases of a turn around. The Management is involved in a much broader range of activity than during normal times such as quick pay-off projects, asset liquidation, cost reduction and revenue generation. Management of turn around of sick units needs professionals of very high competence who are distinct from the general milieu.

A turn around policy for a sick unit should evolve a scheme of prioritisation of activities. If the sickness has been caused by a bad manager, it should be priority number 1 to change the manager. Further action should proceed according to this priority scheme. If the unit is operating around the break-even point, the turn around strategy will be cost-reduction to increase profit margin. If the unit is operating below the break-even point, cost reduction plus revenue generation will be major elements of turn around. If the unit is very sick, and is operating well below the break-even point, cost reduction plus revenue generation plus asset reduction will be major turn around elements. The deeper the sickness, the more complex will be the turn around strategy. If the Unit is operating in a young industry, its growth might be retarded by over-trading and lack of internal
coordination which can be rectified by initial control and internal coordination. If the unit is operating in a mature industry and faces set backs, the remedy will lie in cost reduction, revenue generation, asset liquidation etc.

Once a unit is diagnosed as sick, the issue to be considered is whether the unit is salvageable. A number of factors reduce the salvageability of a Unit. The greater the presence of these negative factors, the lower the salvageability of the firm. It is easier to tackle the problem of sickness if it has been caused by a single factor i.e., say lack of power supply. But if sickness is the result of power deficiency, financial deficiency, poor law and order situation, lack of demand, poor management etc., turn around will become a tremendous task. Acute sickness is more difficult to cure than a mild one. If the price hardly covers the variable cost, salvageability of the unit would be doubtful. Bad industrial relations will reduce the chances of salvageability of the Unit.

**Viability Conditions**

The viability exercise involves identifying causes which affect the enterprise working and seek to answer the following:

a) whether the enterprise can operate at a level higher than before and obtain a reasonable rate of profitability under the existing market conditions;
b) whether the existing plant and machinery are adequate to manufacture the required output;

c) whether the organisation can cope with a higher level of operations;

d) whether the raw materials are plentifully available and at economic rates to enable the unit to sustain production at the desired level; and

e) whether the enterprise should diversify its production?

The financial institutions have developed considerable expertise in conducting techno-economic viability study.

"A viability study can be defined as 'all round' investigation into the unit's various functional areas i.e. finance, production, marketing, personnel and corporation management and the external environment influencing the industry. This takes into account the past and present working results for projecting the future performance. The main objectives of such a viability study when undertaken for a sick unit is to ascertain the surplus generation capacity and its capability to service its debts in a reasonable time. Such studies also highlight the strengths and weaknesses and suggest future course of action."(9)

The following criteria may indicate potential viability:

(i) Possibilities of making profits before depreciation at least in the third year, followed by operating profits thereafter.

(ii) Net working capital will become positive at the end of the fourth/third year.

(iii) Capacity to service debts from the fourth year and commence repayment of loans at least from the sixth year.

It involves a study of various financial ratios for the first few years of rehabilitation programme as also
the Unit's products, manufacturing process, capacity, plant layout, maintenance, quality control, production planning and performance standards etc. It also takes into account the marketing strategies, external constraints, opportunities, such as credit restraint, price control and import restrictions. After analysing, the comprehensive data, a rehabilitation package is suggested.

The basic considerations are whether the unit is economically viable and whether it has potentialities to become viable under certain conditions such as expansion, diversification, additional finances and better management. If the Unit is currently or potentially viable, a rehabilitation package may be developed. Usually an adviser is deputed to the Unit to oversee implementation and speed up liaison with financial institutions.

Special attention needs to be drawn here to the problem of over-manning which is all pervasive in PEs in our country. There is hardly any undertaking which is not suffering on account of over-staffing. The need for rationalisation of labour is imperative. With the advent of improvement in technology in future, labour is likely to become surplus on a greater scale. The Government and the unions should not object to rationalisation of labour. The Incremental Economic
Rate of Return (IERR) is a good indicator about the viability of an enterprise. It is normally calculated by, first, estimating the benefit and cost streams for the entire rehabilitated plant and then subtracting the benefit/cost streams that would occur without rehabilitation. It can also be calculated directly by estimating the additional benefits and additional costs which are attributable mainly to the rehabilitation investment.

It will have to be ensured that there is no dearth of working capital to operate the rehabilitated unit at the level used in calculating the ERR. It would be wrong to rehabilitate a unit which does not have sufficient working capital.

It is advisable to rehabilitate those units which are both competitive in the long run and yield a satisfactory rate of return to the investment for the entire rehabilitated firm. The incremental economic rate of return (IERR) attributable to rehabilitation investment alone should exceed the opportunity cost of capital because capital availability is constrained. Firms which can use inputs efficiently taking capital costs as sunk, but for which the return to rehabilitation investment is not satisfactory should be kept open without rehabilitation. In other words, so long as all variable costs are more than covered by revenues, continued operation will be justified. Such
firms will be those where the full ERR exceeds the opportunity cost of capital but the IERR does not because the benefit will be represented by the difference between the ERR and the IERR. Units should also be kept open without rehabilitation in cases when the full ERR is below the opportunity cost of capital, if the short run net benefits stream is positive, taking capital as a sunk cost.

