Companies in Distress and their Turnarounds: A Guide to Business Continuity

University of Cape Town Graduate School of Business

In Partial Fulfilment of the Master of Business Administration

Ryan Sherring
9/12/2011

Financial Distress, Company Turnarounds, Strategy
Declaration

This thesis is not confidential and may be used freely by the Graduate School of Business.

I wish to thank my family whose support made this possible.

I extend my gratitude to Dr. Chipo Mlambo of the Graduate School of Business for her valuable advice and supervision over my research. I would also like to thank all those interviewed who gave so generously of their time and who contributed interesting and detailed insights and discussions.

I hereby certify that except where noted the thesis is my own work and all references used are accurately reported.

Signed ____________________________ 9th December 2011

Ryan Sherring
Abstract

There are many reasons companies find themselves in distress. Companies operating in a competitive market with constantly changing consumer needs may not adapt quickly, which could result in the company experiencing financial difficulties thereby threatening its existence.

This paper examines two fundamental elements relating to this threat, exploring each in turn and assessing where it agrees or deviates from the theory. The two elements explored are the prediction of financial distress and the methods used in turning the company around.

Each aspect is investigated through the eyes of both theory, and those of practitioners who have experienced firsthand the requirements in the South African context. This paper provides methods, frameworks and practical approaches with specific tried and tested actions, used in conducting a successful turnaround.

To provide context, the paper provides a brief background to South African business and the country’s social issues. It provides some explanation on the much talked about and very recent Chapter 6 of the New Companies Act, which defines the legal requirements which must be met in all aspects of the business rescue.

There is very little knowledge on turnarounds in South Africa. For this reason the topic of this paper is broad in nature, although deeper empirical evidence will be investigated where applicable.
<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>8.1</td>
<td>Appendix 1</td>
<td>73</td>
</tr>
<tr>
<td>8.2</td>
<td>Appendix 2</td>
<td>74</td>
</tr>
<tr>
<td>8.3</td>
<td>Appendix 3</td>
<td>75</td>
</tr>
<tr>
<td>8.4</td>
<td>Appendix 4</td>
<td>76</td>
</tr>
</tbody>
</table>

8 Appendices

8.1 Appendix 1

8.2 Appendix 2

8.3 Appendix 3

8.4 Appendix 4
1 Introduction

1.1 Research Area and Problem statement(s)

The issue of companies becoming insolvent is an ongoing concern for all stakeholders. Often these situations can be prevented with an early diagnosis and a proactive plan. In ensuring business continuity in a struggling company, two key elements are required in preventing a company from insolvency. These two elements are explored in the context of:

1. Failure prediction models and methods and
2. Methodologies of company turnarounds exercised by practitioners

This paper serves to explore both these areas by providing insight from practitioners who have tried and tested these methods in real situations. Although the emphasis of this paper is on turnaround methodologies it is important to recognize when a company is in need of such action and therefore identify financial distress early on. For this reason we will explore failure prediction methods.

1.2 Financial Distress Prediction

So what does financial distress mean? Due to its subjective nature it is difficult to define financial distress. Chapter 6 of the Companies act 2008 states the following:

- “Financially distressed: in reference to a particular company at any particular time, means that:
  - (i) it appears to be reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months; or
  - (ii) it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months”

The prediction of financial distress serves as a signal to warn failing companies, an increasingly common occurrence, that there is a need for action. With a constantly changing environment in
which businesses operate, it remains progressively more challenging for many businesses to continually function profitably, which can often lead to companies going into liquidation. Excluding the challenges of global or local recessions, companies are faced with fluctuating business cycles, increased global competition, limited resources and changing consumer tastes, coupled with pressure from shareholders, boards of directors and concerned financial institutions. Many previously profitable firms now face serious financial difficulties.

Li-Jen Ko (2001) explains that “the economic consequence of corporate failure is enormous, especially for the stakeholders of public companies. Prior to a corporate failure, the firm’s financial status is frequently in distress. Consequently, finding a method to identify corporate financial distress as early as possible is clearly a matter of considerable interest to investors, creditors, auditors and other stakeholders.”

One common method of financial distress prediction is financial ratio analyses. Financial ratios are comprised of financial data sourced from the company’s own financial statements. These ratios are not only used to aid in identifying financial distress but can also be used as a tool to monitor the financial health of the company, during and after action has been taken to correct the decline in performance. The two primary financial statements required are the Statement of Comprehensive Income (formally known at the Income Statement) and the Statement of Financial Position (formally known as the Balance Sheet). Using financial ratios one can explore other methods of financial distress prediction using various models.

“The theoretical literature on financial distress is couched in complex models. However, the underlying concepts are straightforward and can be conveyed by relatively simple models. Also, despite their apparent generality, the predictions of the theoretical models are dependent upon their underlying (explicit or implicit) assumptions or postulates.” (Yehning Chen, Weston, & Altman, 1995)

“In the last 60 years there has been extensive research regarding the prediction of corporate bankruptcy, producing a number of valuable multivariate and uni-variate financial models. (Ohlson, 1980; Deakin, 1972; Altman, 1968). Beaver (1966) presented a paper in which he used
accounting-based measures as variables to predict bankruptcy and showed that financial ratios provide early warning signals. Follow-up studies drew vast attention to various factors associated with bankruptcy probability.” (Hsueh-Ju Chen, 2009)

“Due to their complexity, insolvency predictions were, in the past, confined to the academic world. A possible reason why insolvency prediction models did not gain greater use in the business community is because the results were difficult to calculate. This, however, changed with the easy to use Altman model. Edward Altman was the first person to successfully use step-wise multiple discriminate analyses to develop a bankruptcy prediction model with a high degree of accuracy. Altman's model achieved an accuracy rate of 95.0%, one year prior to default and 75%, two years preceding default.” (Bankruptcy Prediction Models, 2011)

“The Altman model applies statistical techniques (Multiple Discriminant Analysis) to a combination of financial ratios which produces a score (Z-Score) representing the overall financial health of the company. The Z-Score serves to highlight the analytical as well as the practical value inherent in the use of financial ratios. Specifically, a set of financial and economic ratios will be analyzed in a corporate distress prediction context using a ‘multiple discriminant’ statistical methodology.” (Altman E. , 2000). Z-Scores are not limited in their application, but are somewhat inclusive. There are three Z-Scores which cater for both the legal state of the company as well as the industry in which the company operates. The choice of Z-Score methods is used to address companies that are listed or unlisted and/or those involved in manufacturing or non-manufacturing. This method has been empirically tested and for this reason it is a widely accepted distress prediction model.

The Z-score is a signal to the company that a turnaround or, in dire circumstances a business recue, is necessary. With the use of the Z score it is easy to see how the company is performing. Ideally, the commencement of the turnaround should be initiated when the Z-Score starts declining, and at the latest when a business enters the Danger Zone. However, in practice, turnarounds tend to suffer from late starts. Once in the Failing Zone, the business, in the absence of turnaround action, has a 95% probability of being insolvent within a year.
The Altman model changed bankruptcy prediction and since 1968 there have been a number of financial prediction models based on this model. One such model, the Springate model, developed in 1978, came close to achieving an accuracy of 92.5% in the year prior to default. Other, similar models, with lower proven accuracies were also developed such as the Basztk System and the CA-Score, all based on the Altman model. None however are as accurate as the original. As this paper is concerned with accurately predicting and identifying companies in distress, the model we will explore on is the Altman model.

1.3 Business Rescue and Company Turnarounds

It is important to specify what the terms ‘Business Rescue’ and ‘Company Turnaround’ mean, as they are both terms that are open to interpretation. Turnaround situations vary according to the degree of distress, intervention by creditors, and legal considerations. A ‘Soft Turnaround’, hereafter referred to as a company turnaround, is a business transformation where although the company is underperforming there is no real threat of pending failure. Business transformations experience early indicators which serve to highlight moderate underperformance. A more robust turnaround is required when severe underperformance is identified which requires emergency management to stabilise the crisis. If however, the company is close to or has already failed, that is, the company is insolvent or near insolvency, the turnaround takes place within the legal framework. This is a business rescue. Keith Braatvedt (2009), from the legal firm Eversheds, describes a "business rescue" as “the proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for certain procedures. The concept of business rescue is designed to provide a mechanism to a company that has indicated financial difficulties but has not yet reached the stage of insolvency.”

Recently established South African legislation by way of Chapter 6 of the Companies Act 2008 defines a business rescue as:

“The proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for:
- the temporary supervision of the company, and of the management of its affairs, business and property
- a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and
- the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company’s creditors or shareholders than would result from the immediate liquidation of the company.”

“Chapter 6 business rescue legislation represents a codification of the turnaround procedures, followed in workout in the informal sector, but is designed to overcome a number of practical problems faced by a workout, and to protect the interests of all stakeholders.” (van der Walt, 2010)

Although similar to a business rescue, a corporate turnaround is somewhat different. A corporate turnaround is defined as “The implementation of a set of actions required to save an organisation from business failure and return it to operational normality and financial solvency. Turnaround management usually requires strong leadership and can include corporate restructuring and redundancies, an investigation of the root causes of failure, and long term programmes to revitalise the organisation.” (BNET Business Dictionary). Stanley J. Goodman specifies that the objective of a turnaround is “To produce a noticeable and durable improvement in performance”.

Although business rescue and company turnarounds share a common theme and approach, there are a number of important differences between them such as the management required, the management style necessary, stakeholder management involved, change management processes and the pace of execution required. Both do however, have many similarities and for this reason, the research has been conducted and assessed on both concepts together.
1.4 The importance of corporate failure prevention in South Africa

So why has the new Companies Act of 2008 provided legislature offering some guidance as to the proceedings of company turnarounds? Why has corporate turnarounds received so much attention recently? Why is it so important to South Africa that company failures are controlled and prevented?

Company failures have recently become topical in South Africa and much focus is dedicated to what can be done to prevent this occurring. It is clear that companies operating within clearly defined ethical boundaries play a huge role in any economy. Depending on variables such as size and industry, the implications of a failed company extend to all areas of the economy affecting shareholders and employees, clients and suppliers and of course creditors and debtors. It is imperative that these businesses continue to operate profitably.

Companies operating in South Africa serve many crucial purposes. They provide products and services to its citizens and other businesses. Companies are able to do this because they procure, manage and organise the production of a wide variety of resources, which individuals could not otherwise do, so as to satisfy demand. (Schrumpter, 2010) Without those products and services, both the population and companies are affected, possibly leading to the closure of those dependant companies. Secondly, governments’ primary source of income is obtained through revenue tax received by companies operating in South Africa who pay tax to government. This revenue is used for providing essential services such as security, energy, clean water and education for those citizens. In the 2010/11 tax year alone, the South African Revenue Service (SARS) collected a total sum of R647 billion. This being comprised of both corporate and income tax, which companies and employed individuals must pay. The importance of taxation extends past providing revenue to fund the public sector to investments and sustaining the essential needs of the populace. (Fjeldstad, 2009) Less tax means a smaller budget which inevitably leads to a reduction in services or a decline in service quality. For this reason it is imperative that companies continue to operate. Thirdly, there are macroeconomic factors at play too. Governments borrow money to build infrastructure such as roads, bridges and hospitals. This money is loaned and must be repaid with money collected by taxation.
The fourth reason and perhaps the most critical is that companies also provide employment, a serious consideration in South Africa, infamous for its disproportionate level of unemployment. Unlike developed countries, South Africa faces a significant socio-economic dilemma in the form of unemployment. “High unemployment and negligible job creation characterise South African labour markets” (Lewis, 2001). Both the public and private sector work together to try alleviate this pressing issue. Schumpeter (2010) puts is plainly “Companies routinely employ thousands of workers”. According to data collected from the Reserve Bank of South Africa, the official, strict unemployment rate is 23.3% with the unofficial or expanded unemployment rate at 36.2%. This highlights the socio-economic predicament South Africa is challenged with. Of those South Africans employed, approximately 70% are employed by companies, a significant proportion.

Government is not the only party concerned with the health of South African companies. The fifth, and by no means last reason, are external stakeholders. With more efficient markets and more enlightened investors, companies are coming under more scrutiny as the spotlight is placed on business performance and continuity. “Shareholders and employees have a common interest in the success and growth of the business. Local community, employees and shareholders benefit” (tutor2U, 2011). It is with that in mind that South African companies and their stakeholders were in support of the overdue government legislation that would advance business rescue.

As discussed failing companies have dire consequences on the entire economy and it is essential that there are methods and frameworks in place to prematurely detect financial distress and prevent companies from going insolvent and ceasing to operate.

“Chapter 6 of the new Companies Act of 2008 introduces, for the first time in the South African context, business rescue and the appointment of a ‘supervisor’ or, as used in this text, the ‘turnaround manager’. Turnaround managers are consultants who specialize in saving distressed firms from failure. They are management specialists who resolve financial crises and rehabilitate failing firms, regardless of the industry in which the firm is involved.” (Fredenberger, Lipp, &
Watson, 1997) “The broad intention of Chapter 6 of the act is to create a more conducive, debtor-friendly environment for successfully achieving business rescues. Chapter 6 does have apparent shortcomings, which will open opportunities to exploit loopholes, as case law will not be in evidence for several years at least. It is therefore prudent for a prospective turnaround manager to be cognisant of these opportunities and to accept the liability of these legal loopholes.” (Pretorius & Holtzhauzen, 2008)

The purpose of this section is to examine tested, workable methodologies and frameworks rooted in theory, compared to those practices utilized by industry practitioners in company turnaround and business rescue situations efficiently.

