# Information Priorities In Turnaround Situations

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## Abstract

*This study, carried out among members of the Turnaround Managment Association, describes the information needs of turnaround managers as they go about rescuing firms from financial crises. Working with limited resources, within a very short timeframe, the managers prioritize their information needs. In so doing, they confirm three hypotheses. First, turnaround managers are more likely to source information from the company's management information system than from the company's customers. Second, they tend to opt for cost cutting rather than increasing revenues. Finally, they are more likely to adopt a current (instead of a future) time horizon in analyzing the information.*

## Introduction

The threat of bankruptcy is not new in the corporate world. What is new is the advent of turnaround management in response to distressed companies. It is a managerial process which determines accountability, examines the deteriorating situation, gets hold of the information system, acts urgently, and evaluates results (DiPrimio 1988).

One expects a basic set of activities to prevail among successful turnaround strategies (Hall 1980, Bibeault 1982, O'Neill 1986). The sourcing of information is one such activity. A company "in extremis" is one where the information to operate is either not available or is not being used properly. An incoming turnaround manager must quickly assimilate the role of chief communications officer in order to perform an urgent diagnosis and prognosis (Horton 1988). The establishing of constant and consistent information helps the manager decide whether there is a core business in the distressed corporation which may be profitably salvaged (Albaum et al. 1979). This lessens the possibility of inadvertently postponing liquidation when liquidation is warranted. The sourcing of information also reveals any possible paths to profits and growth and makes it easier for the managers to predict whether it is worth hitching scarce resources to further difficult tasks ahead (Hickson et al. 1986).

However there are various problems about sourcing information. First, the information gathering system in an ailing company is usually in disarray. If the system had been fully functional, the company could have more likely foreseen and corrected the impending financial disaster ages ago. Second, the literature fails to prioritize the importance of different information sources in a turnaround situation. The field is so recent in the management literature that it lacks an established in-depth analysis in this regard. Third, current managers may have a vested interest in shielding off adverse information which could threaten the *status quo* and their respective position on the organizational chart. Fourth, sourcing of information taxes both time and financial resources, both of which tend to be scarce at the final stage of the company's life cycle. All these problems tend to reduce the search for pertinent information into a frenetic guesswork.

## Areas of Underperformance

A troubled company is usually one whose achievements fall considerably short of what its directors expect. Bibeault (1982) segments this underperformance into two main types of categories. The first category refers to strategic shortcomings which arise when the company operates in businesses in which it lacks expertise. This could be due to earlier overexpansion, overdiversification or excessive leverage. Overexpansion results from obsession with growth, and the myth that a company which is not earnestly expanding is somehow dying. With regards to overdiversification, Drucker (1974) believes that companies which diversify into different and unrelated markets usually end up performing poorer than those

companies which focus on and operate in one area. Hence, overdiversification entails the peril of losing focus (Schlender 1993). On the other hand, excessive leverage has to do with financial problems caused by an excessive reliance on financial loans to support expansion. Olympia & York Development's sky high debt load is a case in point where excessive leverage destroyed the world's largest real estate company.

Bibeault's (1982) second type of underperformance is what he calls "the operational gap." This occurs where a company may be operating a business in which it has expertise but for some reason or another it underperforms. When the government of Malta, one of Europe's smallest nations, set up the Malta Shipbuilding Company as a natural extension of the country's long-time expertise in ship repair, the new company seemed set to go. However, the appointment of inexperienced and semi-illiterate administrative and training managers, the setting up of poor auditing standards, and the company's exclusive dealings with an unreliable Soviet Union, created a bankrupt mess. These various problems prevented the company from running its core business efficiently.

Although the above underperformance categories include financial problems, financial actions may be regarded as a third category, given that the key to survival in a turnaround company is cash. In fact, if companies do not underperform on cash, they are unlikely to sink into the turnaround phase. Many financially underperforming companies increasingly receive the unwelcome attention of their customers, suppliers and banks (Lurie and Ahearn 1991).

## Hypotheses

To examine turnaround managers' search for revitalizing information, one may focus on strategic and operational possibilities as guidelines for the recovery of sales-starved organizations. One possibility to improve sales figures is to refocus marketing. Refocusing marketing requires such actions as foregoing market share development for improved profits while protecting current franchises, raising prices even at the expense of volume, paring down advertising budgets, eliminating low-contribution products, and stalling the introduction of new products (unless they have the promise of being sure winners). Another strategic possibility to consider is the selling or liquidation of whole business units. While the core business is closely protected, and other profitable operations are spared the ax, business units which are currently retained in milking status should be examined for their future potential while those which are currently retained for rehabilitation are ripe to be taken off their life support systems. This possibility suggests that from a priority perspective,

**$H_1$** A turnaround manager is more likely to source information for the purpose of downsizing than to refocus marketing.