If the full ERR is below the opportunity cost of capital and the net benefit of operating is negative even where the capital costs are ignored, it is advisable not to rehabilitate and close down. These are cases where even the variable costs are not covered by revenues. Such units can not be competitive in the long run even with rehabilitation and even when capital is treated as a sunk cost.

There are many public enterprises incurring cash losses continuously over a period of years. In some cases, the average value added per employee per month is even less than the average monthly emoluments per employee. Such units can seldom break-even and can hardly justify their existence by eating into the Government resources. The equity capital of such units is wiped out by mounting deficits.
Capital Restructuring

Capital restructuring will be needed to make a sick unit financially viable in the future in those cases where past accumulated losses are responsible for unpayable interest burden but current operations meet the test of economic rate of return.

These decisions will require the application of strict criteria based on the economic rates of return for the whole firm after rehabilitation and after capital restructuring. Evaluation of the economic benefit of rehabilitating an existing enterprise differs from evaluation of a new project because productive capacity already exists which can generate benefits even without further investment. Correct evaluation of benefits and cost streams both with and without rehabilitation is important.

The Arjun Sengupta Committee Report recommends that BPE should conduct suo moto studies. If the BPE reaches the conclusions that capital restructuring would help the enterprise in avoiding the cash losses, the same can be undertaken. It should also be examined whether modernisation can improve the situation. If the unit is suffering cash losses due to faulty pricing policy, remedial measures should be taken.
1. Change in top management:

Change in the top management is the first essential step in a successful turn-around. This is true as much for PSEs as for private sector enterprises. In one Indian study of successful turn around, there was a change if the Chief Executive in 8 out of 9 cases. In another study of successful turn around of 5 textile companies, there was a change in the top management in all the 5. Similarly, there was change of top executives in overwhelming number of units in Britain, America and Japan resulting in turnaround. A new Chief Executive, if he is an outsider, is likely to take a fresh view of the situation and will not be constrained by the past as an existing one. The Chief Executive must have entrepreneurial instincts and qualities combined with professional management skills, a broad business experience and expert negotiating skills. Several sick units taken-over by HMT and BHEL were turned around by these organisations by deputing teams of top managers.

The personality of the top manager and his reputation for integrity, fairness, sacrifice for the organisation, hard work, resourcefulness, and concern for the staff will go a long way in mobilising the
energies of the staff for turn around and in institutionalising the right organisation culture. The top management should demonstrate a spirit of self-sacrifice. He must be committed to the unit and the welfare of his subordinates and workers. He should be indifferent to his own comforts and luxuries. Such a leader will succeed in creating a sense of esprit-de-corps i.e., the fellow feeling, the feeling of belonging. This feeling will motivate the workers and they can deliver wonders to the organisation.

2. **Credibility**:

The new Chief Executive or top management must establish credibility as soon as possible. Credibility can be earned by a new management by successfully negotiating wage settlement as was done in the case of Bharat Heavy Plate and Vessels, facing a strike and breaking it as was the case at Richardson Crreddas, meeting the annual targets as was the case with Bharat Pumps and Compressors, ensuring high quality service to consumers as was the case with Hindustan Photo Films and deputing teams of executives to sort out the long standing grievances of the staff as was done in the case of Damodar Valley Corporation.

Credibility must not be acquired through terror because in India the management has little freedom to fire staff and strike terror. A problem should be identified that can be solved easily with resourceful
planning and perseverance. It should be solved quickly with accomplishment and publicity.

3. **Controls**:

Sickness is often due to slack paralytic administration. An immediate turn-around step usually needed is tight financial controls. These should cover purchases, capital expenditure, cash collections and disbursements and inventories. Daily, weekly and monthly cash flow forecasts must be prepared. Targets for each manager should be fixed and performance assessment done. It also means setting up profit responsibility centers. As one British expert puts it,

"......strict financial controls need to be imposed on the organization......the use of a participative management approach in introducing and using new and improvised control systems is not recommended in the early phase of turnaround." (11)

A sick unit should reduce costs at the earliest. The scope to reduce costs is available in material costs, unit labour costs, control of wastes, identification of surplus manpower, fixing work norms, retrenchment of surplus staff, better production planning and scheduling, quality control, maintenance of plant and equipment and management of inventory. A productivity-linked incentive system can produce good results. Negotiations must be carried out with the
bank and financial institutions asking for relief pending finalisation of a rehabilitation package. A good system of information must be developed with the help of computers and through market surveys. This will help in exploiting the markets better. To ensure revenue generation, market structure must be kept in mind. If the nature of demand is inelastic, a hike in price will yield more revenue.