1.5 Research question(s) and Scope

In the last 5 years 17,602 South African companies were liquidated, shedding thousands of jobs and destroying economic value. The purpose of this paper is to explore what proactive, preventative measures can be taken to avoid this happening in the future. To do this we need to ask the following two questions:

1) How can companies identify poor performance early, thus avoiding financial distress and ultimately bankruptcy?
2) When a company is distressed, what practical steps, by way of strategic methodologies, can be taken to turn the company around?

From the two root questions above we will explore a number of sub-questions:

1. What are the primary causes for companies in South Africa becoming distressed?
2. What methods are used in industry to assess the financial health of companies and ultimately facilitate bankruptcy prediction?
3. What methods or frameworks are being used in conducting a turnaround?
4. What are the main challenges that companies face when performing a turnaround solution?
5. What is the leadership role of the turnaround specialist?

6. What requirements regarding the future strategic focus and organisational change are necessary?

In answering the first question, how can companies identify poor performance and therefore predict financial distress, we will explore two methods making use of financial data sourced from companies’ financial statements. The first method discussed is the analysis of financial ratios. “Financial ratios are a comparison of financial statement numbers to each other. They help a business owner to analyze current operations and predict the future performance of the company. Various financial ratios can present measures of liquidity in the business, speed of sales, and debt levels, amongst other benchmarks. Ratios tell the financial story of a business.” (Mohr, 2011)

The second method of financial performance prediction is done using the Z-Score, a statistical technique known as *Multiple Discriminant Analysis*. Using a combination of ratios a score is calculated representing a measure of the firm’s financial health. Z-Scores are adaptable and by adjusting the variables, this technique can be applied accurately to public or private companies as well as manufacturing and non-manufacturing companies.

The second question explores the frameworks and methodologies that can be used in practice to assist in the company turnaround process. Although there are a number of models that practitioners base their work on, we will focus on the more popular Slatter and Lovett turnaround model. We will examine where practitioners differ and where the framework is not followed, and explore whether it will be more useful in practice than alternative methods being used. “A successful turnaround depends on developing an appropriate turnaround prescription and effective implementation. The first point addresses “what” needs to be done and the second point addresses “how” to do it.” (Slatter, Lovett, & Barlow, 2006)

1.6 Research Assumptions

The assumptions are primarily related to the second section of the study, that of company turnarounds. Due to the nature of the turnaround industry there is not a large group of
practitioners. This is due to the early stage of this industry as well as the legal professional requirements stipulated to practice in this field. It is assumed that there will be sufficient willing practitioners to supply information.

A second assumption is that during this research companies and practitioners will be willing to participate and share valuable information and thus contribute to this research. There is a stigma attached to financial distress which could alienate companies and prevent practitioners from contributing sensitive data.

1.7 Research Ethics

Ethical considerations may preclude the identity of parties involved in providing information to this research. For this reason anonymity is respected. The information provided is of a sensitive nature and where permission is not given, data remains confidential. Data will be represented in an encoded format as a result. All interviews conducted will be treated as confidential with data and transcripts only being released with the permission of the respondent in question. As part of the requirement for UCT submission of the research report, a clearance certificate has to be signed by the researcher.

2 Literature review

2.1 Introduction

“Businesses of today are confronted with unique challenges caused by rapidly changing financial and market conditions. The rapid growth conditions that companies experienced during the 1990’s have been replaced with financial and market uncertainty. Previous business models are not applicable to business in the twenty-first century. The current business environment is one of unpredictable instability, which can lead a business into rapid decline if its management does not understand and interpret the signals. Long before a business commences its decline, warning signals start flashing however managers often do not notice or explore the red lights but rather ignore them.” (Scherrer, 2003)
What exactly are the warning signs present which companies fail to notice? What methods are available that enables managers to take a more proactive approach in recognising the deterioration of a company’s health? What practices exist that allow managers to act in ensuring companies do not experience prolonged financial decline by actively identifying and implementing remedial actions ensuring the company returns to a profitable state.

There are many methods and models available to measure the health of a company and ultimately predict bankruptcy however this study will focus on two popular methods used by practitioners in industry, namely financial ratio analysis and the Z-Score.

Financial ratios are derived from company financial statements and reflect the way the company operates in terms of liquidity or solvency, profitability, asset management and debt management. Using a variety of financial ratios in each of these categories one can explore the status of the company and make comparisons to other players in the same industry. Due to the large amount of information presented in financial statements and since a ratio is simply one number divided by another, this opens up the investigation to a wide variety of ratios one can choose from. In this study we will seek to identify specific ratios used in the turnaround process and thereby deemed essential, in identifying and understanding a company’s financial health.

The second method is a common industry technique used not only in the identification of companies which may be experiencing financial distress, but provides a longer term view used in accurately predicting bankruptcy. “The Z-score formula for predicting bankruptcy was published in 1968 by Edward I. Altman, who was, at the time, an Assistant Professor of Finance at New York University. The formula may be used to predict the probability that a firm will go into bankruptcy within two years. Z-scores are used to predict corporate defaults and an easy-to-calculate control measure for the financial distress status of companies in academic studies. The Z-score uses multiple corporate income and balance sheet values to measure the financial health of a company.” (Wikipedia, 2011)

Understandably these financial models are extremely useful in identifying financial distress but what can this information be used for? What remedial action can be taken to turn a companies’
situation around and why is this so much more important to South Africa as opposed to countries such as the U.S or Canada? South Africa is not without its share of corporate bankruptcies and previous legislation did not cater for ailing companies in their recovery. Historically the process of business turnarounds has not been very successful in South Africa. “While most corporate defaults aimed at rescue are reportedly handled on an informal basis, the system is hampered by having no centrally supported guidelines to support informal restructurings. On the formal side, compromises (schemes of arrangement) were not widely used due to the cumbersome nature of the procedure, high creditor approval thresholds, and other limitations in the statute, some of which have been addressed in the new Companies Act, which came into effect April 1, 2011. The judicial management procedure was even more impractical as a business rescue mechanism, numbering on average about two cases annually. This was repealed by the new Companies Act.” (Gordon W. Johnson, 2010)

This study extends passed the early stage of merely identifying struggling companies and explores the preferred methods that can be adopted to assist in returning the company to a profitable state. There are several popular models used by practitioners when conducting a company turnaround however this paper has identified one popular model which will be explored in detail.

2.2 Legal Framework and Policy

The South African legal framework relating to liquidation and bankruptcy has evolved since its first inception. “Bankruptcy is best addressed by a comprehensive and integrated system to address issues of insolvency. In South Africa, the law has evolved differently and there was no integrated approach where an insolvent could move seamlessly from business “rescue” to “liquidation”. There are no less than six laws previously governing company exit, business rescue and insolvency procedures.

- Companies Act 61 of 1973, governing winding-up procedures for companies, unless insolvent.
- Companies Act 71 of 2008, soon to become effective, repealing the former
- Companies Act with some exceptions and governing compromises (schemes of arrangement) and a new business rescue process (Ch 6).
- Close Corporations Act 69 of 1984, governing liquidation of close corporations, with the administrative process being defined, at least in part, by reference to the Companies Act.
- Insolvency Act 24 of 1936, governing procedures for insolvent companies, consumers, partnerships and other juristic entities.
- Magistrates’ Court Act 32 of 1944, governing procedures for administration orders.
- National Credit Act of 2005, regulating the process of debt restructuring for individuals (consumers) with respect to credits governed by the NCA."

“The multiplicity of laws and procedures added to the legal and regulatory complexity and did not provide for seamless treatment of an insolvent. Moreover, multiple courts exercise independent, or in some cases concurrent, jurisdiction over matters. Johnson (2010) explains how the new Companies Act introduces a more modern and flexible business rescue procedure to be administered by newly designated and certified business rescue practitioners.”

“The proposed Chapter 6 legislation draws mainly on existing legislation from Canada and the United States of America (USA) and to a lesser extent also on Australian experience. The USA and Canada seem to be at the forefront of turnaround legislation and models. In the USA, the well-known Chapter 11 proceedings are well debated and reported in the literature. The International Association of Certified Turnaround Professionalism, situated in Chicago, USA, is an international organisation dedicated to developing, monitoring and maintaining a programme for the certification of professionals that engage in turnarounds. There are chapters of the association in various countries abroad, of which South Africa is one of the latest additions.” (Pretorius & Holtzhauzen, 2008)

The new companies act highlights a number of benefits for stakeholders. “Board members may resolve that the company voluntarily begin business rescue proceedings and place the company under supervision, if the board has reasonable grounds to believe that either the company is financially distressed or there appears to be a reasonable prospect of rescuing the company. In the event that the company does not voluntarily begin rescue preceding any person affected may
apply to a court at any time for an order placing the company under supervision and begin business rescue proceedings.”

The act also functions to protect employees. “In the event of a business rescue, employees of the company immediately before the beginning of those proceedings continue to be employed on the same terms and conditions, except to the extent that changes occur in the ordinary course of attrition; or if the employees and the company, in accordance with applicable labour laws, agree different terms and conditions. Chapter 6 states that companies involved in a business rescue must appoint a turnaround manager. The practitioner, after consulting the creditors, other affected persons, and the management of the company, must prepare a business rescue plan for consideration and possible adoption at a meeting held in terms of section 151. The business rescue plan must contain all the information reasonably required to facilitate affected persons in deciding whether or not to accept or reject the plan, and must be divided into three parts, containing the background, proposals and assumptions and conditions.” It is the implementation of the approved proposal upon which the strategy will be designed and constructed using a turnaround model or framework.

2.3 Review of Financial Models

What does financial modelling mean? A common theme among definitions holds that a financial model constructs a financial representation of the firm in question, from which a clearer, more concise information requirement can be deduced.

“The past 50 years have witnessed a number of publications exploring this subject and extending conventional models for prediction. In 1996, William Beaver explained how financial ratios, obtained through accounting based measures, were used to provide early warning signals and accurately predict bankruptcy. Follow-up studies drew attention to various factors associated with bankruptcy probability. A group of researchers (Bhargava, Dubelaar, & Scott, 1998; Ketz, 1978; Laitinen & Laitinen, 2000; Norton & Smith, 1979) based their work largely on financial data, focusing on variables obtained from adjustment statements and cash flow. Other researchers, alternatively, had great interest in applying non-financial information to bankruptcy
forecast models. For example, Becchetti and Sierra (2003), and Fabling and Grimes (2005) emphasized macro-economic variables; Donoher (2004) stressed the importance of corporate governance, whereas Atiya (2001) indicated that stock price volatility could also provide additional, useful information. However, their results are mixed and are subject to diverse interpretations. One thing holds true: financial ratios are irreplaceable because of their long history in bankruptcy research.” (Hsueh-Ju Chen, 2009)

“Research has also revealed that although there are qualitative underlying factors, financial and statistical data is more robust in being tested for accuracy. Numerous research projects have been conducted to identify early warning indicators of corporate financial distress. In the 60’s, researchers used statistical models to identify financial ratios that could classify companies into failure or non-failure groups. The statistical approach includes uni-variate and multivariate models.” (Li-Jen Ko, 2001)

“An interest in bankruptcy prediction was first aroused by William Beaver in 1966, who utilized the uni-variable analysis technique for use in the investigation. His utilization of the paired-sample approach and the use of a hold-out sample to validate the model has been a benchmark for later researchers. The uni-variable analysis is widely used because of its competitive advantage over simple calculation, its low-cost, easy explanations, and “not bad” performance. However, neither the contradictions nor the possible interactions among the variables are considered by such an approach, which limits its application, and so multi-variable techniques have been subsequently developed. Two years later in 1968, Edward Altman tried to explore a bankruptcy prediction model with more financial statement variables taken into consideration, allowing for the multi-variate discriminant function to be applied to his data.” (Hsueh-Ju Chen, 2009)

“More recently, researchers have used probit and logit methods, which require less restrictive assumptions. However, it remains unclear whether there are potential gains from using probit and logit rather than discriminant analyses, as previous probit and logit studies have not reported tests for misspecification.” (Lennox, 1999)
It is with this in mind that this study will explore the Z-score model in measuring financial
distress prediction, in order to assess both its practicality in the South African context and its
adoption.

2.3.1 Financial Ratio Analysis

Investopedia defines financial ratio analysis as “a tool used by individuals to conduct a
quantitative analysis of information in a company's financial statements. Ratios are calculated
from current year numbers and are then compared to previous years, other companies, the
industry, or even the economy to judge the performance of the company.” (Investopedia, 2011).
“Ratio analysis is very important in fundamental analysis, which investigates the financial health
of companies.” (Farlex Financial, 2009)

A common theme throughout various definitions holds that financial ratio analysis or ‘ratio
analysis’ is a method of analysing a company’s performance using accounting data sourced from
the company’s financial statements. Although accounting data is always historic, by using this
data one can assess where the company is underperforming and therefore identify which area of
the company needs attention. Ratio analysis is a tool used to highlight financial distress before
the problem leads to insolvency. By using the latest financial data available from the period
immediately preceding the investigation, be it final or interim results, will yield the best results.

