Financial Distress and Corporate Turnaround: A Review of the Literature and Agenda for Research

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Abstract

A considerable body of research aims to discriminate between companies with the potential to stem decline, or recover from financially distressed conditions, from those which will ultimately fail. The literature spans a number of academic disciplines and embraces theorising, case studies and anecdote. Even so much confusion remains regarding the circumstances where recovery is feasible, and those factors and strategies likely to facilitate such recovery. This paper reviews this literature by focusing on the turnaround decision, the process and problems of reorganization and the probability of its success. Categorization of studies centres on the turnaround process to facilitate the generation of an analytical overview of findings with regard to alternative strategies which are a precondition for success. The paper concludes with a future research agenda embracing an alignment of strategy, implementation, and the sources of financial distress, together with an extended scope for turnaround studies.

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Introduction

Voluntary administration legislation allows companies to reorganize their affairs and make arrangements with creditors to the point where they can continue trading. The survival of an ailing business, or at worst improved returns, by avoiding immediate liquidation can be extremely beneficial to stakeholders. However, this legislation currently also provides incentives to prolong the existence of non-viable companies, so that the gap between the incidence of 'financial distress' and the eventual 'corporate death' has become increasingly complex. Efficient managerial decision making can give a company the opportunity to survive, but some organizations will be beyond help, and it is important that we can avoid unnecessary time and expense by distinguishing between the two. The following review of current turnaround literature categorises, summarises and compares the analyses and findings of important studies in this field.

The Turnaround Decision

Routledge and Gadenne (2004) recognise the importance of the role of decision-makers, their behaviours and their relationship with information cues. They develop statistical models to clarify and investigate these issues. Their first step was to examine the 'reorganization event', the actual decision as to whether a company should set about reorganization or decide to liquidate as soon as it enters voluntary administration. Routledge and Gadenne recognise the work of Bulow and Shoven (1978) and White (1980, 1983 and 1989), who demonstrate the importance of information to the potential coalitions of decision makers, including equity-holders, managers and different groups of creditors.

Over the last thirty years, particularly in US, the concept of financial distress has changed radically, partly because of major changes in both the law and the markets. Firstly, the number and the scale of bankruptcies have increased greatly since the adoption of the 1979 Bankruptcy Reform Act. Secondly, companies have increasingly substituted public original-issue high-yield debt for commercial loans, and the number of investors buying and selling in and out of distressed

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firms, sometimes to the extent of participating directly in their reorganisation, has ballooned. This added complexity has increased the time-lag between the onset of irreversible 'financial distress' and 'corporate death' with an associated impact on claimholders.

Clear, reliable information can be particularly difficult to obtain or verify during a period of financial distress. Even the valuation of a distressed firm can be so complex that decisions about potential action are extremely debatable. A major problem is for claimholders to determine whether a company is insolvent on a stock as well as a flow basis, making precise definitions important. Wruck (1990: 421) observes that:

> *A stock-based definition describes as insolvent a firm with a negative economic net worth: the present value of its cash-flows is less that its total obligations.*

This equates to Altman's (1968) "insolvency in a bankruptcy sense", whereas Wruck's "A firm in financial distress is insolvent on a flow basis, it is unable to meet current cash obligations.", equates to Altman's "technical insolvency". Investors must be aware of the history of a company's cash flows, as well as being able to predict future cash flows. Reorganization policies are required by concerns for company value maximization and by a variety of groups' self-interest. Where these two factors clash considerable resources will be required to resolve the problem.

However, there will inevitably be conflict of interest over the best way to resolve distress, as different reorganization policies will distribute wealth in different proportions between shareholders, creditors and managers. This may even lead to bias or inaccurate data being presented by groups pursuing their own ends (e.g., Kaback, 1996, Dalton & Daily 2001). The possibility of value-destroying behaviour and decisions is strong; in the most extreme cases prolonged controversy can be the 'last straw' leading to corporate death.

