OXFORD

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Chapter 21
Decline and turnaround

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Learning outcomes

- Describe the troubled business
- Identify and discuss the stages in business failure and the danger signs of impending trouble
- Explain the drivers and moderators of business decline
- Describe the turnaround model, including the turnaround situation, turnaround response and turnaround strategies
- Understand the processes regarding bankruptcy and insolvency

Troubled business

A business experiencing a decline in performance over an extended period of time as a result of:

- Inadequate or negative cash
- Excess number of employees
- Unnecessary and cumbersome administrative procedures
- Fear of conflict and taking risks
- Tolerance of work incompetence
- Lack of a clear mission or goals
- Ineffective or poor communication within the business

Areas of most frequent cited causes of trouble:

- **Strategic issues** - failure involves the alignment or misalignment of the business and its environment, it is, by definition, about strategy
- **Management issues** - failure deals with strategy and the implementation of strategy, the choices that management make can accelerate failure or avoid falling into its clutches
- **Poor financial/accounting practices and systems** - business failure can be avoided even after a decline, rapid or prolonged, the ultimate failure of the business really stems from a failure to manage and control finances

Warning signs of trouble

- You don’t know where your next sale is coming from
- The business seems to be always late in delivering
- Your employees are unhappy or demoralised
- You feel like you can never be away or take a vacation
- You are losing more customers than you are gaining
- The company’s objectives are not clearly defined to your employees
- You feel financial control is slipping away
- Your business is constantly in a “survival” mode

Stages in business failure

- **Decline:** A business is in decline when its performance and operations slows down over consecutive periods and it experiences distress in continuing operations
- **Failure:** A business fails when it involuntarily becomes unable to attract new debt or equity funding to reverse the decline process and can, therefore not continue to operate under the current ownership and management
- **Turnaround:** Occurs when a business has been able to recover from the decline stage which threatened its existence in such a way that enables it to resume normal operations and achieve performance acceptable to its stakeholders

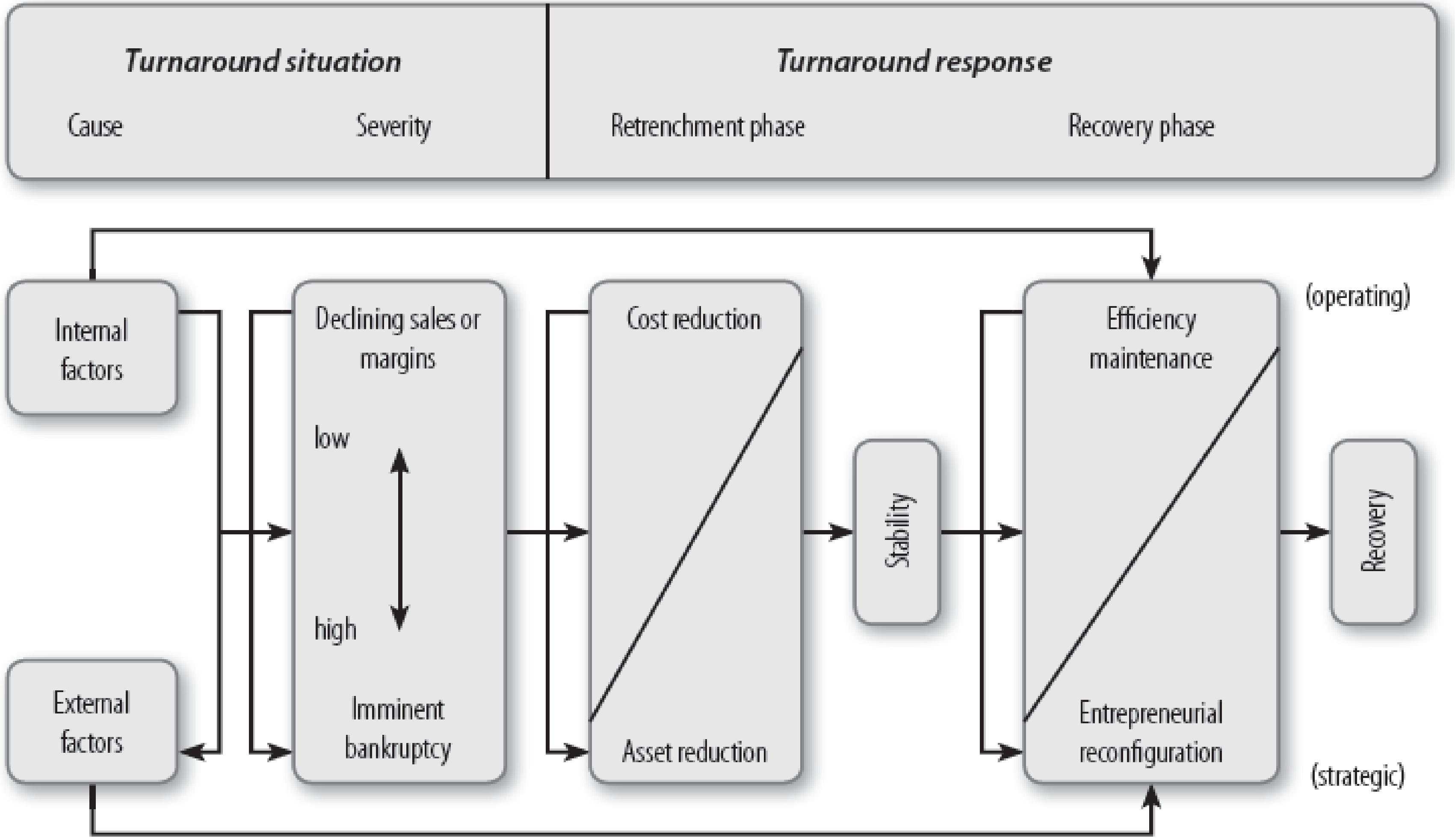
Drivers and moderators of business decline