“The detection of a company’s operational and financial difficulties is a subject which has been
particularly susceptible to financial ratio analysis. Prior to the development of quantitative
measures of company performance, agencies were established to supply a qualitative type of
information assessing the creditworthiness of particular merchants. Formal aggregate studies
concerned with portents of business failure were evident in the 1930's. A recent study involved
the analysis of financial ratios in a bankruptcy-prediction context. This latter work compared a
list of ratios individually for failed firms and a matched sample of non-failed firms. Observed
evidence for five years prior to failure was cited as conclusive that ratio analysis can be useful in
the prediction of failure. The aforementioned studies imply a definite potential of ratios as
predictors of bankruptcy. In general, ratios measuring profitability, liquidity, and solvency
prevailed as the most significant indicators. The order of their importance is not clear since
almost every study cited a different ratio as being the most effective indication of impending problems.” (Altman E., 1968)

There exists a potentially large number of ratios one can obtain using financial statements. The most commonly used ratios which reflect how a company is performing can be summarised as follows:

**Liquidity or Solvency ratios**

Liquidity or Solvency ratios provide information about the company’s ability to meet its short term financial obligations. This figure is particularly interesting to companies in financial distress and to those companies extending short term credit to the company. This is done by comparing a company's most liquid assets, that is, those that can be easily converted to cash, namely its short-term liabilities. In general, the greater the coverage of liquid assets to short-term liabilities the better, as it is a clear signal that a company can pay its debts that are due in the near future and still fund its ongoing operations. On the other hand, a company with a low coverage rate should raise a red flag for investors as it may be a sign that the company will have difficulty running its operations, as well as meeting its obligations.

**Profitability ratios**

Profitability ratios offer several different measures of the success of the firm at generating profits. These ratios, much like the operational performance ratios, give users a good understanding of how well the company utilized its resources in generating profit and shareholder value. The long-term profitability of a company is vital for both the survivability of the company as well as the benefit received by shareholders. It is these ratios that can give insight into the all important "profit".


Asset turnover ratios

Asset turnover ratios measure the operational performance of the company or how efficiently the company utilizes its assets. Asset turnover ratios are often referred to as efficiency ratios, asset utilisation ratios or asset management ratios. These ratios look at how well a company turns its assets into revenue as well as how efficiently a company converts its sales into cash. Basically, these ratios look at how efficiently and effectively a company is using its resources to generate sales and increase shareholder value. In general, the better these ratios are, the better it is for shareholders.

Leverage ratios

Leverage ratios provide an indication of the long term solvency of the company. Leverage ratios measure the extent to which the company is using its long term debt. These ratios also give users a general idea of the company's overall debt load as well as its mix of equity and debt. Debt ratios can be used to determine the overall level of financial risk a company and its shareholders face. In general, the greater the amount of debt held by a company the greater the financial risk of bankruptcy.

Limitations

It is important to note the limitations to financial ratios. Firstly, a reference point is always needed. Ratios must be compared to past data or similar firms in the industry. Secondly, most ratios by themselves are not meaningful. They should be used as indicators in conjunction with one another to describe the whole picture. Thirdly, year-end figures may not reflect accurately due to seasonal fluctuations. Lastly, it is important to acknowledge that ratios are subject to the limitations of accounting methods which due to a variety of accounting choices may result in significantly different values.
2.3.2 Z-Score

The financial distress prediction model which this paper explores is the Altman Z-Score. “The Z-score is a statistical method of predicting financial bankruptcy using five financial ratios. It is clear from research the distinct potential of predicting insolvency using financial ratios. The most prevalent indicators came from those ratios which measured solvency, liquidity and profitability. These findings did concrete important generalisations concerning the trends and performance of certain measurements, however what remained questionable was the adjustment of the results for evaluating insolvency potential. In the majority of cases, a uni-variate methodology was applied, placing a great deal of importance on specific indicators of immanent problems. When presented in this manner ratio analysis is subject to flawed interpretation. Altman (2000), after careful consideration of the nature of the problem and of the purpose of this analysis, chose multiple discriminant analysis (MDA) as the appropriate statistical technique. The MDA technique has the advantage of considering an entire profile of characteristics common to the relevant firms, as well as the interaction of these properties. A uni-variate study, on the other hand, can only consider the measurements used for group assignments one at a time. Another advantage of MDA is the reduction of the analyst’s space dimensionally, that is, from the number of different independent variables to G-1 dimension(s), where G equals the number of original a priori groups. Perhaps the primary advantage of MDA in dealing with classification problems is the potential of analyzing the entire variable profile of the object simultaneously rather than sequentially examining its individual characteristics. The Z-Score model is a linear analysis in that five measures are objectively weighted and summed up to arrive at an overall score that then becomes the basis for classification of firms into one of the a priori groupings, distressed and non-distressed. The five measures are comprised of a number of financial ratios which can be classified into five standard ratio categories namely profitability, solvency, leverage, liquidity and asset turnover. Each area is weighted accordingly and once calculated produces a final Z-score. (Altman E., 2000)

The issue with the Altman Z-Score is that its accuracy was assessed using public companies operating in the United States, a very different market to South Africa. In this regard it is flawed from a South African perspective. In its flexibility, the Altman model was adjusted to cater for
those companies operating in emerging markets. Although South Africa has many developed market attributes it remains an emerging market and as such the Altman model for emerging markets should be used. This may differ according to industry or geographic location.

“Although various alternative multivariate techniques have been used to develop failure prediction models, including quadratic discriminant analysis (Altman et al., 1977), logit and probit (Ohlson, 1980; Zavgren, 1985), non-parametric methods (Frydman et al., 1985) and neural nets (Altman et al., 1994), there is no evidence of significantly superior performance associated with such approaches compared with traditional linear discriminant analysis. The uni-variate normality and homogeneity of variance-covariance assumptions are rarely satisfied in practice, but this does not appear to impact on the classificatory ability of discriminatory models, attributable by Bayne et al. (1983) to its robust nature and non-ambiguous group cut-off scores. For these reasons, and given that the source Z-scores are based on Taffler’s linear discriminant model, then discriminant analysis is preferred.” (Smith & Graves, 2005)

2.4 Review of Turnaround Models

“There has been much research on business continuity and corporate turnarounds. Schendel et al. (1976) were among the first to contend that recovery strategies can be classified into two distinct groups: efficiency-oriented and entrepreneurial-oriented strategies. They argued that if the downturn is primarily due to inefficient operations, then the company should adopt efficiency-oriented recovery strategies such as cost cutting and asset reduction activities. If the corporate strategy is no longer relevant, then the company must make changes so that it is more suited to its current or new market(s); that is, it should adopt entrepreneurial-oriented strategies. Bibeault (1982), Pearce and Robbins (1993) and Arogyaswamy et al. (1995), however, viewed the turnaround process as consisting of two stages: decline stemming and recovery strategies. The primary objective of decline stemming strategies is to stabilise the company’s financial condition and includes actions such as gathering stakeholder support, eliminating inefficiencies, and stabilising the company’s internal climate and decision processes. The severity of the distressed state and the resource slack available ultimately determines the extent to which the decline-stemming strategies are applied and succeed. Once the company’s financial position has
stabilised, it must decide on its recovery strategy: whether or not it will continue to pursue profitability at its reduced size or implement growth-oriented (entrepreneurial-oriented) strategies.” (Smith & Graves, 2005)

In either scenario it is important to distinguish if a successful turnaround is indeed possible. According to legislation a successful turnaround varies from a company operating on a solvent basis to a position where the company creditors benefit more than if the company was liquidated. This leaves a huge gap in the proposition of a successful turnaround. Recognising what is required in achieving the turnaround of a flailing company is another story.

The Slatter and Lovett model is consistent with the efficiency-orientated and entrepreneurial-orientated strategies and decline stemming and recovery stages supported by the theory. Slatter (2006) posits that “a successful turnaround depends on developing an appropriate turnaround prescription and effective implementation. In this approach, one first needs to address what needs to be done and secondly how to do it.” Identify the root causes and design a strategy to resolve them.

Barker and Duhaine (1997) found that “early corporate turnaround theorists argued that strategic reorientations are central to the recovery process at many declining firms. However, subsequent large-sample empirical studies have reported that performance turnarounds for declining firms are primarily associated with cutback actions that increase efficiency, thus creating a gap between theory and empirical findings. In the late 1970s, several streams of research were initiated in the organizational sciences that focused on how firms reverse firm-threatening performance declines. Within strategic management, much of the pioneering work was done by a group of researchers led by Schendel and Hofer (e.g., Schendel et al., 1976; Schendel and Patton, 1976; Hofer and Schendel, 1978; Hofer, 1980). In their models, a firm performance decline is framed as a strategic decision problem to be solved by a turnaround strategy. For this turnaround strategy to be effective in reversing decline, it has to address the declining firm's core problems, which could be either operational (not efficient) or strategic (weak strategic position relative to competitors). They argued that ineffective turnaround attempts often occur when managers fail to successfully diagnose causes of their firm's decline and respond inappropriately (e.g., trying to
increase efficiency when the firm's weak strategic position is the cause of the decline).

Meanwhile, a second group of organization theorists, based on case studies, were modelling firm decline as pathology in organizational decision making and adaptation processes (Hedberg, Nystrom, and Starbuck, 1976; Starbuck and Hedberg, 1977; Starbuck, Greve, and Hedberg, 1978; Grinyer and Spender, 1979a). These researchers proposed that firm-threatening performance declines (e.g., organizational crises) are an inevitable consequence of organizational stagnation over time as managers fail to maintain the alignment of the firm's strategy, structure and ideology with the demands of an evolving and changing environment. Accordingly, successful turnaround from stagnation-caused crisis generally involves an organizational metamorphosis that drastically alters the firm's strategy, structure and ideology to better fit and change with an evolving environment. Despite the different perspectives of these two groups of researchers, their work shares two common themes: both groups asserted first that strategic change is adaptive for firms suffering from performance declines; and second that failure to enact strategic change often explains why some firms are unable to turn around. As presented by these theorists, the adaptive role of strategic change in the turnaround process is based on several important assumptions; one being that a declining firm's performance deterioration is caused primarily by weak strategic positioning. The early strategic management theorists explicitly made this assumption on the basis of their contingency models of turnaround by proposing that when a firm's performance decline stems from inefficient implementation of a sound strategy, a turnaround attempt focusing on increasing efficiency through tactical changes such as cost cutting, asset reductions and sales push campaigns can reverse the performance slide.” (Barker & Duhaine, 1997)

An organisation’s profitability and effectiveness can be affected by a variety of factors, which in certain circumstances can cause business failure. A UK Insolvency Helpline recently identified 65 of the most common reasons why companies fail. These included “failure to control costs ruthlessly; failure to adapt the company’s product to meet customer needs; failure to build a team that is compatible and has the skills to finance, produce, sell and market; tougher market conditions; poor management and over-trading. The principal aim of any corporate turnaround is to remove the company quickly from any immediate danger of going into liquidation, and to focus on activities and tasks that restore corporate value.” (Downey, 2009) Although there are
many causes of collapse, the reasons for company failure hold true for businesses regardless of where they operate geographically.

Leadership too is a core requirement in a company turnaround. A leader must exhibit considerable management skill to revive a distressed company. Leaders must display the ability to articulate the direction and motivation for the company turnaround to all stakeholders, conveying a message with calm and control. The situation requires flexibility and to remain open and listen to suggestions. The theory suggests that the leader should be able to wield a strong hand in replacing those individuals who do not perform to standard.

Turnarounds usually follow a number of steps which involve identifying and stabilizing the crises; replacing and installing capable leadership at the helm to guide the turnaround process and managing stakeholders. There are a number of suggested frameworks on which strategies are based. The Slatter and Lovett turnaround model, as illustrated in the theory above is, however based on substantiated evidence. Authors of many books and papers on turnarounds, Stuart Slatter and David Lovett designed a corporate turnaround strategy which is widely used in industry.

2.4.1 The Slatter and Lovett Turnaround Model

Authors and practitioners, Stuart Slatter and David Lovett in their book ‘Corporate Turnarounds’, developed a framework on which to base an appropriate turnaround recommendation followed by successful implementation. The revival of a failing company depends on a rescue plan which should deal with the underlying problems by attempting to solve the causes instead of focussing on the obvious symptoms. The strategy should be broad in nature to solve all the important concerns. It is crucial that limited resources are not wasted on sorting out the ‘non essential’ areas of concern. The causes must be the focal point as any effort on solving the symptoms will be temporary and will present themselves in other areas.