Downsizing involves reintegrating work processes and delegating traditional managerial duties to small groups of frontline people. In turnaround management, this could involve setting up new team environments -- involving through redesigns of frontline jobs, work processes and systems, and management roles. A turnaround manager in this new environment needs to develop self-motivated people who in their diversity generate and implement their best ideas. The strategy is to champion cross-functional efforts to improve productivity, quality and service, with the ability to anticipate, start and respond to challenges (Zenger et al. 1992).

As the Ricoh experience shows, rather than refocusing marketing, the prime goal is to slash the number of products and parts which are not financially successful. In addition, executives for the remaining products are given a limited time within which to ensure profitability for their products (Friedland 1992). To clamp down on bureaucracy and high costs, the turnaround manager analyzes the work that needs to be done and the number of people needed to accomplish the new goals. The emphasis is on identifying and eliminating redundant layers of management and workers (MacKenzie 1992) because this gives a quicker infusion of cash to the balance sheet. Refocusing of marketing, while helpful, is not so immediate in its financial improvement of an organization which is on the brink of bankruptcy.

Given such an inward-looking perspective,

**$H_2$** A turnaround manager is more likely to source the company's management information system than the company's customers, for information.

The consideration of acquiring other business units and expanding the customer base is premature at the crisis stage because it threatens to absorb the scarce resources available and worsen the company's precarious situation.

Even if the institution needs marketing information, it may not look beyond its files if expediency and finance constrain its turnaround strategy. For example, banks operating in such an adverse situation may tap into new account forms, general ledger accounting systems and data processing files, certificates of deposit maturity schedules, central marketing information files, and officer call

program reports. From a marketing standpoint, the central information file is probably the most valuable source of customer information (Motley 1990).

The possibility of reducing expenses, whether through downsizing or sacrificing external consumer studies, is usually quicker to attain than to meaningfully increase sales. An examination of administrative, marketing, research and development costs will show to what extent the organization may be flattened and support withdrawn from activities which are not producing positive cash flows. An operational possibility is the cutting of costs by reducing direct and indirect materials, labor and overhead costs through efficiency measures or elimination of unprofitable product lines. An increase in sales, to the extent that it is pursued, usually emphasizes the generation of revenues by increasing dollar sales, possibly through price hikes. The accent is on dollar sales rather than unit sales because during the crisis stage, cash flow supersedes market share considerations. For a moribund patient, survival is paramount to other considerations. Cash flow is the lifeblood of the organization, and given that cutting down costs in a financially-strapped organization is usually a more successful possibility than increasing revenues,

**$H_3$** A turnaround manager is more likely to ask for information about cutting costs than about increasing revenues.

Cost control may range from an integral aspect of a highly successful turnaround process to a vacuous and dangerous approach which further damages the organization. To cut down on costs, turnaround managers examine the relationship between the costs and the revenues supported by the costs. They identify quality and cut costs as long as such cutting does not impinge upon quality. A successful cost-control program improves the organization's historical expense management record (Ward and Woosley 1991).

High inflation rates in the 1970's covered up many sales problems and cash hemorrhaging (Marks 1991). This cover-up is increasingly difficult in the 1990's where "a turnaround requires that management's belief that profitability and operational problems will be solved by planning and increased sales margins be dispelled" (Daughtrey 1991). Nowhere is this more acutely visible than in the long-term care service sector where immediate and significant increases in profits are virtually nonexistent: most LTC services are not reimbursable. Hence, cost control is the main emphasis in managing LTC facilities (Giardina et al. 1990). Tight cost control suggests that,

**$H_4$** A turnaround manager is more likely to ask for information from suppliers than from external data bases.

Suppliers may not only provide highly relevant information (Reimann 1992), but may also supply it for free, unlike external data sources. Besides, the service of external data sources may at times be provided by in-house information systems. Suppliers have every incentive to cooperate with management as long as turnaround success guarantees long-term sales and financial reimbursement for the suppliers.

Tight control is an intensive operation where every cash outflow transaction needs the approval of the turnaround manager who must constantly be updated about the cash balance. The urgency of the situation suggests that:

**$H_5$** A turnaround manager is more likely to adopt a current rather than a future time horizon in the analyses of information.

Eisenhardt (1989) observes that in a high velocity environment there is a premium on quick decision-making. Decision speed directly affects the organizational performance in such environments (Bourgeois and Eisenhardt 1988). Such speed is described by Hickson et al. (1986) as a differentiating characteristic in strategic decisions.

