Leadership and Cultural Renewal
in Corporate Turnarounds

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Abstract

Turnarounds are corporate changes which take place when a firm undergoes a survival-threatening performance decline, whereas restructurings can take place also if a firm is not facing a deep crisis, but a slight decline or is simply looking for new business opportunities.

A turnaround is successful when the firm is able to reverse the performance crisis, end the threat to its survival and achieve sustained profitability.

Successful corporate turnarounds depend upon the replacement of the current top management and actions to be taken simultaneously at three different levels, strategic, financial and organizational.

Successful turnarounds seem to imply a renewal of the organization's shared basic assumptions, i.e. the firm's culture. Cultural renewal appears to be crucial, as well as complex and uncertain.

Keywords: Turnaround; Leadership; Cultural Renewal; Management; Global Competition

1. Introduction

After a decade of expansion and dramatic productivity increases, economic growth in western countries has recently slowed down. Key indicators of economic development (e.g. corporate growth and profitability, and consumer confidence) have declined. Stock markets have reacted negatively, reducing the valuation of many listed manufacturing and service companies, in some cases by up to 90% during a one-year period (Roland Berger, 2001). In this context, corporate crises, and consequently corporate restructurings, seem to be back in fashion. These phenomena appear to be relevant and generalized, since they regard a large number of companies, with no sectoral, dimensional or geographical distinguishing marks. Thus, corporate crisis and restructuring seem to have now gathered greater attention among both practitioners and academics.

This paper will focus on a particular kind of corporate restructurings, i.e. turnarounds. These are corporate changes which take place when a firm undergoes a survival-threatening performance decline, whereas restructurings can take place

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also if a firm is not facing a deep crisis, but a slight decline or is simply looking for new business opportunities (Guatri, 1995; Barker III and Duhaime, 1997; Rispoli, 1998). Therefore, a turnaround is successful when the firm is able to reverse the performance crisis, end the threat to its survival and achieve sustained profitability. More in particular, it will be argued that successful turnarounds depend upon three main issues. The first concerns the fact that a new top management is required to perform the actions which are necessary to get the company back on track. The second relates to the fact that actions to be taken should regard simultaneously strategic, financial and organizational aspects. Thus, creating a balanced turnaround mix of actions which is able to ensure the firm's survival. The third regards the fact that corporate turnarounds should be founded on a process of cultural renewal.

2. The Establishment of a New Leadership

When a survival-threatening situation comes to evidence, and in order to overcome it, a new leadership should be established.

□ *At this regard, Brenneman, the former chief executive officer at Continental Airlines, has recently stated, 'I have never seen the team that managed a company into a crisis get it back on track. Oh, I'm sure it has happened some time in the history of business, but I can't believe it has happened very often. Instead, managers who have gotten a company into a mess are usually mired in a puddle of overbrained solutions. They can't see any way out either. In fact, they have many ways of saying: If the solutions were simple, we would have already thought of it' (Brenneman, 1998).*

There are several reasons why in distressed firms the establishment of a new leadership represents a fundamental issue in order to perform the turnaround. First, the existing top management usually fails in accepting responsibility for and reversing the poor decisions it has made in the past. 'It's an ego thing', as Brenneman states (Brenneman, 1998). Second, the replacement of the top management enables a strong and immediate break up with the past and consents to communicate to stakeholders, both external (e.g. banks and partners) and internal (e.g. middle management and lower levels), the intention of a radical reorientation. Finally, it should be underlined that the employees generally do not trust the existing top management anymore.

The systemic approach to the study of the firm also underlines the importance of new leaders in particular moments of the system's development path (Golinelli, 2000a; Golinelli, 2000b; Sterman, 2000). If the structure which originates the system needs major changes and the system has to be guided along a radically different path, as when it has to overcome a crisis, then its governing body has to be substituted first. Furthermore, the Resource Based View (RBV) implicitly assumes that radical change in a firm needs leadership to be changed (Prahalad and Hamel, 1990). If the resources or competencies on which the firm is based do not support its competitiveness, a necessary step is to replace the actors that manage the resources or competencies at the top level. In other words, if the firm has to search for new foundations, the founding competence represented by the top

management has to be different. Nevertheless, as the distinguished Professor Donaldson points out, in some cases the radical changes implied by a turnaround have been effectively managed by the existing management (Donaldson, 1994). For example, this is what has happened with General Mills, Burlington Northern and CPC International. However, these seem to be extremely rare cases (Hofer, 1991).