The seven essential ingredients as devised by Slatter and Lovett are each discussed in some depth.
2.5 Conclusion

It is apparent that the identification of early warning signs must be adhered to and not ignored. Too often managers fail to recognise these signals or at least fail to raise the alarm. Leaving a troubled company for too long has been identified as one of the core reasons why firms fail. With numerous methods and models to check the financial status of a company, senior management has no excuse for not being aware. Once a problem has been acknowledged there are various frameworks on which corrective action can be taken. Provided the management team react to the problem quickly and focus on the root causes and not the symptoms, companies who are experiencing difficulty should recover, provided they have the right management structure in place. This is of course assuming that the problems are of a strategic or operational nature and the company has the required resources to implement necessary actions.
3 Research Methodology

3.1 Research Approach and Strategy

As cited by Okunade (2010) “while a quantitative study seeks to explain or predict relationships and develop generalisations that contribute to existing theories, a qualitative study uses emergent processes to seek a better understanding of a complex situation and to design new interpretations through inductive reasoning. Emergent processes involve settings where researchers enter with ‘open minds, prepared to immerse themselves in the complexity of the situation and interact with their participants’” (Leedy, 2010)

“This common sense perspective on qualitative research is now accepted in most social science and medical research settings. While quantitative experimental studies are seen as the ‘most scientific’ way of doing research, qualitative research is accepted as a useful adjunct to qualitative science. It can be used to identify potentially important variables and to generate hypothesis about possible relationships among variables, and it can add some ‘human drama’ to the impersonal world of scientific research. The common sense perspective on qualitative research is essentially a positivist perspective.” (Terre Blanche, Durrheim, & Painter, 2006)

Due to the very nature of the topic, this paper takes a qualitative approach throughout the research. The research is comprised of the qualitative aspect of financial distress prediction and the strategies involved in company turnarounds. It aims to provide a ‘how to’ approach for those embarking on a company turnaround. The research will compare the theory outlined in the framework established by Slatter and Lovett to those practices being followed by turnaround managers. The financial distress prediction methods, namely financial ratio analysis and the Z-score, use financial statements, a globally accepted and standardised method of preparing a company’s financial status. Therefore, financial analysis is not hindered by geographic borders and as such these methods are interchangeable for the use of assessing all companies regardless of location. The Z-score too is flexible in nature and is adaptable to companies and their environments and has been adapted for use in emerging markets.
As is characteristic of qualitative research studies, the aim of this paper is to:

1. Compare practitioners experience in the field to the underlying theory and assess where practice differs from the theory and what the implications may be
2. Describe the context of financial distress and corporate turnarounds so as to better understand the purpose and shortcomings associated with each
3. Explore new insights and gaining a better understanding and discovering new problems, challenges or areas of concern around the methodologies prescribed.
4. Test the validity of the prescribed frameworks to determine to what extent either methodology meets its objectives successfully
5. Evaluate the general efficiency of the proposal
6. “Interpret the findings and extrapolate lessons identifying the conditions and actions that should be followed to ultimately succeed” (Leedy, 2010)

The model being tested and compared to practice is comprised of seven steps. These steps defined by Slatter and Lovett in their book ‘How leaders fix troubled companies’ (2006) are discussed below for two core reasons. Firstly, to provide the reader with a good understanding of the proposed theoretical turnaround process. Secondly, it gives the reader some context when interpreting the research findings.

**Step 1. Crises Stabilisation**

“Crisis stabilisation commences immediately, as these companies suffer from rapidly declining cash positions and lack of management control. Often in these conditions the business is in a ‘free fall’ whereby senior management is in a state of paralysis facing a seemingly desperate situation with the business under threat of shortly running out of cash. The crisis manager must move speedily to take charge of the situation and begin managing cash diligently.

Crisis stabilisation aims to achieve two primary goals:

1. To preserve cash immediately, offering a window of opportunity allowing for the development of a turnaround strategy and reach agreement on financial restructuring.
2. To restore all stakeholders trust and confidence that the management team are in control of the state of affairs

Initially the turnaround manager imposes tight controls for cash flow in the organisation restricting any authority to incur credit, spend cash or commit the company. Short term cash becomes a top priority. A critical element is to rebuild some predictability into the business and the generation of rolling short term cash flow forecasts becomes an essential management objective. This serves to rebuild the confidence of stakeholders which at this point remains critical. It is also important to implement a series of cash generation strategies. Working capital is reduced by liquidating surplus stock, improving debtor collection and stretching payments. All capital expenditure except that which is essential is put on hold. Sometimes the opportunity to increase short term revenues exists by increasing prices or promotional events however this is an exception not the rule. Crisis stabilisation requires robust leadership forcing a radical mindset change in the organisation. (Slatter, Lovett, & Barlow, How leaders fix troubled companies, 2006)

Step 2: New Leadership

The most commonly cited and significant cause for a company’s decline is an incompetent management team. Therefore it is in most, but not all situations, that a new CEO is required.

Many investors and turnaround practitioners argue that in almost every case a change of CEO is required for two reasons:

1. Since the CEO was the principal architect of the failure it is very unlikely he or she can form part of the solution.
2. A change of CEO has enormous symbolic importance. It sends a strong message to stakeholders that something positive is being done to improve the firm’s performance.

An alternative view, however, is that the immediate removal of a CEO may not be in the best interests of the company. It is a decision that makes the stakeholders feel positive in the short
term but one they may come to regret at their leisure. A good turnaround leader is usually a highly effective general manager, and experience suggests that effective general managers can usually work across most industries, other than that they are highly specialised. The leader must move quickly to initiate the development of a rescue plan and communicate it to stakeholders. Finally, the leadership must be seen to be taking action quickly; it is essential to achieve some ‘early wins’.” (Slatter, Lovett, & Barlow, Leading Corporate Turnaround, 1999)

Turnaround situations typically involve a number of changes to senior management. There are two schools of thought on this. Firstly, there are those that support the elimination of existing management which sends a message to the company often acting as shock therapy which is what the company may need. Replacing all senior management removes any resistance to change so the new team can move quickly and efficiently. A second view is that, provided the existing management team are willing to change, the new CEO should work with them in righting the company. Whichever way the turnaround manager wishes to go the financial director is almost always replaced due to the crucial importance of critical financial administration. The turnaround manager at the start of an engagement will conduct a skills assessment to ascertain where potential gaps exist and how they can be catered for. Companies going through a turnaround process often need experts in finance, operations, marketing and sales.

**Step 3. Stakeholder Management**

Due to the nature of distressed companies and the effect that may have on stakeholders, relationships between parties are usually in a poor state. These stakeholders can be divided into those who are critical to the success of the turnaround and those who are not. Most often when a company gets to a distressed state the stakeholders are well aware of the situation and are first and foremost concerned with their exposure to risk in the event of the company failing.

“A history of poor trading, inadequate communications, unfulfilled promises from management, and unpleasant surprises, coupled with the risk of failure will have eroded confidence in the business. The other key issue is that the stakeholders will have different objectives and priorities. If the company is going to be rescued these differing agendas have to be reconciled and
stakeholder confidence rebuilt. The guiding principle is that the turnaround leader must start to rebuild stakeholder confidence through a process of open communications and the provision of reliable information. Predictability must be restored and unpleasant surprises avoided at all costs. Success depends on persuading the stakeholders to recognise and accept the reality of the company’s position and work co-operatively towards a solution to the actual problems of the business. Gaining stakeholder support requires careful stakeholder management, and the first stage involves the clear unbiased communication of the company’s true financial position to relevant stakeholders. During the early stages of the turnaround there should be regular communication of the short-term cash and position, and the turnaround leader should seek the involvement of stakeholders in the development of turnaround plans. Finally, stakeholders’ formal approval and agreement to the company’s detailed rescue plan should be obtained. Ongoing communication of trading performance and progress of the recovery should occur during the implementation process.” (Slatter, Lovett, & Barlow, Leading Corporate Turnaround, 1999)

**Step 4. Strategic Focus**

Companies, who are performing significantly poorly, tend to face at least one severe strategic problem. Darwin’s law explains that survival of the fittest excludes all companies expecting the entitlement of lifelong continuity. Business continuity is dependent on establishing a strategic advantage through the delivery of a product or service so that it gives the company a competitive edge. Such a strategy must bring together a clear set of objectives and purpose to achieve the intended long term goals. Unfortunately distressed companies seldom have feasible strategies. Often the existing goals of the troubled business are unrealistic or lack common sense. The issue could be that the company lacks necessary resources to achieve its goals. In this case the primary objective of the turnaround is to design and establish a revival plan to solve the incapability’s of the company.

“The strategic problems faced by many troubled companies can be very serious, but are often not complex, and although the solutions tend to be simple in concept they are not so simple in their execution. The desired end state or vision for the business must be understood across the
organisation. That destination must be intrinsically attractive, that is, profitable and based on an underlying demand for that service or product. The business must be capable delivering a range of services or products, taking into consideration the resources it has at its disposal (infrastructure, people, knowhow, technology, etc.) and it must be able to do so more effectively than its competitors. The strategy must be written down and widely communicated throughout the organisation. It incorporates a simple definition of the goals and objectives of the business, and should encompass the “what” and the “how”, that is, what products/services are we going to deliver and to whom, and are we going to do it. The choice of strategy must take into account the existing resources capabilities of the organisation. A focus on the key success factors for the strategy must be at the heart of the recovery plan, since they provide the parameters within which the entire recovery plans be developed. The product/market mix provides the target or for the entire organisation; it defines what products or services are sold to whom. The importance of clarity on this issue cannot be overstated. In many cases the strategic analysis will have to be quick and dirty. It is better to be ‘80% right and act than 100% right and have missed the opportunity’. ” (Slatter, Lovett, & Barlow, Leading Corporate Turnaround, 1999)

Strategic focus can be achieved through various means including redefining the business, divestiture of assets, refocusing the product and market offering, outsourcing processes or in rare cases growth through acquisition.

**Step 5. Critical Process Improvements**

“Substantially under-performing companies typically have serious problems with both their core and their support processes. These processes are often characterised by high cost, poor quality and lack of flexibility and responsiveness. The underlying causes of these problems vary. Many processes are poorly managed due to a lack of focus on cost, quality and time. Problems with the physical infrastructure, such as state of machine repair, outdated IT systems and an organisational structure that breaks natural links in processes can exacerbate problems. The tools and techniques of mainstream business process reengineering (BPR) substantially apply. The emphasis in turnaround situations is on “quick win” process re-engineering. Typically this will cover procurement, conversion, logistics and sales and marketing. The emphasis is on achieving
a rapid quantum leap improvement in time, cost or quality without the need for major MIS improvements.” (Slatter, Lovett, & Barlow, Leading Corporate Turnaround, 1999) Business process enhancements typically focus on areas such as cost, quality and time improvements.

**Step 6. Organisational Change**

“People problems are usually among the most visible signs of a troubled company. Typical symptoms include a confused organisation structure, a paralysed middle management, resistance to change and demoralised staff. Staff turnover is probably high, the most able people have left and the remaining workforce lack key skills and capabilities. Dysfunctional behaviour, where employees fail to co-operate towards achieving the corporate objectives, may be encouraged by silo thinking, a rewards system not aligned with the strategy, and a culture of non-performance. Significant organisational change is therefore required. Changing the organisation structure can be a powerful way of rapidly changing the operations of an ailing business. A revised structure that facilitates clear accountability and responsibility will make the implementation process more straightforward. Any revised organisation structure should emphasise an external market-facing perspective, remove unnecessary hierarchical levels and seek to breakdown “silo thinking”. Structural change should, however, be kept to a minimum in the early stages of a turnaround, as it can very easily lead to unnecessary confusion as individuals learn new ways of working and build new relationships.” (Slatter, Lovett, & Barlow, Leading Corporate Turnaround, 1999)

**Step 7. Financial Restructuring**

“Companies in need of a turnaround typically suffer from one or more of the following:

1. Cash flow problems such as insufficient future funding or an inability to pay debts when they fall due
2. Excessive gearing (too much debt/too little equity)
3. Inappropriate debt structure such as excessive short term – on demand borrowing and insufficient long term debt
4. Balance sheet insolvency
Irrespective of the health of the underlying business, if the operating cash flow cannot finance the debt and equity obligations, the company will remain fatally wounded. In these circumstances the only solution is a financial restructure.” (Slatter, Lovett, & Barlow, Leading Corporate Turnaround, 1999)

3.2 Research Design, Data Collection Methods and Research Instruments

In order to define the facts, evidence was applied in a converging manner. Using six methods of data gathering the methodological objective is to employ the conception of triangulation. With this method a recognised fact may be deemed to have been established if confirmation from 3 or more diverse sources all corresponds.

When designing the study it is important to develop the theory. In doing so, one can use rival theories to build alternate hypothesis to which to compare one’s own hypothesis. The concept of this research paper identifies the underlying hypothesis. That is, the practices suggested in theory and those used in application, in identifying companies in distress and orchestrating a company turnaround are the same. The hypothesis is examined through the investigation of practitioners comparing where the theory and practice agrees and/or disagrees. The identification of rival theories should not be overly concerned with threats of becoming a component of the academic underpinning of the study. The best case rival would not be absent, as this would not be helpful contrasting contrary information, but rather a theory which endeavours to explain the same result with a different theory or approach.

The theoretical propositions do not need to show impressive theory in social science but should preferably have an adequate blueprint for the study which necessitates theoretical propositions. One should distinguish between explanatory, descriptive and exploratory studies.

The previous theoretical propositions emphasized circumstances where ‘why’ or ‘how’ questions were the motivating force. As this is a guide to the best practices, this study follows a descriptive or ‘how to’ approach. It is important to note that when following a descriptive case, it is possible to describe anything.
“Although ethnographic efforts can lead to case studies with ‘thick description’ in fact all description is selective. To think that a study can cover everything is to overlook this inevitable selectivity and also leads to an impossible undertaking. Instead one should focus on such questions as (a) the purpose of the descriptive effort, (b) the full but realistic range of topics that might be considered a ‘complete’ description of what is to be studied, and (c) the likely topic(s) that will be the essence of the description. Good answers to these questions, including the underlying rationales underlying the answers, will help you go a long way towards developing the needed theoretical base and research design for your study.” (Yin, 1997)

Designing the study requires that a logical sequence connecting the empirical data to the study's original research question, and eventually to its final deduction. The research design acts as a plan from moving from A to B, where A is characterised by the preliminary collection of questions requiring answering and B is a series of conclusions. In order to get there requires a series of steps such as the collection and analysis of data.

A strong argument for this method of research methodology is its capability in dealing with contextual concerns. This method allows one to begin the research not knowing the exact boundaries of the topic. Using a variety of sources is of huge benefit as this acts to strengthen any analytic generalisations, similar to that of conducting multiple experiments to achieve an outcome. The analytic generalisations can be reinforced as they are created to duplicate each other, thus generating corroboratory support from more than one source. On the other hand generalisations may be extended as numerous sources are intended to encompass diverse theoretical circumstances, generating distinguishing outcome, but for expected reasons.