- **Driver**: causal factor with ability to strong influence business decline
  - Divided into core and peripheral drivers
- **Moderator**: condition that will alter the way that drivers impact on business decline, such as:
  - Life-cycle stage
  - Qualitative vs. quantitative nature of causes and preconditions related to decline
  - Age and size effect
  - Stakeholder perspective

Core and peripheral drivers

- **Core drivers**:
  - Resource munificence
  - Leadership
  - Causality of decline
- **Peripheral drivers**
  - Continuous decision driver
  - Preconditions
  - Extremes dichotomy driver

Figure 21.2 The business turnaround model



Source: Pearce and Robbins (1993:624).

Turnaround situation

- **Turnaround situation** - business experiences multiple years of declining financial performance subsequent to a period of prosperity
- **Turnaround situations** - caused by combinations of external and internal factors

Turnaround situation (cont.)

- May be the result of economic slowdown or downturn (external) or financial decline within the business
- Resulting threat to company survival posed by the turnaround situation is known as *situation severity*
- Low levels of severity indicated by declines in sales or income margins
- High levels of severity signaled by imminent bankruptcy (*failure*)

Internal driving forces

- Business of machinery and equipment
- Technological capacity
- Business culture
- Management systems
- Financial management systems
- Employee morale

External driving forces

- Competitors and suppliers
- Customer behaviour
- Industry outlook
- Demographics
- Economy
- Political movements and/or interference
- Social environment
- Technological changes
- General environmental changes
- Government interference

Turnaround response

- Turnaround responses include two stages of strategic activities, retrenchment and recovery
- Aim of r*etrenchment* is to stabilise the business' financial situation by means of cost cutting and asset reducing activities
- A business is in severe situations can achieve *stability*, through cost and asset reductions
- A business in less severe situations can achieve stability through cost retrenchment

Internal and external factors

- Downturns caused by external factors can be turned around by implementing entrepreneurial creativity and innovation strategies and activities
- Downturns caused by internal factors can be turned around when focusing on efficiency strategies and activities

Turnaround strategies

- Management and general administration
- Human resources and industrial relations
- Marketing
- Engineering and research and development
- Production
- Financial management

Bankruptcy and insolvency

- When the severity of the turnaround situation is extreme or has implemented turnaround strategies but found no positive changes to the productivity of the business, the business owner may be faced with imminent bankruptcy

Bankruptcy and insolvency

- Bankruptcy is a legal status of a business that cannot repay the debts owed to its creditors – two types:

  Involuntary – creditors may file a bankruptcy petition against the business in an effort to recoup a portion of what is owed to them.

  Voluntary – the business owner initiates the bankruptcy due to a position of insolvency, thus not being able to repay its creditors

Laws governing company exit in SA

- Companies Act 71 of 2008 (CA), soon to become effective, repealing the former Companies Act with some exceptions and governing compromises (schemes of arrangement) and a new business rescue process (Chapter 6)
- Close Corporations Act 69 of 1984 (CCA), governing liquidation of close corporations, with the administrative process being defined, at least in part, by reference to the Companies Act

Laws governing company exit in SA (cont.)

- Insolvency Amendment Act 122 of 1993, governing procedures for insolvent companies, consumers, partnerships and other juristic entities
- Magistrates' Amendment Court Act 120 of 1993 (MCA), governing procedures for administration orders
- National Credit Act of 2005 (NCA), regulating the process of debt restructuring for individuals (consumers) with respect to credits governed by the NCA

Table 21.1 Insolvency procedures in South Africa

TYPE OF LEGAL PERSON	RESCUE (RELEVANT ACT)	LIQUIDATION (RELEVANT ACT)
Business	▸ Informal workouts ▸ Compromises (CA, CCA) ▸ Business rescue (CA)	▸ Voluntary winding-up or bankruptcy (CA, CCA) ▸ Involuntary winding-up or bankruptcy (CA, CCA, IA) ▸ Insolvency, liquidation (IA)
Individual	▸ Informal agreements and voluntary compositions ▸ Debt adjustments (NCA) ▸ Administration orders (MCA)	▸ Sequestration (IA)

Source: USAID (2010:10).

Entrepreneurial management

- **Manage the people** – owner and team as well as stakeholders
- **Manage the process** – identifying and capturing the values of the next 'quick wins' so that the plan continues to show positive results all the way through
- **Manage the business** – keep an eye on the numbers and manage the day-to-day business as well
- **Manage the turnaround risks** – keep an eye on the risks whilst operating a business in difficulty and ensure cover against potential problems

Key stages of turnaround plan

- Recognising the need
- Being around to do it
- Deciding what to do
- Generating detailed action plans
- Preparing marketing plans and forecasts and (re)organising the management team
- Doing it
- Keep on succeeding