Establishing a new leadership generally implies that the chairman and/or the chief executive officer (CEO) and/or the chief operating officer (COO) has to be replaced. It should be noticed that the decisions concerning the replacement of the top management (e.g. when and who should be the new leaders) are taken by different actors depending upon the firm's property structure. In large public companies, choosing the new leaders is a responsibility of the board of directors. This choice, however, is generally the outcome of a mixture of pressures by the directors, the banks and the institutional shareholders. In owner-managed firms, of course, the decision lies within the responsibility of the owner. However, banks may insist to introduce a turnaround manager to work alongside the owner (Slatter and Lovett, 1999).

The establishment of a new leadership often involves substitution of employees at a middle management level. In these cases, the new top management, once it has settled, decides to perform its task bringing in the company new actors in key positions. This is what has happened in many distressed companies in the U.S.A.

> □ *In the case of the turnaround of Intergroup of Arizona Inc., for example, a new CEO replaced the chief financial officer, the vice president of sales and marketing, the vice president of operations and the director of individual products (Gonzales, 2000).*

If the outlined process of middle management substitution is extensive, then it can be said that the company faces a management reengineering.

Once the new leadership has been established, it has to integrate effectively with the firm's structure, i.e. people working within the firm at every level. The reason for this is that everyone in the structure has to be involved and committed, in order to support the change with enthusiasm. It is generally claimed that, in order to recover, old habits and procedures should be abandoned and a unity of intents built. At this regard, classical and enlightening examples come from Alfred Sloan's approach at General Motors and Lee Iacocca's at Chrysler (Sloan, 1963; Iacocca, 1983).

The Human Resource (HR) department generally plays an important role in rendering the changes shared by the company at all levels, especially when external consultants are involved in or even guide the turnaround process.

> □ *As Milite, a HR management expert, points out, 'Top management can bring in turnaround professionals, and top management can let the rest of the company know it backs the turnaround process. But that may not be enough to calm the fears of employees … That's where HR comes in. Because of their unique place in the company, HR people can help or hinder turnaround efforts considerably … The HR department can set the tone for the turnaround acceptance … Communication and cooperation are the most important elements of a successful turnaround effort. The HR department is the most qualified to serve as a bridge*

between turnaround professionals and the rest of the company' (Milite, 1999).

It should be noticed that in Anglo-Saxon countries, where the managerial labour market is highly dynamic, distressed firms frequently turn to professionals named turnaround specialists (Mackay, 1999; Editorial, 2000; Maurer, 2000). These are managers which have considerable leadership skills, flexibility (the ability to listen and modify views), the ability and courage to make rapid decisions based on a minimum of data and analysis, and a relevant experience at driving through change in difficult times. The turnaround specialist is usually appointed as CEO, but may not start out in this position. In fact, turnaround specialists sometimes work as consultants while assessing the firm's crisis situation and then join the board. Moreover, the turnaround specialist generally brings in the company a team of professionals whom he trusts.

3. Turnaround Actions and the Firm's Equilibria

Once the new top management has entered the company, it has to assess the causes of the crisis and then take action in order to turnaround the firm's performance. Consequently, a plan of action is needed (Weston, Siu and Brian, 2001). This should carefully evaluate the firm's strengths and weaknesses, as well as environmental opportunities and threats, thus representing a useful guide for developing decisions and policies. Once the plan has been set, the firm should stick with it and continually monitor its performance against it. However, plans are subject to revision, both in anticipation and reaction to internal and environmental change. The product mix, for example, is continuously reviewed and modified on the basis of external changes and new knowledge and understanding.