It is important, then, that managers and claimholders share as much accurate information as possible. Managers may contribute the best information about internal operations, whereas creditors or shareholders may themselves have (or employ specialist analysts who have) a better assessment of external factors such as the effectiveness of top management etc. It may be that, in such circumstances, information flow may be the crucial difference between success and failure in

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turnaround, and should therefore be taken into consideration in any assessment.

Despite this environment of conflicts of interest and imperfect information, financial distress is often resolved through private workouts or legal reorganization (in US, under Chapter 11 of their Bankruptcy code). For example, according to Gilson (1989, 1990) and Gilson etal, (1990) using New York and American Stock Exchange companie, whose performance over three years had put them in the bottom 5% – while 51% became distressed, either defaulting or restructuring their debt, 49% did not. Yet, even among distressed companies, 47% were able to resolve this distressed state through private negotiation with creditors, without ending up in the bankruptcy courts. Other studies (e.g., Weiss, 1990; Morse and Show,1988) have shown, respectively, that of 95% of companies emerging from Chapter 11 with reorganization plans, only 5% were eventually liquidated; and that of 60% of those emerging from Chapter 11 with reorganization plans, 7% merged with other companies and 15% were eventually liquidated. Similarly Section 588 of the Australian Corporations Act (2001) imposes a duty on directors to prevent insolvent trading. A series of subsequent high profile failures has made this issue highly topical in Australia, suggesting that the implications of the legislation for managerial action and corporate governance deserve increased attention in the corporate distress and turnaround literature.

Gilson et al. (1990) further found that the higher the ratio of bank debt to total liabilities, the higher the probability of private renegotiation. On the other hand, the more complicated the company's capital structure and the larger the number of classes of debt, the less likely that private renegotiation would be successful. Less obvious was their finding that when a company's ratio of market value to replacement cost of assets was higher, private renegotiation was also more likely. The suggested implication is that private reorganization is more probable in companies whose activities generate significant intangible assets.

White (1983, 1989) emphasises the incentive that equity holders have to avoid liquidation that would eliminate their holdings, and that managers, through self-interest in the preservation of their own jobs, may be said to act as agents for equity-holders. Therefore, where equity commitment remains, the probability of reorganization should increase. Indications that the going-concern value of the firm (minus the costs of reorganization) would exceed its liquidation value (future profitability), or

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that levels of liquidity will be high enough to pay off unsecured creditors, also promote the possibility of reorganization.

In many financial studies, the focus has been on the cost of distress and the financial restructuring costs, rather than on the potential benefits. However, numerous researchers (e.g., Kaplan, 1989; Smith, 1990; Baker and Wruck, 1989; Kaplan and Stein, 1990) concur in their findings that distress is often accompanied by comprehensive organizational changes in governance, management and structure, which can create value by improving the use of resources and improving efficiency. Financial distress can actually overcome inertia and force management to rethink, producing change and adaptation to a depth and scale unlikely to have occurred otherwise.

The costs of financial distress would normally comprise direct and indirect costs.

Out of pocket or direct costs include the legal, administrative and advisory fees that the company must pay, and are the easiest to measure. Hence, for US, Gilson et al. (1990) compute the median cost of restructuring debt to be 0.32% of the company's total assets, as measured at the financial year-end closest to the event, whereas other studies (e.g., Warner, 1977; Altman, 1984; Weiss, 1990) estimate actual bankruptcy costs to be between 6.6% and 9.8% of market value, almost ten times more than when private debt restructuring is possible.

Indirect costs, as opportunity costs, are incurred when a company can no longer carry on its business as usual. It may have lost the right to make decisions, such as to sell assets or spend money, without the delays associated with seeking legal approval. Demand for its products may fail if their value depends on or is affected by the company's future performance or survival, whereas production costs may increase if suppliers include a risk premium in their prices, tighten credit terms or withdraw. It may even be necessary to include the cost of stress on management and the time and energy they divert solely towards managing, then resolving, immediate problems.