It is in this context that Monroe (1992, p.42) describes the turnaround effort at Blue Cross of California in the mid-1980s:

*"Leadership is in a turnaround is extremely important but has a very short-term focus. The way to get things done in the survival stage is with hub-and-spoke leadership... 'do it now' ... When the wolf is at the door every day... the top team roles demand control, an eye for detail and involvement."*

In the words of Lurie and Ahearn (1991), a turnaround manager has to act quickly, often without the benefit of long analysis and almost invariably with risk.

## Research Methodology

To test the above hypotheses, the cooperation of the Turnaround Management Association was ensured in collecting data from its members. As a first step, the Association recommended fourteen highly-qualified managers to help in the development of a questionnaire. The managers were presented with several classes of informative ratios culled from the turnaround literature (cf.

Robbins and Pearce 1992) and asked about their information needs. As Table 1 shows, financial analyses ratios use balance and income statements to measure productivity (return) of financial resources; working capital analyses concentrate on liquidity and productivity (turnover) of current assets and liabilities; cost and expense analyses concern operating efficiencies; personnel and asset analyses deal with productivity of human and physical resources; and market analyses measure productivity of outputs. Twenty-five ratios from the above classes were selected by the pilot group as being important for turnaround information needs.

Table 1

TURNAROUND INFORMATION

| |
|---|
| FINANCIAL ANALYSES |
| 1. Balance Sheet |
| 2. Income Statement |
| WORKING CAPITAL ANALYSES |
| 3. Cash Flow |
| 4. Accounts Receivable |
| 5. Secured Debt Due |
| 6. Accounts Payable |
| 7. Credit Available |
| 8. Inventory |
| 9. Notes Payable |
| 10. Notes Receivable |
| MARKET ANALYSES |
| 11. Sales/Product |
| 12. Sales/Customer |
| 13. Competition |
| 14. Industry |
| COST ANALYSES |
| 15. Materials/Product |
| 16. Labor/Product |
| 17. Overhead/Product |
| 18. Purchases/Product |
| PERSONNEL ANALYSES |
| 19. Management |
| 20. Employee |
| ASSET ANALYSES |
| 21. Machines & Equipment |
| 22. Land & Buildings |
| EXPENSE ANALYSES |
| 23. Sales Exp/Product |
| 24. General Exp/Product |
| 25. Admin Exp/Product |

Sources: H. R. Kibel, How to Turnaround a Financially Troubled Company. New York: McGraw-Hill, 1982; and R. S. Sloma, The Turnaround Manager's Handbook. New York: The Free Press, 1985.

Next, a questionnaire using a spreadsheet format and including the twenty-five ratios was mailed to the Association's turnaround managers. The questionnaire asked the respondents to write down for each ratio their reporting interval, the time horizon involved, and the sources of information. Thus, for each ratio, the respondents had to reply whether they primarily sourced the information for cost cutting purposes as opposed to increase revenues, and so on.

Cover letters from one of the researchers and the Turnaround Management Association were enclosed with the questionnaire. The initial and follow-up mailings produced ninety-nine responses, equivalent to about a sixty-seven percent response rate.

The hypotheses were tested on the basis of the replies, using a paired difference experiment form. Each type of report was paired for every hypothesis, and the difference analyzed. Neter, Wasserman and Kutner (1985) observe that blocking as a form of restricted randomization in paired difference experiments reduces experimental errors. Blocking is superior to complete randomization in producing more precise results. It is superior because it sorts the experimental units into groups whose elements are homogeneous with regards to the dependent variable. This statistical procedure assures that the between-groups differences are as great as possible.

**Results**

Following McClave and Benson's (1985) suggestions about paired difference experiments, one-sided alternative hypotheses were used in order to determine whether for each of the five hypotheses, $\mu_1$ exceeded $\mu_2$.

The elements of a paired difference test may be expressed statistically as:

$$H_o: \mu_D = 0 \quad (\mu_1-\mu_2=0)$$
$$H_a: \mu_D > 0 \quad (\mu_1-\mu_2>0)$$

The test statistic, $t = \frac{\overline{x}_D - D_0}{S_D\sqrt{n_D}}$

was selected on the assumption that the population of differences' relative frequency distribution was normal, and that the differences were randomly selected from the population of differences. Given that the tests were upper-tailed, $H_o$ was rejected every time that

$$t > t_a = t_{.05} = 1.711$$

where $t_a$ was based on $\eta_D$-1 = 24 degrees of freedom. Table 2 shows the calculations computed for each of the hypotheses, using $X_{Di}$ to represent the ith difference measurement.