In a turnaround situation the top management should plan major changes of three different kinds, strategic, financial and organizational. The first concern the scope of the firm's activities, i.e. the firm's business areas and the way in which it operates in them. Actions to be taken at this level may include, for example, sell-offs or divestitures and acquisitions. The second refer to the firm's financial structure and policies. Changes at this level may include, for example, recapitalizations and exchange offers. The third concern the reengineering of the firm's organizational structure in a broad sense. This includes, for example, the adoption of a functional structure in lieu of the multi-divisional one and downsizing.

The importance of taking action simultaneously at a strategic, financial and organizational level may be connected to the circumstance that firms which face deep crisis need radical change, which in turn requires the firm to change as a whole. In other words, radical change may not be effectively implemented if it fails to take into account all of the three faces of a business dynamics, which are the strategic, the financial and the organizational one. Furthermore, it should be underlined that a firm's survival and possible competitive advantage is based on the simultaneous and continuous achievement of three types of equilibria, economic, financial and organizational (Cafferata, 1995a). Firms which are facing a crisis generally need to restore all of the three equilibria and consequently to pursue strategic, financial and organizational change.

It has been claimed that turnaround situations differ from normal conditions in that the former require radical change, whereas the latter do not. In normal situations, in fact, firms should be characterized by dynamic stability (Abrahamson, 2000). At its essence, this is a process of continual but relatively small change efforts that involve the reconfiguration of existing practices and business models rather than the creation of new ones. Firms, like individuals, should continuously engage in sequential learning and in small adjustments and improvements, which should be implemented at the right intervals.

In order to perform a successful turnaround the top management should build a cautiously balanced turnaround mix of actions of the three kinds. In building the aforementioned mix, it should take into account the interactions existing among the three kinds of actions. Furthermore, it should be pointed out that the mix is to be built both ex ante and ex post. Ex ante, to meet the need of planning, with consciousness and rationality, the actions which seem to be able to grant the firm's survival. Ex post, to assess the degree of success of the different actions which have been implemented.

After the turnaround mix has been planned, it has to be implemented. It has been claimed that effective implementation depends not only upon the new top management's capabilities, but also upon the efficiency with which the actions are carried out. More in particular, it has been argued that effective implementation of radical change, such as a turnaround, is influenced by the quality of the firm's resources, processes and values (Christensen and Overdorf, 2000). Resources relate to the tangible and intangible endowment which characterizes the firm. Processes represent the patterns of interaction, coordination, communication, and decision making employees use to transform resources into products and services of greater worth. Finally values, which sometimes carry an ethical connotation, are the standards by which employees set priorities that enable them to judge whether an order is attractive or unattractive, whether a customer is more important or less important, whether an idea for a new product is attractive or marginal, and so on.

The relative importance of each kind of action varies depending upon the concrete case, so it can cannot be argued that actions of one kind are always more or less important in comparison with actions of another kind (Bowman, Singh, Useem and Bhadury, 1999). Regarding this issue, early corporate turnaround theorists claimed that strategic reorientations are central to the recovery process at many declining firms. However, subsequent empirical research has reported that successful turnarounds are primarily connected to cutback actions that increase efficiency, i.e. mostly financial and organizational actions. It seems that the gap between theory and empirical evidence has been recently closed by Barker III and Duhaime, who discuss a model proposing that the extent of strategic change initiated in a successful turnaround, and therefore its contribution to the success of the process, varies systematically with a declining firm's need and capability to reorient its strategy (Barker III and Duhaime, 1997).

Turnaround processes generally take place over a long period of time (Grudzinski, 2000).

□ *Consider, for example, Finmeccanica, the biggest Italian company operating in the defence and space industries. It took the firm more than three years (1997-2000) to reverse its poor performance and achieve sustained profitability (Gatti, 2002). During the same period (late 1990s), many other Italian state-owned firms have gone through*

similar rejuvenating processes, in order to create the conditions for privatisation (Cafferata, 1995b).

Nevertheless, in some cases successful turnaround processes seem to conclude very quickly (Nelms, 2000). This is what has happened, for example, to Qatar Airways, which recovered in a few months. Turnaround processes, no matter if they take a long or a short time, are always very complicated and uncertain, and should gain momentum at all times (Brenneman, 1998).

