UNIT 12 TURNAROUND

Objectives

The objectives of this unit are to:

- introduce you to the concept of retrenchment strategy;
- explain the need for retrenchment strategy;
- understand the concept of turnaround strategy; and
- discuss other variants of retrenchment strategy.

Structure

12.1 Introduction

12.2 Retrenchment Strategies

12.3 Turnaround Strategy

12.4 Survival Strategy

12.5 Liquidation Strategy

12.6 Summary

12.7 Key Words

12.8 Self-Assessment Questions

12.9 References and Further Readings

12.1 INTRODUCTION

Many organizations decline due to falling sales, declining profits and more importantly declining demand. Demand in an industry declines for a variety of reasons (Harrigan & Porter, 1983). New substitutes emerge (computers with word processing capabilities replacing manual electronic typewriters) often with higher quality and lower cost (PVC pipes for GI pipes, Ball pens for fountain pens) or buyers shrink or simply disappear (jute industries). Changing customer needs, lifestyles and tastes also lead to declining demand (vanaspati oil, cigarettes, agarbattis, etc.). Also cost of inputs may increase and reduce demand for products (Petrol cars). In such situations, top managers must find a strategy that will stop the organization's decline and put it back on a successful path.

Organizational decay is a slow, long-term deterioration of the firm's operations caused by its inability to change and adapt to its external environment. It is a function of environmental adversity (external opportunities and threats) and internal adversity (organizational negative aspects). HMT Watches Division, a market leader in mechanical watches, is a case of an organization, which could not adapt itself to the rapid technological changes. The company was not quick enough to latch on the growing digital watches market and its premier position in the process. Another example of this decay is evident in the period before LTV, a US Steel producer, declared bankruptcy. LTV's financial difficulties included reduced steel orders as a result of an increase in the level of steel imports (to 20% per year), a decrease in domestic automobile sales (LTV's sales of the flat rolled steel products to GM Corporation represented approximately 14% of its 1986 sales), and high price competition from national and local producers, especially in the bar steel products.

Also, profit had deteriorated as a result of the high costs of raw materials and the low productivity of labor. These conditions reduced the availability of trade credit and long-term financing.

Environmental adversity may be viewed as an overall measure of the firm's difficulty in coping with the environment. The higher the level of adversity encountered by the organization, the more difficult it is to achieve its goals. This results in organizational decay (decline). Low adversity produces more appropriate adjustments and motivates the firm to pursue a defensible niche. Severe adversity generally produces mixed results ranging from adaptation to complete misalignment with the business environment. Many firms faced with severe adversity make short term or stop gap arrangements at the expense of the long-term arrangements, which only exacerbate the already worsening situation. Proactive organizations, which exercise strategic options, before reaching a very high level of adversity, can significantly reduce threats from the environment.

Activity 1

Identify a company either in public or private sector, which in recent times has closed down. State the reasons (external and internal) that have lead to its decline.

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Impact of Decline/decay on the organizations:

Companies on the decline or facing bankruptcy may experience several negative effects discussed below.

Psychological and Behavioural Reactions to Decline

When employees and management recognize the onset of organizational decay and scarce resources, they experience low morale (because few needs are met) and may withdraw their confidence in or blame top management. Other negative responses to decay include: a) conservatism, rejection of new alternatives, and risk aversion; b) competition and infighting for acquiring scarce resources; and c) employee turnover (the most competent leaders tend to leave first, causing leadership anaemia).

The Stigma of Closing the Company

Retrenchment and more so liquidating a firm is a discrediting label that causes key constituents (buyers and suppliers) to react negatively toward the firm, including: a) severing business ties if possible; b) reducing the quality of engagements (e.g. bad supplies); c) bargaining for more favorable terms than in earlier relationships; and d) assaulting the credibility of the company and its leaders.

These significant and potentially devastating negative reactions continue through the retrenchment and restructuring process. Stigma often creates negative perceptions and potentially spoils the image, self-esteem, and reputation of the organization and its management leading to a) organizational death; b) damaged managerial careers; and c) an accelerated chance of managerial succession.