The importance of quality control of information used during the research cannot be overstated. One must continually judge the quality of the design. Four tests have been used to ensure the quality of empirical social research:
<table>
<thead>
<tr>
<th>Test</th>
<th>Study Tactic</th>
<th>Phase of Research in which tactic occurs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Construct Validity</strong></td>
<td>• Use multiple sources of evidence</td>
<td>Data Collection and Composition</td>
</tr>
<tr>
<td></td>
<td>• Establish a chain of events</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Have key informants review draft case study report</td>
<td></td>
</tr>
<tr>
<td><strong>Internal Validity</strong></td>
<td>• Do pattern matching</td>
<td>Data Analysis</td>
</tr>
<tr>
<td></td>
<td>• Do explanation building</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Do time series analysis</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Do logic models</td>
<td></td>
</tr>
<tr>
<td><strong>External Validity</strong></td>
<td>• Use rival theories within single cases</td>
<td>Research Design</td>
</tr>
<tr>
<td></td>
<td>• Use replication logic in multiple case studies</td>
<td></td>
</tr>
<tr>
<td><strong>Reliability</strong></td>
<td>• Use case study protocol</td>
<td>Data Collection</td>
</tr>
<tr>
<td></td>
<td>• Develop case study database</td>
<td></td>
</tr>
</tbody>
</table>

*Table 1: Source: Revised from Yin (1994)*

The tactics described above don’t take place at the start of the study. Instead, these tactics transpire right the way through the research process, that is, throughout the design of the study, gathering of data, the data analysis and finally the reporting of the findings.

In conducting the research five important skills are drawn on. The extent to which these skills are present in the researcher is subjective and there is no existence of any certification method used for determining who is or is not qualified to conduct the research. It is likely that such skills are present in different people in varying degrees. The five skills examined above were necessary during this research and are discussed by Yin (1997) below:

“**Question Asking:** Topic selection was paramount to ensure that the researcher was interested. This enabled for an enquiring mind during the research activity and not just after or before. Data collection follows a formal plan but the specific information that may be relevant to the study...
may not be readily predictable. Like a detective, as one does the fieldwork, one must constantly ask oneself why events appear to have happened or be happening.

*Listening:* Listening during the study is not limited to the aural modality, it includes observing and sensing more generally. Being a good listener means being able to assimilate large amounts of new information without bias. Whether conducting an interview or reviewing a document, a good investigator constantly asks whether there is any good information between the lines; any inferences, of course need to be corroborated by other sources of information, but important insights may be gained this way.

*Adaptiveness and Flexibility:* Very few studies will end up going as planned. The skilled investigator must remember the original purpose of the investigation and then be willing to change procedures or plans if unanticipated events occur.

*Grasp of the Issue being studied:* Research required an understanding or grasp of the issues being studied on the part of the members of the data collection team. This research is not just a matter of recording the data in a mechanical fashion. One must be able to interpret the information and know immediately, for instance if several sources of information contradict one another and lead to the need for additional evidence.

*Lack of Bias:* All of the preceding conditions will be negated if one seeks to use research only to substantiate one’s own preconceived positions. A test of one’s possible bias is the degree to which one is open to contrary findings.” (Yin, 1997)

Data collection is done through multiple sources. During this study data collection took on the following forms:

*Interviews and informal discussions* consisting of structured and unstructured discussions with all parties involved in a turnaround situation including turnaround specialists, legal advisors and administrators, consultants and financial creditors. This primary research involved structured interviews which took a hard look at the topic through a number of questions in two defined
sections, namely financial distress prediction and turnaround scenarios. The section on turnarounds was further broken down into Turnaround Context, Methodologies and Processes, Management and Leadership. This data was captured through field notes and digital recordings which were later transcribed. Informal discussions were exactly that. Talks with those parties directly involved in turnarounds took a very informal manner and explored experiences, methods and practices. Informal talks were conducted in a semi-formal structure gaining insights that would not necessarily be available from structured surveys. This allowed for the conversation to run off course yielding additional information not originally planned for (Leedy & Ormond 2005).

**Direct Observation** is the truest form of primary research. During the course of this research I was privileged to begin working for a consulting firm who works in the turnaround space. Two of my first projects were working within an experienced team conducting a turnaround. The first projects involved a textile manufacturing company who was in a distressed state and needed assistance. The second project involved a retailer, who under the increased pressure from cheaper imports was struggling financially and strategically and required assistance in turning the company around. During these projects I was involved in data collection and interpretation used to draw up the business rescue plan and future growth strategy. Both cases were initiated by the major creditor.

**Documentation:** This research is composed of secondary data. Theory based research was conducted using scientific resources from a number of databases namely Ebsco-Host, Emerald, Jstor, Science Direct, Wiley-Blackwell and other databases where searches were conducted based on the title, author and date. The preferred date, although arbitrarily selected sought after those resources published post 1990, however date was not a restriction particularly where the work was extensively referenced. Significance and input to the body of knowledge was central and thus valuable content was found predating the specified date and was therefore used in the research. Other resources included books, abstracts, company training material and resources and websites harbouring significant information beneficial to the study.
The search was divided based on the two areas of the study, financial distress and turnaround models. The first search conducted included the terms ‘financial’ combined with ‘distress’, ‘models’, ‘ratio analysis’ and ‘frameworks’. The searches were narrowed down using variations of the keywords during searches. The second search conducted included the terms ‘corporate’ or ‘company’ combined with ‘turnaround’, ‘frameworks’, ‘restructuring’ and ‘models’. Again the search results were narrowed down using variations of the keywords during searches. In dealing with potential failure related issues, all titles and article abstracts were scanned allowing a first complete read of every article.

A third search was conducted using the names of authors in addition to the search terms used in earlier searches. Lastly, specific journals were explored using the same search keywords. Journals explored but not limited to include Journal of Finance, Strategic Management Journal, South African Business Review, Expert Systems with Applications, Journal of Economics and Business, The International Journal of Digital Accounting Research, Managerial Auditing Journal and the Journal of Management Information Systems. References of articles deemed valuable were investigated and considered so as to form a sizable body of literature. Relevant articles were obtained and the method was repeated to discover key works by other authors.

Having read and analysed the abstract of each article, the papers that denote corporate financial distress and company turnaround models were chosen for further review. Every article was analysed, identifying core concepts. Using the same method as Holtzhauzen (2008) concepts were categorised into sub-domains (categories) of turnaround-related issues and reported individually, with their specific contributions based on Corbin and Strauss (1990: 7). Each article was explored in depth identifying vital contributions once the categories were clearly defined. Articles that were originally rejected went through a second evaluation searching for possible contributing factors to each sub-domain, centred on new insights collected during the process.

As cited by Holtzhauzen (2008) “one of the principles of grounded theory research states the requirement for concepts to be repeatedly present in the new data (Corbin & Strauss 1990: 7), thereby leading to the identification of patterns and categories. Contextual implications are then considered in order to judge how variables manifest under different circumstances. During the
process of grounded research, the researchers look for the conceptual linkages to use for categories. These steps were followed during the methodology, in which steps are repeatedly executed until the key constructs ultimately crystallise.”

Ultimately, a reference list was accumulated and put together. Although there was not a constraint on new additions to the list, no new significant information was revealed as the research came to a close, as suggested by the principles of the research theory process. Lastly, in order to classify the liabilities identified, a conceptual framework was proposed. Every article was analysed for the substantiation of the concepts. This framework was altered and improved as fresh information improved the authors understanding.

The interviews conducted with practitioners are to remain confidential and as such all interviewees will remain anonymous. The findings will be interpreted and the results discussed and compared to the theory on the topic. As the turnaround specialist is a relatively new vocation, the number of practitioners active in South Africa is few. Although the population is unknown, it is understood to be small and therefore research is limited to a large sample size in respect to the population.

4 Research Findings, Analysis and Discussion

A total of 11 participants were involved in the qualitative research collection comprising of no less than 15 hours of both formal and informal discussions. Formal discussions took place during structured interview sessions with 6 key contributors to the material. A further 5 participants were involved and information was gathered through informal talks and correspondence through email. The data was captured in the form of written notes, digital recordings or email during the process of data collection.

The formal interviews were structured around 29 questions based on the research topic depicted in section 1.5 of the text. The data collected is believed to be well informed opinions and experience of key players in the industry. It is believed that the population of turnaround managers in South Africa is still a relatively small population comprised of few turnaround
specialists, consultants, lawyers and those managers who have found themselves in the unfortunate position of being at the helm of a company entering into a distressed state. The 11 contributors to this research are considered to be a fairly large sample size.

The research was conducted based on two primary areas with a number of underlying subsections as follows:

- Financial Distress
- Turnaround
  - Context
  - Methodologies and Processes
  - Management and Leadership

4.1 Research Findings and Discussion

4.1.1 Financial Distress

As defined in literature a company becomes distressed when it is not able to meet its debt obligations. There are many outcomes of a company being in distress however initially they all fall under one of two umbrellas:

1. Once the board of directors or owner senses financial distress, they can sign a resolution, the majority of directors agree and the company goes into a state of rescue.
2. Alternatively if somebody brings a liquidation application or any kind of enforcement action against a company, the company may counter the application, not by defending it, but rather by applying to court to put the company into a state of business rescue.

In the case of a creditor or any other affected person bringing an action against the company a few red flags have been raised and flown high for some time. In this case the company has defaulted on a payment to a supplier for goods or services rendered, or to a financial institution by not paying an instalment payment or letting an insurance premium slip. It is not often that
suppliers will raise an application against the company unless the issue is an ongoing one with large stakes and little chance of receiving the payment owed.

Identifying that the company is heading or has reached a distressed state is another matter. All too often senior executives or owners hide the poor financial state of the company thinking that they can possibly pull the company back from collapse. This only serves to hinder the recovery process allowing the company to sink further into despair. The most recurring theme coming through during the interviews was exactly that. All mentioned that the process is started too late and for this reason the chances of recovery are hugely diminished.

Although the literature supporting the use of the Altman Z-score is vast, there was only one practitioner who used this method in identifying what the financial state the company is in. The reasons given for not adopting this method are that the Z-score is not applicable in the South African market because:

- it does not perform well in this market
- by the time the practitioner is called in, the company has already been declared distressed and further clarification is not necessary
- it is not understood very well
- in distressed companies often the financial statements are in disarray and it is not possible to obtain accurate figures for the formula

Ironically the reasons in support of the Z-score is that it does perform with some accuracy in this market however it needs to be applied very early on and all agreed that this is seldom possible.

What all practitioners agreed on was the essential use of financial ratio analysis. This raised a few key ratios that were common amongst participants. Liquidity ratios were the most cited, looking at short and long term solvency measures:

- The current ratio and even a cash ratio are widely used to determine vital short term cash liquidity.
The debt ratio, so as to understand the company’s long term obligations

The interest coverage ratio, used in determining if the company is going to be able to meet its debt obligations.

In understanding where the issue lies, a deep exploration of the financial statements is required. An analysis on the company’s financials can help determine where the company is going wrong. The ratios referred to by practitioners are the:

- **Day’s Sales in Inventory** to measure if the period has increased from the previous year, requiring further investigation.
- **Days sales in Receivables** to determine whether the company is able to collect on its credit sales. This number is expressed in days and is compared to previous periods to assess whether the debtors collection is increasing. If so further investigation is required.
- **Days Purchases in Payables** is another ratio measured in days and expresses how long it takes the company to pay its creditors. An increase in the days payable will warrant further investigation however in a crisis phase it is not as important as collecting money owed.

Practitioners use financial ratios and compare them not only to previous periods but also to industry norms. If Gross Profit (GP) is below a certain amount in a certain industry where GP’s are known to be higher this will raise an alarm.

“We will know that something is wrong, there is theft or spillage or something. We will definitely look deeper and the issue analysed.”

Another ratio which is not common in the theory but is used fairly often is the Net Assets / Net Liquidity ratio. The normal rate should be around 2:1 however analysts concur that it is lucky if it is near 1:1 but that it is often worse.

“It’s not what the text books say but very few businesses operate at those levels.”
Profitability ratios are used extensively by practitioners during recovery, to monitor the health of the company. There is no doubt that practitioners in the South African market place huge emphasis on financial ratio analysis and the information and guidance it provides. The ratios are not only used in determining where the company is lacking but are constantly used to monitor the status and to communicate to stakeholders throughout the turnaround.

Financial distress is not always a leading indicator that a company is getting into trouble. In fact, financial distress occurs when things in the company have been going wrong for some time.

“You will see a couple of things before you see financial distress. Revenue distress, customer distress – we look for those leading indicators in turnaround situations.”

It appears that a more common approach to identify distress in a company, or at least ascertain at what stage it has reached, is done through the practical use of applying financial ratio analysis to the financial statements of the company. It must be mentioned again, as it was brought up on numerous occasions, that is, the financial recordings in distressed companies are often incomplete, creative and flawed and are therefore found in a less than desirable state, making it difficult to apply any financial analysis with complete accuracy.

### 4.1.2 Turnaround Context

Exploring the tell tale signs of a distressed company is not enough in remedying the situation. Once a company is indeed heading for bankruptcy, the financial warning signals serve to inform how deep the trouble runs and how long the company has before it doesn’t make sense to attempt a business rescue. Never-the-less financial information in any form does not in itself turn a dire situation around. What is required is a turnaround or business rescue plan so as to get the distressed company out of its current state. In order to do that, it is crucial that both the current root causes are identified as well as the main reasons for the initial deterioration in the company’s performance.