4. From a New Ideology to a New Culture: Governing Corporate Fragility

The final aspect on which we would like to draw our attention is represented by the fact that successful turnarounds seem to imply a renewal of the firm's culture. In fact, the effectiveness of the new leadership, effective implementation of turnaround actions (strategic, financial and organizational), commitment, enthusiasm and unity of intents of human resources all seem to imply a renewal of what Schein calls the 'organization's shared basic assumptions', i.e. organizational culture (Schein, 1992). These assumptions pertain to the solutions experimented by the firm over time for adaptation to the environment and internal integration.

This aspect should be looked at more closely. In particular, our aim is to discuss the link between the establishment of a new leadership and the creation of a new culture, as well as to shed light on the essence of the process of cultural renewal. Our interpretation is represented in the following figure (Figure 1).

Figure 1: *Cultural Renewal in Corporate Turnaround Processes*
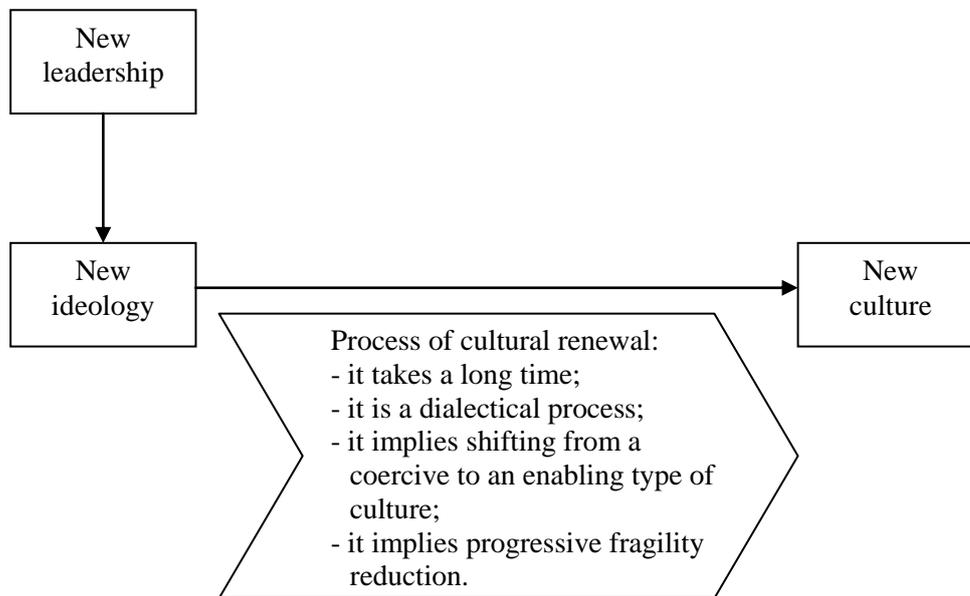
Although the importance of establishing a new leadership in order to perform the turnaround process has been previously discussed, it has to be pointed out that this key issue does not lead directly and immediately to a new culture within the firm. The establishment a new leadership can be expected, instead, to imply the introduction of a new ideology, i.e. a mixture of wishful thinking and declarations

of intents relating to the future of the firm. As such, the introduction of a new ideology typically regards the short term.

Cultural renewal can only be expected to start from the new ideology, as it is not an event, a discrete choice of the new leader that takes place at a single point in time. On the contrary, it is a complex process, which takes a long time to generate a new culture. Furthermore, the contents of a new ideology stem from external sources (Weick, 1995), whereas the ones of a new culture consist in new collective and successful experiences and arrangements which originate within the firm.

The process of cultural renewal takes place by means of numerous and very different actions, such as training, implementation of new managerial approaches and operating systems, etc. It goes far beyond the scope of our work to deepen the different actions, their connections and impacts. To this regard it is our intention to point out four general aspects.

The first relates to the fact that the process of cultural renewal takes place over a long period of time. Creation and absorption of new shared basic assumptions represent a slow process, one that unfolds over years. Keeping the firm's people involved throughout the process is a crucial factor for the establishment of a new culture and it's a job that lies at the heart of leadership.