Factors Contributing to Rapid Decline or Decay

Organizational Slack

Slack is uncommitted or committed (but under utilized) resources that are at the disposal of the organization. The existence of uncommitted slack (especially in the form of cash and liquid assets) is considered a necessary strategic factor for the survival of the declining organization because during decline, there are not enough sales to generate sufficient cash. On the other hand, slack may be a handicap during growth period and it may represent a high opportunity cost causing a drag on performance. While organizations in decline require high discretion and flexibility in using slack, in more stable or growing markets, high levels of slack (especially in the form of cash) may reduce performance. Hence, critical to the choice and the timing of retrenchment strategies and the likelihood of survival, is the amount of slack within the organization. Unfortunately this situation does not exist in many organizations facing decline or decay. In particular, while exercising retrenchment strategy as a strategic option, the existence of critical slack, will give the organization more flexibility in dealing with internal and external adversity.

Leadership

The lack of effective leadership has been identified as one of the most significant causes of business failure. Leadership vacuum may exist due to managerial incompetence or managerial succession. As mentioned earlier, this problem is more acute in declining organizations since qualified managers seek alternate employment before they become associated with any potential stigma. A critical success factor for companies facing high adversity and unpredictability created by competition is the existence of leaders who can create an agenda for change and build an effective implementation environment. The leaders should also be able to alter the organizational philosophy, defining success as lower growth and smaller size and persuade the various constituencies to support the retrenchment choice.

It may be a good idea to recruit influential leaders prior to implementing a retrenchment strategy because in the retrenchment process and more specifically in turnaround process, powerful leaders with an access to elite groups and other networks can; a) provide more flexibility with creditors, stockholders, and the government, b) influence creditors to support the management's right to continue in control, and c) provide additional capital more easily and on better terms. Highly educated, well connected, competent, and trustworthy leaders have better chances of successful reorganization.

Managerial Control

In successful organizations, managerial depth provides better coordination and control. However, organizations in decline often choose to cut back their managerial staff especially at the middle levels of management. Creditors may also force cutbacks in staff or reduction in management compensation. Excess reduction in managerial depth may eliminate critical functions and decrease chances of survival. Organizations may have the option, however, to replace personnel involved with coordination and control functions by applying appropriate information technology. In order to cope with high complexity in the external and internal environment, firms may find it useful to increase their usage of information and communication technology.

An organization can stop its decay and increase its survival by adopting an appropriate retrenchment strategy at the appropriate time. The following propositions provide guidelines for the timing of retrenchment strategies. The choice of a specific strategy is a function of the level of environmental adversity and the level of organizational slack.

Condition of Moderate Adversity

Firms with low slack should consider an early retrenchment strategy when faced with moderate adversity because alternatives are limited. In the context of strategic planning, retrenchment may include the shrink selectively strategy: discharging some debts while restructuring others, reducing stigma, and shifting the organizational philosophy to define success as accepting lower growth and size. It is important to trigger the actions and implement a retrenchment strategy while talented top management is still in the organization and still feels positive (moderate adversity) about their business and its future.

When slack is moderate, the organization should focus on profitable or promising businesses in which it has distinctive skills and experience. This strategy variant may take the shape of a combination of an "extracting cash strategy" and a "shrink selectively strategy". Firms with high slack can withstand moderate levels of adversity. High slack enables the organization to maintain its strategic direction through the use of uncommitted or under utilized (committed) assets.

Condition of High/Severe Adversity

Small firms are more likely to stop operations apparently due to lack of slack resources, thus increasing the probability for failure. Large firms have greater physical and financial capacities to hold excess resources and are expected to have more slack than small firms. Therefore, small firms or firms with low levels of slack, faced with high/severe adversity, may select to sell off assets outside of its strategic focus (i.e. SSS) or to accept a leverage buyout (divest). When high slack exists, augmenting the organization's leadership and managerial resources would be beneficial. The coordination and control provided by managerial depth could take the form of a computer based reporting and budgeting system linked with the strategic planning system.