4. **Quick pay-off projects**:

A demoralised organisation needs success immediately to build up enthusiasm for the turn around among staff and other stake holders. Even modest success can restore morale. Hence, an initial emphasis on quick paying projects can be extremely useful. These may be to replace obsolete equipment, restoration of quality controls, getting licenses for expansion and diversification, cutting down on overtime by introducing a work incentive system, dropping of products incurring heavy losses making an efforts to get new orders, disposing of scrap to get much needed cash, laying off surplus staff with the help of voluntary retirement schemes, updating of productivity standards, identification of larger debts for concentrated follow ups for realisation etc. Concrete, visible goals such as doubling capacity utilisation, achieving the year’s production programme will be easily understood by the staff and their achievement.
will stimulate them further. These targets are visible and concrete and will measure the progress of the turn around. The Management will impart a sense of challenge to the staff.

5. **Availability of working Capital:**

All out efforts should be made by the Units to ensure that adequate working capital is made available to the mills so that production does not suffer. The Govt. may decide to write off unsecured loans, conversion of unsecured loans received from the Govt. to equity, interest remission for a period of 5 years or so and concessional rate of interest. With such concerted efforts, the unit would be able to bring down the cash losses and hence the Government's budgetary liability towards reimbursement of such losses.

A sick enterprise needs immediate cash. How to generate it, has to be considered. Fixed assets such as surplus vehicles, buildings, offices, lands and plant can either be disposed of or leased. Surplus inventories should be disposed of. Overdue debtors should be identified and vigorous efforts made to effect recoveries from them.

6. **Reduction of Labour Force:**

Most sick PSEs are saddled with surplus man power. The application of Special Voluntary Retirement Scheme should be expedited in order to bring down the
component of wages. Off loading of surplus manpower from the Unit is essential to make it viable. In addition, unproductive activities should be eliminated.

5. **Mobilisation of the organisation for turn around:**

The employees should be taken into confidence about the happenings in the organisation. Factual information about the financial position of the unit will destroy rumour-mongering and restore a sense of reality in a myth-ridden situation. For effective internal financial control over internal costs, the wisdom of lower level managers can suggest valuable solutions. This should be brought to the surface with the help of "participative, redesign work group" mechanism. Good performance must be rewarded by a mix of motivators: promotions, public praise, greater responsibility, more challenging assignments, etc. It is imperative that only right type of Chief executives are appointed to revive a public sector enterprise.

Poor inter-personal and inter-departmental coordination is a contributing factor to industrial sickness. Intrigues, dissensions, making scape-goats and organisational politics are common troubles of organisations responsible for under-performance. The malady can be taken care of by improving internal coordination and creation of a body under one Boss with profit responsibility as was the case with Bharat Heavy Plate and Vessels, as also Richardson and Cruddas.
Various coordination committees can be set up to coordinate production, sales, maintenance and quality as was done in the case of Sylvania and Laxman. In addition, monthly performance reviews must be undertaken by Senior Managers to find out lapses in operations. Disputes must be settled locally without involving higher authorities. This will promote a healthy culture of managerial autonomy, initiative, low degree of dependency and co-operative functioning.

Concluding Comments:

The New Industrial Policy, 1991, has taken into account the deteriorating position of the public sector enterprises as under:

"After the initial exuberance of the public sector entering new areas of industrial and technical competence, a number of problems have begun to manifest themselves in many of the public enterprises. Serious problems are observed in the insufficient growth in productivity, poor project management, over-manning, lack of continuous technological upgradation, and inadequate attention to R&D and human resource development. In addition, public enterprises have shown a very low rate of return on the capital invested. This has inhibited their ability to regenerate themselves in terms of new investments as well as in technology development. The result is that many of the public enterprises have become a burden rather than being an asset to the Government. The original concept of the public sector has also undergone considerable dilution. The most striking example is the take over of sick units from the private sector. This category of public sector units accounts for almost one third of the total losses of central public enterprises. Another category of public enterprises, which does not fit into the original idea of the public sector being at the commanding heights of the
Thus a new approach to public sector enterprises seems to be inevitable. They should become growth-oriented and technically dynamic which should be the main focus of every turn around strategy adopted for the sick PSEs. The sale of top executive is very vital. He will ill afford to be indifferent like the person sitting at the Post Office window and selling stamps. If somebody comes to purchase stamps well and good and if nobody turns up to purchase the stamps, he is not bothered. Such an attitude will destroy PEs.
References


3. A Study Commissioned by Industrial Development Bank of India in association with Industrial Credit and Investment Corp. of India Ltd. and Industrial Finance Corporation of India, Effective Management of the Turnaround of Sick Enterprises, Chapter 3, pp. 3.3.


5. A Study Commissioned by Industrial Development Bank of India in association with Industrial Credit and Investment Corp. of India Ltd. and Industrial Finance Corporation of India, Effective Management of the Turnaround of Sick Enterprises, Chapter 3, pp. 51.

6. A Study Commissioned by Industrial Development Bank of India in association with Industrial Credit and Investment Corp. of India Ltd. and Industrial Finance Corporation of India, Effective Management of the Turnaround of Sick Enterprises, Chapter 3, pp. 47.

7. A Study Commissioned by Industrial Development Bank of India in association with Industrial Credit and Investment Corp. of India Ltd. and Industrial Finance Corporation of India, Effective Management of the Turnaround of Sick Enterprises, Chapter 3, pp. 47.