The second aspect to be considered is that cultural renewal should be intended as a dialectical process (Benson, 1977). As such, its development is guided by the application of four principles:

- social construction/production: cultural renewal can be seen as a result of continued social interactions both within the firm and between the firm and its environment. Through these interactions old social arrangements are gradually modified or replaced. The production of new social patterns is itself guided and constrained by the new leadership and the external context;
- totality: the process has to be guided relationally, that is with attention to the multiple inteconnections existing among each part and participant in the firm and between the firm and its environment;
- contradiction: every social order, and thus every organization, contains contradictions, ruptures, inconsistencies, and incompatibilities. On one hand, these contradictions are to be used as levers for radical breaks with the old shared assumptions. On the other, they should be controlled in order not to exacerbate conflicts among human resources or in ways which contain it;
- praxis: cultural renewal should contribute to the construction of new shared assumptions on the basis of reasoned analyses on both the limits and the potential of the old social forms.

The third aspect to be considered is that the process of cultural renewal, considered as a whole, should consist in shifting from a coercive type of culture to an enabling one. Borrowing concepts from prior research on bureaucracy (Alder and Borys, 1996), the aforementioned distinction can be traced as follows. A coercive culture stifles creativity, fosters dissatisfaction and demotivates employees, whereas an enabling culture provides needed guidance and clarifies responsibilities, easing role stress and helping individuals at every level to be and feel more effective. Thus, an enabling culture represents a complement to, rather than a substitute for commitment. Among other things, an enabling culture depends on the characteristics – not the different degrees – of the core features of the bureaucratic form, i.e. workflow formalization, specialization and hierarchy. Consider, for example, formalization, i.e. written rules, procedures and

instructions. An enabling logic is founded on the attributes of the type of formalization which is adopted, not its different degrees. In an enabling logic, formalization designs procedures that facilitate responses to real work contingencies. Procedures are not designed to highlight to superiors whether subordinates' actions are in compliance and deviation from standard procedures is not seen as suspect. Thus, formalization helps to signal to the organization emerging problems and becomes an opportunity for learning and improvement. Furthermore, enabling formalization provides human resources with visibility into their work. It isn't formulated as a list of flat assertions of duties. Moreover, the enabling approach to formalization provides human resources with a wide range of contextual information, designed to help them interact creatively within the organization and with its environment.

The last aspect relates to the fact that the process of cultural renewal should be intended as a mechanism for governing the firm's fragility, both internal and external. The former concerns its internal functioning, whereas the latter its relationship with the environment. The aforesaid fragility derives from the fact that the firm is undergoing a deep crisis. In particular, the distressed firm faces a situation characterized by the fact that the systemic conditions which enable its survival and competitiveness are seriously damaged. Stemming from mainstream theories of organization, these conditions may be said to include differentiation, structuring, integration, goal seeking and equilibrium (Cafferata, 2003). The new leaders should then govern the process in order to restore the firm's systemic conditions, thus progressively reducing its fragility. The process of cultural renewal then consists in a process for governing the firm's fragility, it aims at reducing such fragility by building a new, enabling culture which consents the systemic conditions to be restored. Thus, the new, enabling culture represents a fundamental organizational technology, and in turn a powerful weapon for the firm in competition.

Intending the process of cultural renewal as a means for governing corporate fragility appears to be central, as it may provide two major benefits. A first benefit may come to the new leaders, offering them powerful motives for initiating and pursuing thoroughly cultural renewal in the turnaround process. Which in turn may strengthen the rational basis for the investment of financial resources in the process of cultural renewal. In fact, in order for the new ideology to turn into a new culture, it has to be confirmed by successful strategic and operating choices which require investments for their implementation. A second benefit may come to those responsible for selecting and developing actions for cultural renewal, in that it may clarify the connections between certain actions and the firm's systemic conditions, thus underlining the progressive fragility reduction.