12.2 RETRENCHMENT STRATEGIES

Retrenchment is a short-run renewal strategy designed to overcome organizational weaknesses that are contributing to deteriorating performance. It is meant to replenish and revitalize the organizational resources and capabilities so that the organization can regain its competitiveness. Retrenchment may be thought as a minor surgery to correct a problem. Managers often try a minimal treatment first—cost cutting or a small layoff—hoping that nothing more painful will be needed to turn the firm around. When performance measures reveal a more serious situation, more drastic action must be taken to restore performance.

Retrenchment strategies call for two primary actions: cost cutting and restructuring. One or both of these tools will be employed more extensively in turnaround situations, because the problems are deeper there than in retrenchment situations. A cost cutting program should be preceded by careful thought and analysis. Rarely is it wise to use a simplistic "across-the-board" cost cutting program. Some departments or projects may need additional funding, while others need modest cuts, and still others need drastic cuts or need to be eliminated altogether. If cost cutting is a part of the strategy implementation, then the plan of implementation should clearly specify how it will be applied across the organization and why is it being proposed.

Retrenchment strategy alternatives include shrinking selectively, extracting cash for investment in other businesses, and divestment. While these strategies result in generating cash, they differ in terms of their intentions. Divestment of the whole business is an "end game" strategy and it may be done via selling or liquidation of

business. Under the strategy of extraction of cash for investment in other business, cash is generated from the troubled business mainly via budget and cost contraction. In both strategies, the intention of management is to quit the troubled business.

In the shrinking selectively strategy (SSS), cash is generated via downsizing (contraction of size or divesting some operations. The strategy of shrinking selectively involves retrieving the value of investments in some parts of the market while reinvesting in others because in some niches' demand will continue to be grow while in others the demand shrivels. The objective is to capture the desirable niches. A firm, which chooses the shrink selectively strategy, should have some internal competitive advantages, which it hopes to preserve. Thus, it may prefer to retain some part of its former businesses by shrinking rather than divesting, because of the possible advantages it had built up through the years.

Shrinking selectively as a repositioning strategy (i.e., matching market niche with distinctive competence) often results in renewed strength. For example, the TATA group continued concentrating on its various business including steel, automobile manufacturing, etc while selling Tomco, which did not share a synergistic relationship with its current portfolio of businesses. Similarly, the LTV steel company's decision (after filing in 1986) to concentrate on "flat rolled" steel products, while divesting other steel operations, reflects the intent to maintain a leadership position in production of high-quality, value-added steel for critical engineering application.

In essence, restructuring involves an organization refocusing on its primary business. During the 1970s, many firms diversified into businesses they knew little about. Management teams thought this conglomerate diversification would spread their firms' risks. If the fortunes of one business declined, the others in its business portfolio would protect earnings. Quite often, companies struggled to compete well in the business lines they knew little about. Many of the mergers of the 1980s occurred because these firms restructured their businesses by trying to sell off these businesses and refocus their efforts in their original lines.

Variants of Retrenchment Strategy:

The three major variants of retrenchment strategy are turnaround strategy, survival strategy and liquidation strategy. These are discussed in the following sections.

12.3 TURNAROUND STRATEGY

A turnaround situation exists when a firm encounters multiple years of declining financial performance subsequent to a period of prosperity (Bibeault, 1982; Hambrick & Schecter, 1983; Schendel et al., 1976; Zammuto & Cameron, 1985). Turnaround situations are caused by combinations of external and internal factors (Finkin, 1985; Heany, 1985; Schendel et al., 1976) and may be the result of years of gradual slowdown or months of precipitous financial decline. The strategic causes of performance downturns include increased competition, raw material shortages, and decreased profit margins, while operating problems include strikes and labour problems, excess plant capacity and depressed price levels. The immediacy of the resulting threat to company survival posed by the turnaround situation is known as situation severity (Altman, 1983; Bibeault, 1982; Hofer, 1980). Low levels of severity are indicated by declines in sales or income margins, while extremely high severity would be signaled by imminent bankruptcy. The recognition of a relationship between cause and response is imperative for a turnaround process and hence, the importance of properly assessing the cause of the turnaround situation so that it could be the focus of the recovery response is very important.