Routledge and Gadenne (2004) operationalised the costs of financial distress through financial ratio variables in statistical models, representing both the reorganization event, and the 'performance event'. This latter was the second stage of the research, examining how useful financial data was in determining whether a company would successfully

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reorganize (which they defined as its returns on assets for the next three years equalling or exceeding the industry average.) Controls for company size and industry classification were included, as previous research by White (1983) and Hotchkiss (1995) had found significant links between these factors and potential success or subsequent failure.

Results showed that increases in the debt-to-assets ratio and decreases in the debt-to-equity ratio were significant indicators of reorganization being more likely, as were higher levels of short-term liquidity. It was confirmed that industry classification also affected the decision. The model also concluded that unsecured creditors and equity holders determined the reorganization decision. As both models had the same variables, useful comparisons could be drawn. For example, one important and perhaps surprising result was that, although past profitability was an important variable in distinguishing suitable candidates for reorganization, it was not significant in the decision model. This might indicate that going-concern value was not the main concern of 'coalition' decision-makers.

The Role of Decision-Makers

Having established the relative importance of certain financial data to the decision-making process, Routledge and Gadenne (2004) then examine the decision-making performance of insolvency practitioners, important in their role as appointed administrators.

The theoretical background on which they based their process was that of the Brunswick (1952) Lens Model, along with subsequent studies by Libby (1975), Zimmer (1980), Abdel-Khalik and El-Sheshai (1980), Casey (1980, 1983) and Houghton (1984). Here differentiation is made between imperfect information and imperfect cue utilization when imperfect decisions are made. By examining how the latter might be improved by reference to environmental models, Routledge and Gadenne (2004) show how their efficiency could be improved, particularly as past research had shown that subjects consistently used variables that were different from successful discriminators.

Although only a small sample was possible and the experimental task may itself have lacked realism, results suggested that the individual decision accuracy was significantly lower than that of environmental models. This was so both regarding the reorganization decision and in the selection, from a group of distressed companies, of those suitable for

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reorganization. Experience did prove useful in improving accuracy in identifying companies that should be liquidated, but did not improve accuracy in identifying companies that were likely to reorganize. This may reflect the decision-makers' unconscious operational bias towards avoiding the more expensive misclassifications in 'real life'.

The relative lack of explanatory power of statistical turnaround models suggests that a reappraisal is due if these models are to be successful. Such an evaluation should extend beyond the choice of variables (as above) to sample size, measurement and assumptions. Linear models remain the most popular, and are likely to remain so given data constraints; non-linear models need more cases if they are to be robust and avoid collinearity (e.g., Meier and O'Toole, 2005); researchers struggle to identify a reasonable number of turnarounds within a realistic time frame. The existence of contingent relationships, and variable interaction, poses similar problems for modelling so there is a danger that data analysis may become divorced from both theory and reality.

On the other hand, statistical models like that of Routledge and Gadenne (2004), developed for discriminating between successful and unsuccessful companies, give cause for optimism in future research. Higher classification accuracy might be achieved through the investigation of different financial ratio combinations in these models, especially those incorporating trends and directional change. Other possibilities might be the inclusion of relevant non-financial ratios, such as managerial behaviour and creditor behaviour which might imply the need for improved forms of assessment for external factors.

Turnaround Models

Chronological Context

Robbins (1993, 613) summises: "The identification of appropriate managerial responses to financial decline has become increasingly important. There is mounting evidence that traditional turnaround efforts result in failure far more often than in success (Altman, 1983; Nystrom and Starbuck, 1984)."

In US, for example, business failures more than quadrupled between 1979 and 1985, perhaps partly due to the historical atmosphere and overwhelming concern with expansion and growth.