The corporate world is a complex ever evolving animal comprised of various companies who are always under threat of the economic environment, consumer demands and more recently
globalisation and the increase in competition that brings. There are a number of factors companies need to stay cognisant of and adjust accordingly to stay alive. Companies operating in today’s climate face many challenges and are susceptible to the numerous reasons companies go under. The table below lists some of the reasons companies fail to continue operating.

*Table 2 Causes of Corporate Decline (Slatter & Lovett, Corporate Turnaround: Managing Companies in Distress, 1999)*

<table>
<thead>
<tr>
<th>Internal Causes</th>
<th>External Causes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Poor Management</strong></td>
<td><strong>Changes in Market Demand</strong></td>
</tr>
<tr>
<td>• Autocratic Rule</td>
<td>• Long term Decline in Demand</td>
</tr>
<tr>
<td>• Combined Chairman and CEO</td>
<td>• Cyclical Market Decline</td>
</tr>
<tr>
<td>• Ineffective Board of Directors</td>
<td>• Changing Pattern of Demand</td>
</tr>
<tr>
<td>• Ineffective Management</td>
<td></td>
</tr>
<tr>
<td>• Management Neglect of Core Business</td>
<td></td>
</tr>
<tr>
<td>• Lack of Management Depth</td>
<td></td>
</tr>
<tr>
<td><strong>Inadequate Financial Control</strong></td>
<td><strong>Competition</strong></td>
</tr>
<tr>
<td>• Poorly Designed Management Control</td>
<td>• Product Competition</td>
</tr>
<tr>
<td>Systems</td>
<td>• Price Competition</td>
</tr>
<tr>
<td>• Poorly Understood Management</td>
<td></td>
</tr>
<tr>
<td>Accounting Information</td>
<td></td>
</tr>
<tr>
<td>• Effective Control Hindered by</td>
<td></td>
</tr>
<tr>
<td>Organisational Structure</td>
<td></td>
</tr>
<tr>
<td>• Methods of Overhead Allocation Distort</td>
<td></td>
</tr>
<tr>
<td>the Costs</td>
<td></td>
</tr>
<tr>
<td><strong>Poor Working Capital Management</strong></td>
<td><strong>Adverse Movements in Commodity Prices</strong></td>
</tr>
<tr>
<td><strong>High Costs</strong></td>
<td></td>
</tr>
<tr>
<td>• Relative Cost Disadvantages</td>
<td></td>
</tr>
<tr>
<td>• Scale Economies</td>
<td></td>
</tr>
<tr>
<td>• Learning and Experience Curve Effects</td>
<td></td>
</tr>
<tr>
<td>• Absolute Cost Disadvantages</td>
<td></td>
</tr>
<tr>
<td>• Control of Raw Material Supply</td>
<td></td>
</tr>
<tr>
<td>• Access to Cheap Labour</td>
<td></td>
</tr>
</tbody>
</table>
- Proprietary Production Know-how
- Favourable Site Location
- Cost Disadvantage Due to Diversification Strategy
- Cost Disadvantage Due to Management Style and Organisation Structure
- Operating Inefficiencies
- Unfavourable Government Policies

**Lack of Marketing Effort**

**Overtrading**

**Big Projects**
- Start up Difficulties
- Capacity Expansion
- Market Entry Costs
- Major Contracts

**Acquisitions**
- Acquisition of Losers
- Paying too much
- Poor Post Acquisition Management

**Financial Policy**
- High Debt: Equity Ratio
- Conservative Financial Policies
- Inappropriate Financing Sources

**Organisational Inertia and Confusion**

Of the reasons experienced by those parties directly involved in turnaround situations, internal reasons were by far the most cited for companies requiring turnaround attention. A total of 6 internal reasons and only one external reason were raised during the research. Both internal and external reasons relate well with the theory as seen in the research findings.
4.1.2.1 Internal Reasons

The most commonly referred to reason for a company becoming distressed was due to its management. Further investigation revealed a subset of explanations.

*Management* lacks the competency to run the company they are in charge of.

“It’s mainly that there is a disjoint between the people that are running the company in terms of their core skills. They might be the best widget salesmen in the world but they have absolutely no idea about corporate governance and control functions and the things required to ensure that you pay your VAT, your PAYE, and manage things from a financial point of view.” 12

All too often senior management is under qualified and doesn’t understand the crucial elements, such as the finances of the organisation. They have little or no grasp of expenses, debt management and creditors and debtor’s periods. With a skills deficiency, managers make poor decisions resulting in the decline of the company.

One reason this occurs is that as companies grow the skills required change. Smaller, often private, companies which develop and mature, often outgrow the people managing these companies.

“I see a lot of owner managed businesses that don’t have enough money to employ people to help them when they aren’t able to do the job themselves. Sometimes one has to understand that one doesn’t have the skills one needs to just be able to go on and do it. There is a skills mismatch whereby they have the technical skills but as the company grows and they don’t have the skills to manage the company anymore.” 13

Leadership is yet another core skill required by management which is often lacking. These leaders lack the crucial soft skill of leading both the company and the employees. As so delicately put by one practitioner “*they are the wrong jockey for the horse*”. 15
Linked to poor and incompetent management is strategic direction of the company or the lack thereof. *Strategic Direction* is linked to poor or non decisive management choices regarding the future of the company. In effect the company does not have a plan going forward. They do not know where they would like to be and therefore how to get there.

The basic strategic requirements insist that a company decides on a position and maps the requirements to get there.

> “The CEO needs to be diligent and skilled at looking for opportunities to throw cash at in the long term.” 16

With little or no direction companies will be forced out of the market by more competitive and flexible companies.

*Servicing Debt* was the second most remarked upon reason for distraught companies. Companies which are over burdened with debt, often experience a cash crises resulting in the near impossible task of managing short term debt obligations. Often financial creditors first notice that companies are not able to meet their debt obligations and call for a review of the financial status of the company.

> “As a financier it doesn’t make sense to just foreclose on them especially when they are still profitable before financing charges. If they are profitable and the financing charges puts them in a position where they can’t survive then we will look at the business and see if we can reduce the financing charges or taking an equity stake in the company. If they can then survive we will give them some breathing space.”13

More often an immediate supply of cash is required. In these situations companies will often try to obtain a cash injection from a financial lender. However with a company failing to meet its existing debt repayments, financial institutions are either not willing to lend, or charge a high interest rate relative to the risk taken. More often companies are left to their own devices to come up with a short term liquidity solution. This can be done through the reduction of debtors,
extension of creditors, reduction in inventories and/or stopping all planned expenditure. A quick solution to generating cash instantly is by improving on the collection of money owed. Cash may also be tied up in stock (working capital) and requires conversion to product and the sale thereof before cash flows back into the company.

In these highly geared situations it is important to assess what management has spent the money on which was raised through debt. Best case scenario is that the money was spent on cash generating assets. It is not uncommon for companies struggling with liquidity issues to sell some of these assets. If the capital borrowed was not spent on cash generating assets or those assets are not being used to their full capacity so as to generate enough money to cover their debt obligations, the company will need to rethink their capital structure.

A fourth reason was the failure to pay attention to what is happening in the market. This includes failing to see when there is a lot of capacity in the market and when there is a lot more supply, thereby making it more competitive and encouraging lower prices. This is closely linked with management lack of strategic foresight or planning. The result is that the company becomes stagnant in a moving market and is quickly left behind. Companies also don’t acknowledge economic trends. Companies not paying attention to the economy may embark on huge spending sprees only for the market to retreat.

“Companies build factories all over the place and when the market turns down they are left standing dry”. 11

Warren Buffet once described the behaviour of companies over spending during the good times, only to get caught short when the economy enters a downturn, in a famous analogy.

“When the tide goes out you can see who’s been skinny dipping” Warren Buffet

A fifth reason similar to the last relates not to management following the markets but rather to management not understanding and planning for the customer trends, tastes and preferences. Consumer tastes and preferences change rapidly and the company needs to adjust and cater for
those changing demands. In these situations companies must understand their customers and remain flexible in order to adjust quickly.

The last of the internal reasons relates to companies trying to be all things to all markets. That is, *companies over extend themselves* and lose. In choosing to compete on a low cost strategy, companies focus their attention on being the biggest one offering the most products and services. This could happen to any company through management allowing the focus to shift from its core offering too many fragmented services or products rendering the company unwieldy, inflexible and slow to adjust. In this situation a company operates either in too many markets and/or with too many products. That is not to say that this strategy does not work however the threats are imminent.

“*Usually what happens is out comes a niche player and takes the market share in the core market.*” 16

Successful companies cater for this by focusing on a single customer segment giving them a narrow area to understand and control.

4.1.2.2 External reasons

In exploring external reasons for companies becoming troubled, only one was prevalent throughout the research. Economic recessions, downturns, depressions or declines affect entire economies having a devastating effect on many companies. As we have seen over the last few years the economic crises the world underwent closed many businesses resulting in a domino effect. As large companies went down many of the smaller peripheral companies supplying those companies went under. Entire industries were affected closing the doors of many companies.

Banks came under threat, many of them requiring bailouts, some of them unsuccessfully. With the banks under pressure little lending took place slowing down the economy. As businesses closed down, people were rendered unemployed causing them to slow down on making purchases. As purchases slowed down, companies produced less and retrenched more staff
causing the cycle to repeat itself. Companies are hard pressed to foresee a recession on the horizons much less plan for them.

Recessions can also be healthy for the economy. In a recession only the strongest companies survive. A true example of the animal kingdom present in the corporate world: Survival of the fittest. Companies require flexibility to quickly adjust to downturns in the economy.

As William Edwards Demming, a celebrated statistician, professor, author and lecturer once said “It is not necessary to change. Survival is not mandatory”.

4.1.3 Methodologies and Processes

As per the theory there are 7 phases that a turnaround may go through during its resolve. In keeping with these core areas of a business rescue or turnaround plan are a number of supportive generic strategies. As per Slatter and Lovett (1999) the seven requirements and their respective actions required are laid out in the table below.

Table 3 Seven Requirements

<table>
<thead>
<tr>
<th>Diagnostic Review</th>
</tr>
</thead>
<tbody>
<tr>
<td>What?</td>
</tr>
<tr>
<td>How?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Key Ingredients of Turnaround Management</th>
<th>Implementation Work Streams</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crisis Stabilisation</td>
<td>• Crisis Management</td>
</tr>
<tr>
<td>Leadership</td>
<td>• Selection of turnaround Team</td>
</tr>
<tr>
<td></td>
<td>• Project Management of the Turnaround</td>
</tr>
<tr>
<td>Stakeholder Support</td>
<td>• Stakeholder Management</td>
</tr>
<tr>
<td>Strategic Focus</td>
<td>• Develop Business Plan</td>
</tr>
</tbody>
</table>
### Organisational Change

Critical Process Improvements
- Implement Business Plan

Financial Restructuring
- Prepare and Negotiate Financial Plan

The theory as a guideline is very inclusive and during the research it was clear that a number of these elements are included in business rescue at varying degrees, situation dependant. In practice however, these phases did not distinctly overlap. The model gives a good overview of what is required and how it should be approached. The research findings show that the practice of conducting a turnaround did not deviate too far from the theory as discussed in the ‘practical’ approach discussed below.

#### 4.1.3.1 Crisis Management

Crisis stabilisation and management remains an initial crucial step in any business rescue. Depending on the seriousness of the situation crisis stabilisation varies. In less severe cases, typically not a business rescue but rather a turnaround, crisis stabilisation is less of a concern than if the company is haemorrhaging badly and without intervention failure is imminent in the short term. At this point the company has gone through a series of crises stages before it is often declared namely:

1. **Crisis Denial**
2. **Hidden Crisis**
3. **Disintegration of Organisation Begins**
4. **Organisational Collapse**
5. **Recovery or Failure**

At the point where the organisation begins to disintegrate, management has long lost its grip on the situation and a revival is necessary should the business wish to survive.

In understanding the severity and establishing the root causes, so as not to merely treat the symptoms, a full diagnostic review is conducted. This serves three purposes. Firstly it reveals the
feasibility of the situation and assessing whether a turnaround is actually viable. One would typically meet with the board of directors to better understand their expectations. At this point the practitioner has a good idea of whether it will work or not and should the assessment reveal that a turnaround is not viable the company files for liquidation.

Secondly, the diagnostic review gets to the heart of the problem. Through a series of meetings and workshops one can quickly grasp the fundamentals of the situation. During this time practitioners speak to all parties involved internally, such as staff, and externally namely suppliers and buyers. The objective is to find out the source of problems within the business. In doing so it looks further than the stakeholders and seeks answers through analysis of the financials which often reveal where the issues lie.

“Practitioners look at the business holistically looking at the various components such as volume, price points, costs, investment to build and productive assets. They analyse all of that and put it all together and see what the return is.”

Lastly the diagnostic phase serves to get everyone onboard with the situation which is the most important step in the process. Buy in from all parties involved is essential in turning the company around. In general practitioners took a hard approach to counterproductive staff.

“...in the first month you find people who are not willing to go your way. You tell them we’re going that way and either you’re on the bus or you’re off the bus. It takes some time to really get to know the people and see who is on sides. You can’t just see who is on sides in the first meeting.”

The typical duration of a turnaround as set out in the companies act is 3 months. After that period the practitioner must prepare and deliver an updated report to the court. Three months was deemed far too short and timeframes of the crises stabilisation stage ranged from 3 – 6 months depending on the severity as well as the seasonality of the business. Seasonality, which includes business cycles, is an important factor. 3 months is considered to be too short for the crises management stage.
Crises management is really about doing what is necessary to keep the company alive in the short term, thereby buying time to make more sustainable changes. Financially distressed companies lack short term cash making it difficult to operate. Freeing up or generating quick cash gives the company some breathing room. Some generic strategies used in practice to generate cash in the short term are the reduction of debtors, extension of creditors, reducing inventories and stocks, putting a halt on any planned expenditure and obtaining short term financial support.