The Turnaround Process

The Turnaround Process begins with a depiction of external and internal factors as causes of a firm's performance downturn. If these factors continue to detrimentally impact the firm, its financial health is threatened. Unchecked financial decline places the firm in a turnaround situation. A turnaround situation represents absolute and relative-to-industry declining performance of a sufficient magnitude to warrant explicit turnaround actions. A turnaround is typically accomplished through a two stage process. The initial stage is focused on the primary objectives of survival and achievement of a positive cash flow. The means to achieve this objective involves an emergency plan to halt the firm's financial haemorrhage and a stabilization plan to streamline and improve core operations. In other words, it involves the classic retrenchment activities: liquidation, divestment, product elimination, and down sizing the workforce. Retrenchement strategies are also characterized by the revenue-generating, product/market refocusing or cost cutting and asset reduction activities. While cost cutting, asset reduction and product/market refocusing are easy to visualize, the idea of revenue-generating is best captured by a strategy that is characterized by increased capacity utilization, and increased employee productivity.

Retrenchment is an integral component of turnaround strategy. The critical role of retrenchment in providing a stable base from which to launch a recovery phase of the turnaround process is well established.. Many firms that have achieved a reversal of financial or competitive decline inevitably refer to the presence of retrenchment as a precursor or prelude to the implementation of a successful recovery strategy (Bibeault, 1982; Finkin, 1985; Goodman, 1982; Hall, 1980). The question remains, however, as to why retrenchment is so frequently an appropriate first step in an overall turnaround process. One possible explanation is that economic decline diminishes the firm's resource slack. Cost retrenchment helps to preserve the residual resources. Resource flexibility provides additional slack and is achieved through asset redeployment Resource flexibility must be substituted for slack that has been largely depleted, or when the heightened requirements of strategic redirection place additional demands on the firm for resources. These heightened requirements stem from concurrent demands on the firm to overcome the destructive momentum of the established strategy and to cover the high startup costs of implementing the new strategic initiatives. Consequently, retrenchment may be necessary to stabilize the situation by securing or providing slack regardless of the subsequent recovery strategy that is chosen.

The second phase involves a return-to-growth or recovery stage (Bibeault, 1982; Goodman, 1982) and the turnaround process shifts away from retrenchment and move towards growth and development and growth in market share. The means employed for achieving these objectives are acquisitions, new products, new markets, and increased market penetration. The importance of the second stage in the turnaround situation is underscored by the fact that primary causes of the turnaround situation have been associated with this phase of the turnaround process- the recovery response (Hofer, 1980; Schendel et al., 1976). For firms that declined primarily as a result of external problems, turnaround has most often been achieved through strategies based on an revenue driven reconfiguration of business assets. For firms that declined primarily as a result of internal problems, turnaround has been most frequently achieved through recovery responses that were heavily weighted toward efficiency maintenance strategies. Recovery is said to have been achieved when economic measures indicate that the firm has regained its pre-downturn levels of performance.

Between these two stages, a clear strategy is needed for a firm. As the financial decline stops, the firm must decide whether it will pursue recovery in its retrenchment-reduced form through a scaled-back version of its preexisting strategy, or whether it will shift to a return-to-growth stage. It is at this point that the ultimate direction of

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the turnaround strategy becomes clear. Essentially, the firm must choose either to continue to pursue retrenchment as its dominant strategy or to couple the retrenchment stage with a new recovery strategy that emphasizes growth. The degree and duration of the retrenchment phase should be based on the firm's financial health.

Turnaround Situations: Severity and Speed of Strategic Response

The nature, extent and speed of the appropriate strategic response depends primarily on two dimensions of the turnaround situation: severity and causality. Severity of the turnaround situation is a measure of the firm's financial health; it gauges the magnitude of the threat to company survival. Since the immediate concern to the firm is the extent to which the decline is a threat to its short-term survival, severity is the governing factor in estimating the speed with which the retrenchment response will be formulated and activated. Of course, performance that declines relative to that of competitors, but not absolutely, may necessitate almost no retrenchment. Rather, a reconsideration of strategy with a probable reconfiguration of assets would usually be deemed appropriate.