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Behn (1983, 310) observed: “In the past, the inevitability of growth—economic, population, and technological growth—made the task of cutback unimportant…moreover for most organizations…growth itself was a primary goal.” This almost exclusive concentration on strategic planning for strong firms had meant that up until this point there was no unifying theory to guide research into business level turnaround. The associated, and increasingly abundant, literature falls into three convenient groups, concerned respectively with successful recovery strategies, the turnaround process and response to specific crises.

a) Successful Turnaround Strategies

Schendel, Patton and Riggs (1976) concentrated on analysing the original causes of decline, categorizing them according to whether they resulted from a failure to adapt to changing situations (poor strategies), from inefficient, costly or disrupted operations or from overall ineffective implementation of apparently sound strategies. They developed a ‘turnaround’ model which emphasized the importance of correctly identifying and assessing the cause/causes of failure so that both operating and strategic components should be included, and noted that turnaround efforts were most usually accompanied by changes in top management.

Further research by Schendel and Patton (1976) demonstrated that there were strong differences in certain variables describing companies achieving success in turnaround. Here, increased cash flow, inventory turnover and new equipment and plant reflected an increased rate of investment, whilst market share also grew. Conversely cost-to-sales and value-added decreased.

Hofer (1980) extended these studies by suggesting the importance of including the degree, the pattern and the time frame of any decline in turnaround research. He supported the conclusion that the type of responses should fit the original causes of decline, but also theorized that the severity of the decline should dictate whether cost-cutting should be undertaken only in operations or, more aggressively, in asset-reduction as well.

Up until this point, research had been based on case studies and had established the theory of strategic moves being of major importance to turnaround success, but Hambrick and Schecter (1983) applied empirical testing to the current concepts. They set out to identify and

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prioritise those strategies already theorized as leading to successful turnaround, by representing them through multiple variables. They then categorized them as efficiency strategies (concentrating on cost-cutting and/or asset reduction leading to improved profits) or entrepreneurial strategies (which concentrated on longer term generation of revenue and market repositioning), and found that both types were significantly related to successful turnaround. Most importantly, they provided empirical evidence that, even within mature or declining industries, companies following efficiency or operating recovery strategies might achieve turnaround.

O'Neill (1986) provided case study evidence to support these findings, leading him to theorize about the essential investigations necessary in selecting a successful turnaround strategy. He decided that not only the initial cause of the decline and the need for new personalities, thinking and planning in management, but also internal-organizational and external-environment factors (such as stage of product life-cycle, competitive position and industry type) all had to be addressed. He then further categorized four theoretical primary turnaround strategies as Management (which included not only drastic replacements of staff but also tackling problems of motivation in the rest of the workforce, and redefining the business itself), Restructuring (which included changes in the framework of the actual organization, new production methods etc.), Cutback, and Growth (the latter two similar to other researchers' thinking). Importantly O'Neill then examined the relationship of these strategies to external, contextual factors, concluding, in support of Hambrick and Schecter (1983), that although growth as a successful strategy would be severely constrained by strong competition, cutbacks and restructuring could be successful. Ramanujam (1984) and Thietart (1988) also followed similar lines of enquiry.

b) The Turnaround Process

Bibeault (1982) theorized that there were four key factors in achieving successful turnaround. A financially and competitively viable core operation had to be identified and achieved (if necessary by 'slimming down' operations), employee motivation had to be maintained or increased, sufficient financing had to be negotiated to bridge the turnaround period, providing resources for innovation as well as maintaining operation, and there had to be new, energetic, competent and fully-supported management in place. All of these factors were seen as being interdependent. Conversely, it was suggested that failure

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to achieve successful turnaround was due to indecision, ineffectiveness or ill-judgement on the part of management, ill-considered or poorly applied turnaround strategies or inability to arrange sufficient financial recourse.

Bibeault (1982) also introduced the concept of a two-stage model of turnaround, based on his own observations, supported by reported usage (e.g., Goodman, 1982; Slatter, 1984; Slatter and Lovett, 1999). This suggested that 'emergency' strategies to address financial crises and ensure a positive cash flow, and hence immediate survival, must be combined with 'stabilization' plans to streamline and improve the company's core operation. He agreed with Hofer (1980) that the severity and duration of this first phase depended on the severity of the company's financial plight.