“Crises management really is about stopping the bleeding and getting a handle on spending. This gives you control of the situation and also provides some valuable time to look around for the problems”

Crises stabilisation is a highly pressured scenario requiring excellent management. Possibly the key factor in company turnarounds is the leaders at the helm who sail the company through the storm.

4.1.3.2 Leadership

Turnaround managers typically inherit a company experiencing dismal conditions with the expectations from stakeholders to turn it around. In one interview it was commented that the turnaround specialist is expected to ‘wear a red cape’. The role requires knowledge of financial, commercial, legal, management and operational issues. Being placed in a situation with such responsibility must come with some credentials. According to the company’s act, which is very vague about specifics, the qualifications permitted to practice turnarounds are attorneys, liquidators, accountants and any other person with specific managerial skills that they can show. Legal experts in this field concur that much is left to interpretation and persons with a commerce or financial degree may practice. Regardless of qualification, it is agreed that experience over shadows qualification. It must be said that practitioners are appointed and as such they are deemed worthy by those with the power to make such decisions.
It is with power too, that practitioners operate. Appointed managers have 100% control extended past the normal practices of business. Practitioners can, with the courts support, suspend any contract save employment contracts. A company experiencing liquidity issues has the power to cease monthly interest payments on a mortgage agreement. With the approval of the court, the practitioner’s authority extends to the cancelation of these agreements. In keeping with the labour laws, practitioners are able to retrench employees provided they are within the legal rights of the labour act. This does not bode well for senior management. Without fail, every interviewee commented that where possible senior management must go. This is contrary to the theory where in some cases it was deemed appropriate to keep senior staff on due to their extensive knowledge of the company.

At turnaround initiation the turnaround practitioner becomes CEO. Typically the CEO will spend some time getting to know the people, identifying the direction and assessing turnaround priorities.

“Only when they have assessed all the opportunities, that is, when the practitioner really understands the business having spoken to everyone and only once they have figured out what they can do, the right enablers, only then will they take action and get people off the senior management level.”11

It also depends on both the situation of the company and that of the industry. In reality it is difficult to find a suitable person in that industry to take over the company and facilitate a turnaround. For example in mining very few people chose to go into that line of work. With a skill shortage, replacing people may not be an option. However in retail there is a much larger supply of resources therefore facilitating senior management replacement. The danger of replacing the top position with an incompetent manager is detrimental and there are industry dynamics that a new CEO needs to be aware of before taking any action. It remains however, that the turnaround manager, where possible will replace some of the senior management team. This is decided by assessing the incompetency or those who oppose the plan. Differing views became apparent during the research. In some cases the practitioners gave management the
benefit of the doubt citing reasons such as often individuals start to perform better under new leadership. Others took a much more callous approach.

"Once a formal business rescue happens I think we can all shake hands with the senior management and say goodbye to them because it is very rare that they are going to stay or be permitted to stay." I2

In these situations one needs an essential amount of time to know who is a benefit to the management team. One practitioner was fairly ruthless in his approach stating that

"You can probably get rid of about half the senior level but never all at once. No one valuable in the value chain. Where necessary you can replace all the middle managers."I1

In every case, practitioners agreed that replacement of the financial director is necessary. Strict financial controls are required during crisis stabilisation and must be implemented immediately. All too often the existing financial director does not have the skills required for a turnaround and must therefore be replaced. Adopting a company in this condition often reveals the true state of the financial affairs. In dealing with the financial problems at hand, practitioners make use of whatever management tools are available. The tools most required in the circumstances are an efficient accounting system used to make sense of the residual financial mess. Usually the company does not have the resources in place or available to purchase any new systems. Practitioners must therefore make use of whatever the company already has.

Turnaround managers are not your typical CEO type characters who are good at managing long term. On the contrary, these practitioners have a different set of unique skills best utilised in distressed company turnarounds. In a highly volatile and stressful state, practitioners step into a role to take charge and lead. A number of ‘soft’ skills were recognized as being important for turnaround managers to possess. The role requires strong leadership abilities and a way of dealing with people in high pressure situations. That is to keep ones cool when all those around them are losing theirs. S/he must be able to deal with conflict and be able to cope with a lot of
frustration and anger directed at them. In leading a team one must obtain the respect and trust of all the stakeholders involved. S/he must be able to deal with tough situations making challenging decisions quickly. Often the practitioner faces the bruised egos of the senior management who brought the company to its current position. It is important during the information gathering stage that one manages these situations carefully.

Practitioners are well rewarded for their work. As per Chapter 6 of the Companies Act, practitioners may bill the company as per a pre-agreed contract. The act does not specify how much will be paid however one practitioner mentioned a method of hourly billing. Remuneration may also take the form of incentives based on performance measures for milestones accomplished. A third method of remuneration is an equity stake in the company. This gives the practitioner some motivation to make sure the turnaround is successful.

4.1.3.3 Stakeholder Support

Of paramount importance during the turnaround is communication with stakeholders. Gaining stakeholder support is crucial in conducting a successful turnaround. The first step requires explicit unbiased communication, stating the true financial position of the company. With that foundation, practitioners can begin a preliminary evaluation of stakeholder positions and ascertain the level of support for the rescue plan at an early stage. An initial meeting, including creditors and employees, is usually held 10 days after the company files for business rescue. During the initial meeting the rescue plan is discussed and each party votes on the plan. At this point affected parties may submit their own plan should they feel the proposed plan is unsatisfactory. This poses a problem for turnaround managers and distressed companies alike as this slows down the process and with too many warring parties a plan may never get off the ground. As the legislation is relatively new it remains to be seen if this will indeed be a counterproductive issue.

“You have to get creditors buy in within 25 days so you need to operate quickly but you can ask for extensions. That’s the challenging part, getting 75% of creditors to agree. On one occasion we had all 4 banks represented as well as all your normal creditors, where
they couldn’t agree at the best of times. The relationships at that point are quite frayed. ”I2

The practitioner must show why there is a reasonable prospect for the company to continue and not be liquidated. During this point nobody may take legal action against the company without the written permission of the practitioner or the courts. Meetings serve to bring everyone who needs to be involved on board.

“Everyone who is going to be delivering must know what their role is. They must have the right tools, systems, processes and support.”I6

In many cases the relationship between the company and its stakeholders has broken down and trust is gone. The new CEO must repair these relationships and restore trust through open and honest communication. This is highlighted in the theory as well. Suppliers and creditors are often more open to assist when all the cards are on the table.

Although the theory talks of involving government, none of the parties involved had ever had to deal with any government body. Unions too were a minor issue in a turnaround situation and in the little experience in dealing with them, received their full support. The stakeholders gaining the most attention were:

*Creditors:* Should the company fail creditors usually stand to lose the most. The new CEO must renegotiate terms and conditions for existing and if possible future funding. Creditors do not want to see companies going into liquidation. Not only do they stand to lose immediately but will lose on any future borrowings as well. This extends to suppliers who have a trade agreement with the company. At this point relationships are frayed and suppliers, sick of late payments, will only supply cash on delivery. Suppliers do not want to see their customers go under. With this in mind, the new CEO can arrange trade terms with the supplier to aid in the continued relationship through business continuity.
Employees: Communication with stakeholders should start in the recognition phase with the board admitting that something is wrong and the situation needs to be addressed. This is seldom the case. Employees are often the first to notice something is not right. It is important to communicate clearly and effectively right through the organisation to make certain you have buy-in from everyone and ensuring you keep them on sides throughout. Communication should not be sugar coated. It should deliver the urgency with a blow. The dire consequences of failure should be well understood from the beginning as should the plan to avoid such an outcome. A number of communication methods are used in the workplace. Practitioners on the whole prefer to communicate downwards from senior levels to lower levels. Ultimately it is the line managers who do the work so it is important that they know what needs to be done. This message comes from above. As constant communication is necessary another tactic is to relay the message though other media.

“Posters in the work place explaining what it means for them to do a great job and the incentives in place for achieving those things.” 16

Throughout the duration of the turnaround senior managers need to encourage their staff to continue doing a great job. People need to be recognised. They will be proud to be part of the solution.

Senior managers receive a more intimate encounter by way of one-on-ones with the practitioner. At a senior level, short, catch-up meetings are held daily in the beginning to make sure that everyone is on track. These meetings may become more infrequent as time draws on and the severity lessens.

4.1.3.4 Strategic Focus, Organisational Change and Critical Process Improvements

This section is comprised of three key ingredients as described in the theory with two core implementation work streams, namely the development of the business rescue plan and the implementation of the business rescue plan.
Develop Business Rescue Plan

During the crises stabilisation and more specifically the diagnostic phase, analysis reveals the underlying causes of the problems identified in the company. The diagnostic review feeds into the compilation of the business rescue plan. Although recovery strategies cannot be elaborated upon until the problems have been fully explored and understood, solutions for obvious problems can be defined, with the continuance of further analyses on more complex issues. Both theory and practice agree that the business rescue plan must be comprehensive and acts as the turnaround bible during the implementation stage.

The requirements of the business plan are set out in Chapter 6 of the companies act and explicitly depict three parts the business rescue plan must contain. Part A requires a deep assessment of the company background. Part B explains any and all proposals such as any moratorium for which the business rescue plan must make provision. Part C requires all assumptions and conditions that must be satisfied in order for the business rescue plan to 1) come into operation and 2) to be fully implemented.

It is this second point in Part C where the business rescue plan defines the turnaround strategy and the requirements to realise the proposed outcome. The plan should present the long term goals of the company, with the proposed strategy to achieve that vision. Constructing the long term strategy requires a deep understanding of both the internal and external forces affecting the company. Generic strategies are used by practitioners in accomplishing this. To better understand the internal elements of the company practitioners make use of two very popular strategic models or frameworks. Those models are Porters 5 Forces and a SWOT analysis. Porters 5 Forces examines the 5 elements directly related to the company. These are:

1. Suppliers and the power they have
2. Buyers and the purchasing power they may wield
3. Companies in the market directly competing with the organisation
4. The threat of potential new entrants into the market who aim to gain market share at the cost of the organisation
5. Substitute products stealing customers away.

Using the Porters 5 Forces model gave practitioners the foundation and guidance to analyse what forces directly affect the company. Another generic tool used in practice is the SWOT analysis which explores the strengths, weaknesses, opportunities and threats inherent to the company. One would typically explore these four elements in depth identifying what is affecting the company. These two frameworks quickly unearth the goings on in the company and can discover quick wins.

The point of conducting either of these assessments is for the practitioner to identify areas which need to be addressed for the business to continue operating. One must take every care to identify the root causes and not focus on treating the symptoms which serve as the indicators. The consensus is to keep the list of identified problem to a minimum however care must be taken to ensure all issues have been explored and recorded.

The most commonly referred to tool used for assessing the external forces, is a PESTEL analysis. Political, Economic, Social, Technological, Environmental and Legal factors are considered to determine a comprehensive picture of the current scenario.

“You can look at a pestle analysis and find out if we are dealing with a legal issue such as a licence requirement which we know is not going to be reissued which inevitably results in a non workable solution available. You can jump through all the hoops but there is no business to save. Or a BBEEE policy that needs to be adhered to. If we don’t have any BBEEE candidates it’s just not going to work. If there is a fundamental consumer protection act angle which is being ignored it’s not going to fly.”

The use of these tools gives the practitioner an all-inclusive view of the business and its environment so as to draw up a suitable business rescue plan. Each and every problem discovered is described in terms of the proposed corrective action including the implementation
schedule, the resources required, delegation of responsibility and accountability and finally the expected impact it will have on the company.

Legislation also requires that a financial model be submitted showing the projected Statement of Financial Position and the Statement of Comprehensive Cash Flows including any material assumptions made, on which the projections are based. The business rescue plan serves the turnaround team, in a defined and structured report, as a guide throughout the implementation phase.

Business Rescue Plan Implementation

The purpose of this phase is to implement the actions as set out in the design of the business rescue plan in a timely and cost effective manner. Progress of the planned initiatives is monitored closely to see where the objectives deviate from the plan so corrective action can be taken quickly. The implementation phase follows a project management style approach. Gantt charts are used to depict the strict timelines with the defined milestones. Progress reports portray a graphical representation of the rescue plans advancement. Weekly meetings to discuss the progress made, is supported by regularly updated reports. Results are realised quickly and can be seen within a few weeks of implementation.

A common theme throughout the interviews was of best practice continuity or sustainability.

“Sustainability is key. In order to do it well you need to think really hard about how to make it sustainable. That’s how we measure success. We see not that costs for instance, are reduced but rather that they stay down. Pulling the levers and getting short term results is really easy. You can cut back costs but what usually happens is as soon as you leave, the company reverts back to how it used to operate.”

One purpose of replacing top management is to make sure that the people who led the company into the dismal situation in the first place leave, so that it doesn’t revert back to the way it used to
be. ‘Sustainability’ is the measures put in place to ensure that it stays that way. This requires both motivation from the leaders and controls to prevent it from reverting back.

The turnaround in its entirety can take years. Stories of turnarounds taking 2 to 3 years were not uncommon in the findings. More often the implementation phase caters for the crucial elements within the company to be fixed. A growth strategy follows which is where the long term plan commences. The implementation of the business rescue plan is usually fairly short ranging from 6 – 12 months depending on the size and complexity of the company. It was not clear on the exact definition of a successful turnaround. Some commented that it is successful when the company returns to profitability or back to a tax paying state. Others say that a successful turnaround is achieved when the company simply provides a better return for the creditors than they would have had under liquid action. At its conclusion, when the turnaround practitioner has implemented the plan successfully, s/he files a notice with the CIPC informing that the business rescue is complete.