When severity is low, a firm has some financial cushion. Stability may be achieved through cost retrenchment alone. When the turnaround situation severity is high, a firm must immediately stabilize the decline or bankruptcy is imminent. Cost reductions must be supplemented with more drastic asset reduction measures. Assets targeted for divestiture are those determined to be underproductive. In contrast, more productive resources are protected from cuts or reconfigured as critical elements of the future core business plan of the company, i.e., the intended recovery response.

In addition, Robbins and Pearce found that the severity of the turnaround situation was the best indicator of the type and extent of retrenchment that was needed, although an immediate cost cutting response to financial decline (absolute and relative to the industry) was consistently found to be of value. The researchers also presented a model of turnaround based on evidence that business firm turnaround characteristically involved a multi-stage process in which retrenchment could serve as either a grand or operating strategy. Hofer (1980) conceptualized a link between severity of the downturn and the degree of cost and asset reductions that a firm should include in its recovery response. He referred to cost and asset reduction activities as operating turnaround strategies. Operating strategies designed for cost reduction were recommended for firms in less severe turnaround situations. Drastic cost reductions coupled with asset reductions were recommended for firms in more severe turnaround situations i.e., more severe problems require more drastic solutions. Usually, asset reduction is more drastic than cost reduction.

As the importance of external environmental factors assume importance relative to the internal factors, effective and innovative activities are more appropriate in the recovery phase of the turnaround process. If the reverse is true, efficiency maintenance activities are more appropriate. In either case, the recovery phase of the turnaround process is likely to be more successful in accomplishing turnaround when it is preceded by proactively structured retrenchment which results in the achievement of near-term financial stabilization. Innovative turnaround strategies involve doing things differently whereas efficiency turnaround strategies entail doing the same things on a smaller or more efficient scale. Revenue generating through product reintroduction, increased advertising and selling efforts, and lower prices represent modifications in existing strategy and can, therefore, be classified as innovative turnaround strategiesIn other words, innovative turnaround strategies involve product or market based activities while efficiency strategies focus on the production and management systems within the firm.

O'Neill (1986) investigated the relationship of contextual factors to the effectiveness of four primary turnaround strategies: management (new head executive, new definition of business, new top management team, morale building among employees), cutback (cost cutting, financial and expense controls, replacing losing subsidiaries), growth (new product promotion methods, entering new product areas, acquisitions, add markets), and restructuring (change in organizational structure, new manufacturing methods). His model predicted a negative relationship between growth strategies and turnaround success where there were strong competitive pressures. Where firms were in weak market positions, success was found for cutback and restructuring strategies. For firms competing in mature or declining industries, efficiency or operating recovery strategies offer the best prospects for successful turnaround. Retrenchment (cost cutting and asset reducing) are sufficient under certain circumstances to reestablish the long term viability of the firm. (*Refer to case study-1 in Appendix-4*).

Activity 2

Scan business dailies in the last few months or browse the Internet for companies that implemented turnaround strategy successfully. Discuss the important issues involved in these cases.

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12.4 SURVIVAL STRATEGY

When the company is on the verge of extinction, it can follow several routes for renewing the fortunes of the company.These are discussed in the following sections.

Divestment

An organization divests when it sells a business unit to another firm that will continue to operate it. Threatened with bankruptcy between 1979 and 1982, Chrysler sold its U.S. Army tank division to General Dynamics, its AirTemp air conditioning unit to Fedders, and its European distribution units to Peugeot/Citroen. The purpose was to focus only on the U.S. auto market- its main market. In our country, the TATA group has, in some form or the other, been realigning its portfolio since the early 1990s. But in the past few years it had done this in a more structured manner. The divestment of Tomco and Tata Steel's cement plant was a conscious decision. It was Tata Steel's decision to concentrate on steel and get out of the cement business. As for Tomco, the company had reached a point where it required immediate attention, not only in financial terms but in terms of management as well. The group felt that it did not have the requisite managerial skills in the specific area where Tomco operated and hence decided to hive it off.