TABLE 2

PAIRED DIFFERENCE TEST OF TURNAROUND HYPOTHESES

| | $\sum_{i=1}^{25} X_{Di}$ | $\sum_{i=1}^{25} X^2_{Di}$ | $\overline{X}_D$ | $S_D^2$ | $S_D$ | t | |
|---|---|---|---|---|---|---|---|
| $H_1$: Downsize vs. Refocus Mkt | 21 | 15,239 | 0.8 | 634.2 | 25.2 | 0.2 | |
| $H_2$: MIS vs. Customers | 957 | 52,787 | 38.3 | 673.0 | 25.9 | 7.4 | * |
| $H_3$: Cut Costs vs. Increase Revenues | 237 | 18,793 | 9.5 | 689.4 | 26.3 | 1.8 | * |
| $H_4$: Suppliers vs. External | -42 | 3,936 | -1.7 | 161.1 | 12.7 | -0.7 | |
| $H_5$: Current vs. Future | 1095 | 51,041 | 43.8 | 128.3 | 11.3 | 19.6 | * |

* Significantly different at $t_{.05}$ with 24 df (= 1.711)

The calculated t's in the above table show that at $\alpha$=.05 only three of the hypotheses hold. Thus, one can state with 95 percent confidence that a turnaround manager is more likely to source the company's management information system than customers for information, and more likely to source information for the purpose of cutting costs rather than increasing revenues. The manager is also more likely to adopt a current instead of a future time horizon. Support for these hypotheses underlines the urgency of the situation as the turnaround manager seeks to save the organization in a frenetic race against time. In Hofer's (1983) words, "the situation is so critical that if action is not taken quickly, disaster is a certainty."

Of the unsupported hypotheses, the most surprising was the one concerning downsizing as opposed to marketing refocus ($H_1$). This was surprising given that the urgency of turnaround situations led us correctly to believe that cost cutting was a major priority in turnaround situations ($H_3$). Turnaround management is usually assumed to give a lot of prominence to downsizing, downscoping or retrenchment, terms which emphasize asset reduction to stop the financial drain on the company (Robbins and Pearce 1992). It could be that the terms "downsize" and "refocus marketing" were somewhat vague, even though the terms were approved in the pilot study. With regards to the lack of support for $H_4$, this could be due to strained relationships between suppliers and the failing corporation.

## Conclusion

During the 1980s, increased competition, limited resources, escalating costs, and turbulent markets caused sudden financial crises in some firms. A new type of professional emerged to guide these firms back to profitability and growth.

Complaints from the members of the Turnaround Management Association motivated this research. They complained that at the onset of their engagements, important information was usually not available, and available information was usually not much useful for diagnosing and prescribing cor-rective actions. Equally troubling was the lack of research describing their information needs and their use of information during these engagements.

This study described some of the salient information needs and identified a set of priorities. Among other things, it established that during financial crises, turnaround managers are more likely to source the company's management information system than the company's customers. Such finding undermines the marketing cliche that the customer is always the best source of information. The study also showed that cutting down costs in a financially-strapped organization enjoys a higher priority than increasing revenues. Again, marketing's emphasis on sales may not be as applicable in turnaround situations where cost cutting is of paramount importance. The third finding confirmed the hypothesis that in the high velocity environment of turnarounds, managers are more likely to source information for a current instead of a future time horizon.

These three findings share one thing in common: resources are so scarce in financial crises that turnaround managers have to prioritize what information to look for. As Eisenhardt (1989) observes, there is a premium on quick decision-making. Quick decision-making, on the basis of this study, demands that a company in turmoil should quickly spruce up or redesign its MIS system to answer the most relevant queries expected in a turnaround situation; it should start a re-engineering process by gathering information about the most suitable areas for cost-cutting; and tap into current information rather than source into future oriented information which may be too remote for the pending corporate collapse.

**Suggestions for Future Research**

Despite shedding important light about managerial reactions to save failing firms from financial disaster, the study only begins to unravel the information sourcing experience in turnaround situations. It leaves unanswered questions with regards to the unsupported hypotheses, and in hindsight makes the researchers question their decision not to include open-ended questions in the final questionnaire. The respondents were highly educated, and their expressed opinions to open-ended questions would have enriched the researchers' interpretation of statistical results through the inclusion of quotes from representative responses.

Future research along the lines pursued in this study would do well to examine also to what extent turnaround managers make an explicit adjustment for risk in their information sourcing. Although managerial studies (e.g., Albaum et al. 1979, Swalm 1966) suggest that few managers explicitly take risk into consideration, it would be beneficial to know whether turnaround consultants are as averse to such explicit adjustments. Measuring the utility function of decision-makers is not a forbidding exercise (Baumol 1977) and has the additional benefit of making managers better aware of the potential worth of their projects (Tull and Hawkins 1984).

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