4.1.3.5 Financial restructuring

The importance of financial controls and financial restructuring cannot be stressed enough. This remains a fundamental function during the turnaround. The theory was however more broad in the suggestions, a matter which practitioners may want to explore. Practitioners, on acceptance of the turnaround situation implement new financial and managerial controls. Short term financial controls are immediate and serve to regain control on the cash crises the organisation is experiencing. These include the centralisation of cash management, cash rationing, a cash management system, establishment of cash needs and a short term cash flow forecast.

Longer term financial controls are established to ensure the sustainability of financial controls and may take slightly longer to implement. Purchasing controls are enforced immediately yielding results within a few weeks. This includes the removal of decentralised authority to make payments, spend money, incur credit or commit the business in any way. Gaining control need not be a complicated exercise. One must simply take charge of the cheque book and the order book. This also gives the practitioner a deeper insight into the workings of the company.
Practitioners must be aware that purchase orders, pricing and sale contracts may have been negotiated in the past with unfavourable terms for the company. Practitioners where possible, must cease these agreements or renegotiate more favourable terms. A second measure is the prohibition of discretionary expenses and any planned capital expenditure. Practitioners can also speak to SARS to negotiate with the receiver concerning taxes and the payment thereof.

The theory contributes a few more long term financial controls which can be put in place. These include stopping any planned salary increases and/or promotions, a freeze of the hiring of new staff and stakeholder communication controls.

5 Research Conclusions

Company turnarounds have only recently received a lot of attention in South Africa. Chapter 6 of the New Companies Act only came into effect in April this year (2011). It is based on the United States Chapter 11, a tried and tested piece of legislature, however it has not yet undergone the same scrutiny in South Africa. It remains to be seen if any amendments are necessary to hone the act for this locale. Regardless of the legalities, the new act has been widely received in business.

As a new profession in South Africa it was surprising to find that practitioners, often through their own intellect, contemplation and experience, devised certain practices which are considered ‘best practises’ by international standards. The theory clearly lays out methods, frameworks and actionable approaches to challenges which practitioners have experienced in their own encounters. These tactics lay the foundation for any person involved in a turnaround, and make it easy to recognise, adjust and apply to their own specific situation.

Throughout this research, the findings constantly revealed that both theory and practice is remarkably similar. In some respects identical. Where findings and theory differ, it is clear that those practitioners in South Africa lack experience and could benefit by tapping into a large theoretical knowledge pool on the subject. The findings did reveal gaps in the practices of turnaround specialists, however these gaps are few and far between as discussed in the findings. It must be noted that the theory on which the comparisons are based was gathered through the
experiences of practitioners in the US and Europe. These markets differ in maturity, size and complexity. Some of the revealed practices in South Africa are found to be more relevant to smaller, developing economies. This includes the exclusion of the Z-Score. Practitioners in South Africa did not find it applicable. Perhaps this is a new area which can be researched.

Turnarounds are no doubt going to become an ever increasing feature in business. The days of simply filing for liquidation are over. A new and powerful solution has been adopted, and many businesses which previously would have had to close their doors and stopped operating, now have a chance of regeneration. Both the turnaround manager, as a profession, and the adhered to structures, frameworks and methodologies, are going to become more formal with stricter requirements set in place for those wishing to practice in this capacity. This is an exciting new occupation in an equally exciting new line of work which will no doubt capture the attention of many.

As this paper serves as a guide, I have provided a high level reference tool highlighting the proposed actions to be taken during a turnaround.

*Figure 2*
6 Future Research Directions

As this was in essence a combination of two topics, the identification of financial distress and the turnaround solutions accompanying it, it required a broad overview delving deeper where possible. Financial distress has been explored in depth and many papers and reports have been written on this topic. Corporate turnarounds in South Africa is however a new topic and there are many avenues one could pursue and investigate to better understand the topic.

One could look deeper into the various steps in a turnaround, analysing each one. Much reading was done on this topic however little information was discovered on turnarounds in the South African context or emerging markets for that matter. There is a vast topic to investigate including legal, human resources, management styles, strategic marketing and stakeholder management.

Another interesting topic requiring further examination is the post growth strategies for companies who have successfully navigated the crises situation and are now looking to grow. Consider the strategic marketing initiatives companies might adopt.
7 Bibliography


8 Appendices

8.1 Appendix 1

Interview Questionnaire

Financial Distress

1. How are turnarounds typically initiated?
2. Who usually instigates a liquidation?
3. What financial measures are used to determine if the company is in financial distress?
4. Do you use the Z-Score to determine financial distress?
5. Do you use financial ratio analysis?
6. What ratios do you typically use?

Turnaround

General

7. In those turnarounds what were the main reasons for the company getting into trouble? Management etc?
8. How does the turnaround response depend on the nature of the sickness situation?
9. What constitutes a successful turnaround? Being liquid?
10. What financial measures are used to monitor success?
11. What is the typical duration of a turnaround plan?

Method/Process

12. Describe the distinctive phases of a turnaround including timeframes?
13. What factors internally and externally are taken into account?
14. What methodology or framework do you use? Please describe
15. What strategic models are used to distinguish whether the turnaround will be successful in the turnaround business plan? Such as Porters 5 forces, swot, pestle?
16. What does a business rescue plan look like?
17. How long till turnaround specialists typically see results?
18. What is the long range timeline of a turnaround? 6 months, 2 years?
19. What are the exit strategies of a turnaround specialists and how are they managed, communicated etc?

Management

20. How is existing management in the turnaround handled?
21. Who do turnaround specialists typically report to?
22. What power do turnaround specialists have?
23. What qualifications should a turnaround specialist have to conduct a turnaround?
24. What are the key success criteria which a turnaround specialist should have?
25. What incentive structure is in place for turnaround specialists and the turnaround teams?
26. What communications are used and how are they implemented during the turnaround?
27. What management tools do the turnaround specialists have at their disposal? MIS

**External Management**

28. Which stakeholders are you typically able to negotiate with? Credit, supply, interest etc?
29. What role do the various stakeholders play?
   - Unions
   - Financial institutions
   - Suppliers
   - Customers
   - Government agencies

### 8.2 Appendix 2

**Table 1.1** Total Number of Liquidations (2005 – 2011)

<table>
<thead>
<tr>
<th>Month</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>328</td>
<td>171</td>
<td>175</td>
<td>166</td>
<td>270</td>
<td>206</td>
<td>313</td>
</tr>
<tr>
<td>February</td>
<td>208</td>
<td>213</td>
<td>150</td>
<td>230</td>
<td>301</td>
<td>328</td>
<td>360</td>
</tr>
<tr>
<td>March</td>
<td>240</td>
<td>241</td>
<td>241</td>
<td>297</td>
<td>347</td>
<td>416</td>
<td>320</td>
</tr>
<tr>
<td>April</td>
<td>279</td>
<td>198</td>
<td>236</td>
<td>241</td>
<td>349</td>
<td>356</td>
<td>287</td>
</tr>
<tr>
<td>May</td>
<td>265</td>
<td>311</td>
<td>273</td>
<td>265</td>
<td>295</td>
<td>394</td>
<td>167</td>
</tr>
<tr>
<td>June</td>
<td>265</td>
<td>262</td>
<td>151</td>
<td>233</td>
<td>311</td>
<td>370</td>
<td>156</td>
</tr>
<tr>
<td>July</td>
<td>318</td>
<td>261</td>
<td>272</td>
<td>320</td>
<td>428</td>
<td>281</td>
<td></td>
</tr>
<tr>
<td>August</td>
<td>273</td>
<td>333</td>
<td>387</td>
<td>284</td>
<td>264</td>
<td>243</td>
<td></td>
</tr>
<tr>
<td>September</td>
<td>297</td>
<td>328</td>
<td>507</td>
<td>328</td>
<td>334</td>
<td>341</td>
<td></td>
</tr>
<tr>
<td>October</td>
<td>234</td>
<td>713</td>
<td>266</td>
<td>246</td>
<td>257</td>
<td>296</td>
<td></td>
</tr>
<tr>
<td>November</td>
<td>234</td>
<td>313</td>
<td>194</td>
<td>246</td>
<td>457</td>
<td>344</td>
<td></td>
</tr>
<tr>
<td>December</td>
<td>196</td>
<td>366</td>
<td>205</td>
<td>347</td>
<td>362</td>
<td>325</td>
<td></td>
</tr>
<tr>
<td>Year Total</td>
<td>1225</td>
<td>3426</td>
<td>3051</td>
<td>3300</td>
<td>4135</td>
<td>3992</td>
<td></td>
</tr>
</tbody>
</table>

**Table 1.2** Total Number of Compulsory Liquidations (2005 – 2011)

<table>
<thead>
<tr>
<th>Month</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>39</td>
<td>37</td>
<td>12</td>
<td>29</td>
<td>16</td>
<td>3</td>
<td>45</td>
</tr>
<tr>
<td>February</td>
<td>73</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>26</td>
<td>10</td>
<td>36</td>
</tr>
<tr>
<td>March</td>
<td>55</td>
<td>51</td>
<td>11</td>
<td>41</td>
<td>12</td>
<td>25</td>
<td>12</td>
</tr>
<tr>
<td>April</td>
<td>19</td>
<td>9</td>
<td>32</td>
<td>22</td>
<td>41</td>
<td>17</td>
<td>16</td>
</tr>
<tr>
<td>May</td>
<td>61</td>
<td>26</td>
<td>13</td>
<td>26</td>
<td>28</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>June</td>
<td>29</td>
<td>50</td>
<td>17</td>
<td>20</td>
<td>12</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>July</td>
<td>84</td>
<td>16</td>
<td>14</td>
<td>13</td>
<td>37</td>
<td>35</td>
<td></td>
</tr>
<tr>
<td>August</td>
<td>39</td>
<td>46</td>
<td>111</td>
<td>20</td>
<td>49</td>
<td>22</td>
<td></td>
</tr>
<tr>
<td>September</td>
<td>27</td>
<td>22</td>
<td>47</td>
<td>22</td>
<td>2</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>October</td>
<td>40</td>
<td>30</td>
<td>56</td>
<td>45</td>
<td>17</td>
<td>45</td>
<td></td>
</tr>
<tr>
<td>November</td>
<td>47</td>
<td>56</td>
<td>13</td>
<td>16</td>
<td>12</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>December</td>
<td>18</td>
<td>53</td>
<td>9</td>
<td>2</td>
<td>1</td>
<td>34</td>
<td></td>
</tr>
<tr>
<td>Year Total</td>
<td>324</td>
<td>373</td>
<td>326</td>
<td>276</td>
<td>215</td>
<td>284</td>
<td></td>
</tr>
</tbody>
</table>
Table 1.3 Total Number of Voluntary Liquidations (2005 – 2011)

<table>
<thead>
<tr>
<th>Month</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>208</td>
<td>134</td>
<td>154</td>
<td>131</td>
<td>216</td>
<td>203</td>
<td>268</td>
</tr>
<tr>
<td>February</td>
<td>206</td>
<td>108</td>
<td>177</td>
<td>215</td>
<td>365</td>
<td>320</td>
<td>373</td>
</tr>
<tr>
<td>March</td>
<td>200</td>
<td>216</td>
<td>229</td>
<td>250</td>
<td>327</td>
<td>367</td>
<td>308</td>
</tr>
<tr>
<td>April</td>
<td>201</td>
<td>189</td>
<td>226</td>
<td>274</td>
<td>308</td>
<td>341</td>
<td>261</td>
</tr>
<tr>
<td>May</td>
<td>204</td>
<td>201</td>
<td>260</td>
<td>230</td>
<td>257</td>
<td>354</td>
<td>77</td>
</tr>
<tr>
<td>June</td>
<td>240</td>
<td>212</td>
<td>172</td>
<td>216</td>
<td>291</td>
<td>367</td>
<td>154</td>
</tr>
<tr>
<td>July</td>
<td>234</td>
<td>249</td>
<td>256</td>
<td>257</td>
<td>291</td>
<td>240</td>
<td></td>
</tr>
<tr>
<td>August</td>
<td>204</td>
<td>297</td>
<td>278</td>
<td>352</td>
<td>215</td>
<td>223</td>
<td></td>
</tr>
<tr>
<td>September</td>
<td>270</td>
<td>216</td>
<td>450</td>
<td>305</td>
<td>332</td>
<td>328</td>
<td>511</td>
</tr>
<tr>
<td>October</td>
<td>194</td>
<td>199</td>
<td>247</td>
<td>300</td>
<td>270</td>
<td>344</td>
<td></td>
</tr>
<tr>
<td>November</td>
<td>187</td>
<td>207</td>
<td>181</td>
<td>226</td>
<td>475</td>
<td>334</td>
<td></td>
</tr>
<tr>
<td>December</td>
<td>173</td>
<td>213</td>
<td>187</td>
<td>315</td>
<td>361</td>
<td>791</td>
<td></td>
</tr>
<tr>
<td>Year Total</td>
<td>2,701</td>
<td>2,651</td>
<td>2,825</td>
<td>3,024</td>
<td>3,838</td>
<td>3,708</td>
<td></td>
</tr>
</tbody>
</table>

8.3 Appendix 3
Porters 5 Forces (Tompson, 2010)
8.4 Appendix 4
Z-Score Zones of Discrimination - Corporate Renewal Services (2011)