Spin-Off

In a spin-off, a firm sets up a business unit as a separate business through a distribution of stock or a cash deal. This is one way to allow a new management team to try to do better with a business unit that is a poor or mediocre performer.

For instance, Indian Rayon and Industries Ltd (IRIL), an Aditya Birla group enterprise, has decided to spin-off its insulators business under Jaya Shree Insulator Division, in favour of a new company - Vikram Insulators Private Ltd (VIPL). The net assets of Rs 92.98 crore of the insulators division were transferred in favour of VIPL and a 50:50 joint venture with the Japanese insulators giant - NGK Insulators Ltd - was forged. The joint venture with NGK Insulators Ltd was proposed in order to upgrade the quality of the existing insulators and to develop new and more technically advanced insulators.

In consideration of transfer of the insulators business, VIPL would allot to IRIL 1.25 crore equity shares of Rs 10 each at par and debentures of (rupee equivalent) $ 25 million. On completion of the demerger, NGK would subscribe to 1.25 crore equity shares of Rs 10 each of VIPL for cash at a premium. This would result in equal shareholding for both IRIL and NGK and equal board representation in VIPL.

With increased and complex demands of the power transmission system, the quality and technical requirements of insulators have become more stringent and rigid. The existing manufacturers of insulators in the country, including IRIL, did not have the technical capability of manufacturing insulators of such high quality and specification and hence the need for this new arrangement.

Restructuring the Business Operations

The company tries to survive by restructuring its management team, financial reengineering or overall business reengineering. Business reengineering involves throwing aside all old business processes and starting from scratch to design more efficient processes. This may cut costs and assist a turnaround situation. This is much easier to visualize in a manufacturing process, where each step of assembly is examined for improvement or elimination. It would be foolish to find more efficient ways to perform processes that should be abandoned and hence, reengineering is strongly suggested in such cases.

Downsizing is a euphemism for a layoff. As the case of Kirloskar Pneumatic Company suggests, it is a good way to cut costs quickly. But unless downsizing is tied to a rational strategy, problems can crop up. Cutting staff without changing the amount and type of work done simply means that the remaining employees must do more work. This will result in cost reduction, but product quality and customer service may suffer. On the other hand, if the firm does not down size, its performance deteriorates. Hence any downsizing plan recommended should fit logically with the strategy proposed. (*Refer to case study-2 in Appendix-4*).

Activity 3

Aditya Birla group withdrew from certain sectors as part of strategic restructuring of the group. Identify these businesses and state the reasons for the group for exiting these businesses.

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12.5 LIQUIDATION STRATEGY

Liquidation is the final resort for a declining company. This is the ultimate stage in the process of renewing company. Sometimes a business unit or a whole company becomes so weak that the owners cannot find an interested buyer. A simple shutdown will prevent owners from throwing good money after bad once it is clear that there is no future for the business. In such a situation, liquidation is the best option. A case in point is the liquidation of loss-making Bharat Starch, a B M Thapar group company, following the sale of its starch and citric acid divisions to English India Clays and Bilt Chemicals, respectively. This was done as a part of financial restructuring to relieve the company of its outstanding liabilities. As part of the deal, the two buyers would actually take over the liabilities of Bharat Starch thereby reducing a major part of the debt burden of the company. The Thapar family is the largest shareholder in the company with a 45 per cent stake, followed by UK-based Tate & Lyle, which has a 40 per cent stake. The rest is divided between financial institutions and the public. For Bilt Chemicals, the takeover of the citric acid plant in Gujarat was a perfect fit since the company was planning to go in for expansions in the segment.

Bankruptcy is a last resort when the business fails financially. The court will liquidate its assets. The proceeds will be used to pay off the firm's outstanding debts. Some companies file for bankruptcy instead of liquidating. Under this option, the firm reorganizes its operations while being protected from its creditors. If the firm can emerge from bankruptcy, it pays off its creditors as best as it can.