□ *As an example of cultural renewal in a turnaround process consider the case of Pirelli, an Italian company engaged in the manufacturing of tyres, energy cables and systems, and telecom cables and systems. In the early 1990s, the CEO, Marco Tronchetti Provera, has based the cultural change on value-based management and on thoroughly different communication patterns within the firm. Moreover, the commitment of each top manager to the firm's turnaround plan has been managed as a personal contract: Pirelli managers had their personal assignments, their budgets and had to keep their word by following through on their promises (Sicca and Izzo, 1995).*

One last point appears to be important to underline. It is difficult to judge the progress of cultural renewal. This circumstance leads us to reflect on a further aspect, which is represented by the difficulty of judging the possibility of its continuation if the leader that started it changes. In other words, the process of cultural renewal is delicate, and may be interrupted, for example if the leader who launched it is substituted during the turnaround process.

□ *Evidence of the aforementioned problem comes from the case of Poste Italiane, the Italian state-owned company which offers postal and financial services. In March 1998, a new CEO, Corrado Passera, was called to guide a turnaround process. The organization's situation at the time was critical, given its inefficiency, relevant losses and transition from a public body to a state-owned company. By giving concreteness to managerial autonomy, which is indeed difficult in public corporations (Cafferata, 1995b), Passera designed a plan of action to turnaround the company. In extreme synthesis, Passera's intent was to focus not only on cost reduction, but also and even more on revenue growth. In order to pursue this intent, two key issues emerged from Passera's plan. First, the strategic idea of exploiting Poste's main strength, its widespread network, to offer financial services in competition with banks. This idea generated immediate and strong opposition by financial institutions (e.g. Vergnano, 1999a; Vergnano, 1999b). Second, the need for cultural renewal, which has been pursued by investing heavily in building a new image and in training hundred of thousands of employees to customer care and pride to be a member of Poste. In this context, an important role was played by the cooperation with trade unions. The new strategy couldn't be fruitful without a cultural renewal.*

The progress of the turnaround process is evidently reflected in Poste's financial statements and the cultural renewal is clear to all Italian citizens. In May 2002, though, Passera moved to lead a primary Italian bank and a new CEO is now guiding Poste Italiane. It is hard to judge the impact of this event on the ongoing process of cultural renewal at Poste. Will it continue? Will it stop? Will it regress?

The case of Poste Italiane rises a general question: which is the impact of CEO succession on an ongoing process of cultural renewal? Our argument then seems to represent a direction for future research in the fields of corporate culture and CEO succession.

5. Conclusions

This paper has argued that successful corporate turnarounds depend upon the replacement of the current top management and actions to be taken simultaneously at three different levels, strategic, financial and organizational. If the company fails to establish a new leadership, it is likely that this fact will have a major effect on the outcome of the turnaround process. It seems important to note, however, that

the choice of the right leaders represents a very difficult issue. The new top management settlement is often followed by the replacement of employees at the middle management level. The new actors should effectively integrate with the existing structure, so that the whole firm will support the process of change. Actions concerning strategic, financial and organizational issues should then be planned, and effectively implemented. In fact, radical change of distressed firms seems to require the firm to change as a whole. In other words, it seems to require the firm to change in a systemic way. What appears to be an important issue to analyse is if systemic change could be implemented before the company's crisis in order to prevent it and avoid the need for turnaround actions.

Finally, it has been pointed out that successful turnarounds seem to imply a renewal of the organization's shared basic assumptions, i.e. the firm's culture. To this regard we argued that firm's ideological change can be expected to result directly and immediately from the establishment of a new leadership, whereas cultural renewal cannot. The latter process is a dialectical process which takes place over a long period of time and is aimed at generating an enabling culture. Furthermore, this process of cultural renewal should be viewed as a mechanism for governing the firm's fragility. Thus, the most difficult task that the new leaders face is not to initiate the turnaround process, but to actually perform it guiding a process of cultural renewal which progressively reduces the firm's fragility. At its essence then, a successful process of corporate turnaround can be seen as a process of cultural renewal which consists in governing effectively the firm's fragility, i.e. in progressively reducing it. It appears to be crucial that the new leaders don't ignore this process at first, that they don't neglect to guide it and finally that they don't fail it. Cultural renewal appears to be crucial, as well as complex and uncertain. That's why it makes the difference.

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