12.6 SUMMARY

Many organizations decline due to falling sales, declining profits and more importantly declining demand. In such situations, top managers must find a strategy that will stop the organization's decline and put it back on a successful path. Retrenchment strategies normally followed by companies during their decline stage. Retrenchment is a short-run renewal strategy designed to overcome organizational weaknesses that are contributing to deteriorating performance. It is meant to replenish and revitalize the organizational resources and capabilities so that the organization can regain its competitiveness.

Retrenchment strategies call for two primary actions: cost cutting and restructuring. Retrenchment strategy alternatives include shrinking selectively, extracting cash for investment in other businesses, and divestment. The three major variants of retrenchment strategy are turnaround strategy, survival strategy and liquidation strategy. A turnaround situation represents absolute and relative-to-industry declining performance of a sufficient magnitude to warrant explicit turnaround actions. A turnaround is typically accomplished through a two stage process. The initial stage is focused on the primary objectives of survival and achievement of a positive cash flow and the second phase involves a return-to-growth or recovery stage where the turnaround process shifts away from retrenchment and moves toward growth and development and growth in market share.

When the company is on the verge of extinction, it can follow several routes for renewing the fortunes of the company and survive. An organization divests when it sells a business unit to another firm that will continue to operate it. This is called a divestment strategy. Spin-off is another version of survival strategy. In a spin-off, a firm sets up a business unit as a separate business through a distribution of stock or a cash deal. This is one way to allow a new management team to try to do better with a business unit that is a poor or mediocre performer. Sometimes a company tries to survive by restructuring its management team, financial reengineering or overall

business reengineering and downsizing its operations. Liquidation is the final resort for a declining company. This is the ultimate stage in the process of renewing a company. Sometimes a business unit or the whole company becomes so weak that the owners cannot find an interested buyer. A simple shutdown will prevent owners from throwing good money after bad once it is clear that there is no future for the business. In such a situation, liquidation is the best option.

12.7 KEY WORDS

Bankruptcy: When a business fails financially the court will liquidate its assets and the proceeds will be used to pay off the firm's outstanding debts.

Divestment: An organization divests when it sells a business unit to another firm that will continue to operate it.

Liquidation: It is the final resort for a declining company. This is the ultimate stage in the process of renewing company.

Organizational Decay: It is a slow, long-term deterioration of the firm's operations caused by the inability to change and adapt to its external environment.

Organizational Slack: Slack is uncommitted or committed (but under utilized) resources that are at the disposal of the organization.

Turnaround Strategy: It is a strategy adopted by firms to arrest the decline and revive their growth.

12.8 SELF ASSESSMENT QUESTIONS

1) What are the conditions under which firms adopt retrenchment strategies? Briefly describe the variants of these strategies.
2) What is a turnaround strategy? Describe the different steps involved in turnaround process.
3) When should a company adopt survival strategies? What are the various approaches to survival strategy?
4) What is divestment strategy and how does it differ from liquidation strategy?

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Appendix-4

Case Study-1

Kirloskar Pneumatic Company Limited-Turnaround Success

Kirloskar Pneumatic Company Limited (KPC) was set up in 1958. It started operations with the manufacture of air compressors and pneumatic tools in collaboration with Broom and Wade Ltd., U.K. and then diversified into Air-conditioning, Refrigeration and Transmission. Currently its activities are grouped into four major divisions: Air-Compressor, Air-conditioning and Refrigeration, Hydraulic Power Transmission and Process gas.

During the recession in the late 1990s, the sales bottomed out and the management realized that the business could not grow any more. This triggered a period of introspection and the company started looking inwards. Every time any business hits the bottom, there are two perspectives – external and internal. Since the management had little control over external factors, it focused on managing the internal working of the company. Fortunately, even on the external front, the company had a chance to buy out one of their major competitors – K G Khosla. The move started in 1994 when KG Khosla Company became sick and the ICICI requested the Kirloskars to manage this business. Subsequently both the companies, KPC & KG Khosla, were merged in the year 2000.

The first thing KPC management team did was to understand the business of KG Khosla - their product lines, style of business, etc. Then it started leveraging the synergies between the two companies. Since the sales of the KPC were already bottoming out and the Khosla product line with its manufacturing facilities was added to its plant in Pune, the company was left with no other option except to cut costs across the board. By the end of 2000, the management of KPC had through an understanding with the staff at Faridabad plant of KG Khosla reduced the employee strength considerably. The VRS at Faridabad was introduced with a total understanding with the parting staff. KPC then shifted 90 people from Pune to Faridabad for about three months during which time the company saw to it that the production continued at Faridabad with these workers. After this activity at Faridabad, the company also restructured its Pune plant by reducing the strength by 650 people. The final strength of employees at both the plants after this whole downsizing exercise finally stood at 800.

The company then turned its attention on restructuring its debt to bring the interest costs down. The third element of improvement was adding new product lines to its existing range while concentrating on improving the efficiency of its existing products. As a result, KPC turned around after successful implementation of all these well-planned initiatives during the period 1999 – 2002.

Case Study-2

Gillette India-Restructuring for Growth

Gillette India has achieved its growth target in the most profitable manner through strategic restructuring and functional excellence. The strategic restructuring focused on its business portfolio to identify the businesses it would like to continue and the ones it wishes to exit. Consequent to strategic restructuring, Gillette exited the Geep Battery business and the Braun business. Likewise, it discontinued all the non-profitable and non-strategic business lines in its existing portfolio. The company also developed strategic governing statements for each of the business, which made each business extremely focused. Advertising spend was focused on the right strategic

product. Advertising or sales promotion, which gave short-term benefits, was discontinued. The company also focused on improving short-term gross profit margins of its core businesses. Comprehensive profit improvement plans were put in place through promotions, SKU rationalizations, cost reduction and improved asset management. Functional excellence initiatives ensured that each and every process within the organization is benchmarked against peer group companies and process improved through a well-defined action plan.

Post Restructuring Scenario

After the divestiture of Geep battery business, grooming business (blades and razors) has emerged as the single largest business – accounting for 70% of turnover. Focus has been on the premium double edge, which was declining earlier, but with focused support and advertising this product made a strong rebound. Mach III the flagship brand of the company continues to perform extremely well with its niche premium positioning. Overall, the blades and razors business has registered a 22% growth. In addition, a new product called Vector Plus has been introduced in India. The product, which is an outcome of three years of development at its Boston Research and Development Facility, is based on the Indian consumer habits.

In personal care business, the main focus was on the tube shaped gel and the Gillette Series products in aerosol, gel, foam, after-shave and splash. This segment has registered a growth of 400%. Activities aimed at preventing the growth gray market have also aided growth in this segment. The oral care strategy for India has been revised to target the mass segment. Two products have been launched - Oral-B Classic and Oral-B Plus, both positioned in the popular price segment. This business has grown by 34% during 1999.

The alkaline battery segment (Duracell), accounts for a small part of turnover, but company enjoys a very high market share in the category. The strategy here would be wait and watch till the alkaline category starts growing. This business has grown at about 11% year on year.

Financial Results

All these restructuring initiatives resulted in:

- The company reporting the highest ever profit of Rs.170 million by Gillette in India. Net profit during the nine month ended September 2003 stood at Rs.437 million
- Operating margins jumped from a low 10% in second quarter of 2002 to 26% in second quarter of 2003. Besides the divestment of the low margin battery business, the strengthening of the Indian rupee also aided profitability, as 40% of Gillette products sold in Indian market are imported products.
- Core grooming business registered a healthy topline growth of 11% and gross margins also improved.
- Inventory came down by 14% and receivables have also been bought down.
- Ad-spend in first nine months of the year of 2003 was Rs.211 million (7.7% of net sales). The company planned to increase ad-spend in the fourth quarter of 2003 and 2004. Surplus cash freed through sale of assets and working capital improvement was proposed to be reinvested in brand building.