After this stage, Bibeault theorized a decision point, where a company had to decide either simply to continue its previous strategies, in a scaled-down, refined form, or whether it would pursue new recovery strategies with return-to-growth, development and increase in market share as objectives.

Slatter's (1984) case studies supported previous researchers' identification of certain key factors for turnaround success, but also suggested strong central financial control, yet with organizational change and decentralization of power (Slatter and Lovett, 1999) and leadership (Slatter, Lovett and Barlow, 2006) as being important. Case evidence from Balgobin and Pandit (2001) for the recovery of IBM UK between 1988 and 1997 was used to establish a significant fit with a turnaround model based on the generic stages of the turnaround process.

Grinyer, Mayes and McKiernan (1988) and Grinyer and McKiernan (1990) investigated the original causes of decline, but concentrated on those specific events which initiated changes in company strategies, and on both the differences and similarities between gradually occurring change and change that was enforced and precipitated by circumstances. Here, they introduced the theories of 'critical threshold' and 'sharpbenders' (those companies achieving sudden dramatic improvement in performance). Their conclusions reinforced previous findings as to different strategies being appropriate to different phases of turnaround.

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Building on this latter concept, Robbins and Pearce's (1992) case study provided further evidence that 'retrenchment' strategies were a crucial first stage of successful turnaround, their nature and extent largely depending on the severity of the failure. Their exploration of the reasons for this produced certain theoretical conclusions: that economic decline having reduced a company's resources, it was essential to safeguard what remained, as a first step towards rebuilding resources through asset redeployment. Only achieving this could provide the flexibility needed for strategic redirection, not only overcoming the costly problems created by present, failing strategies but also enabling the potentially expensive implementation of new strategic initiatives. Therefore, 'retrenchment' would be essential both to stabilize the situation, maintaining the company's viability, and to finance recovery strategies, whatever form these might take. Subsequent work by Smith and Graves (2005) examining turnarounds among UK manufacturing companies substantially supported these findings.

c) Response to Crises Associated with Poor Performance.

A number of studies (e.g., Hedberg, Nystrom & Starbuck 1976, Nystrom and Starbuck, 1984; Starbuck, Greve and Hedberg, 1978) examine crises associated with performance problems, where the performance issues are not so severe as to threaten the survival of the enterprise. These studies attempt to differentiate and explain the distinct stages of response and the determinants and influences involved, such as management changes or available financial resources.

An Integrated Two-Stage Model

Robbins and Pearce (1993) reviewed, summarized and integrated the most important conclusions of the literature up until this point, importantly drawing on multiple disciplines. They concluded that further research would need to investigate the inter-relationships between the four components of the turnaround process already identified: the turnaround situation, the 'retrenchment' response, the 'recovery' response and the level of turnaround success achieved.

To guide potential empirical testing they developed a model of their theory of the turnaround process, expressed as a series of interrelated phases associated with the 'Turnaround Situation' and 'Turnaround Response'. They show the original causes of the company's performance downturn, divided into external and internal factors that, if

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not addressed, will eventually cause financial failure. The turnaround situation is represented here by both absolute and relative-to-industry decline important enough to trigger specific, targeted responses. The next stage of analysis allows an estimation of the threat to be made, within the parameters of declining sales (low-level threat) and imminent bankruptcy (high-level threat).

The Turnaround Response stage they divided into two distinct stages, specifying respectively the measures necessary to ensure survival and/or achieve stability, and then to achieve a long-term recovery.

Where the severity of the situation is limited, and a company has some financial reserves, it might turn the situation around simply by following policies of 'retrenchment' and cost-reduction through improving operational efficiency. However, where risks are high and imminent, the model indicates that a further, more drastic option is also required: a strategy of asset reduction, consolidating operations by divesting the organization of its least productive parts, so gaining essential finance whilst further improving efficiency. As has been noted from other studies, the decision to be made must also be based on the causes of the original decline. This involves assessment of the relative significance of operational inefficiency and strategic misalignment. Smith and Graves (2005), for example, use evidence of recovery in Taffler's (1983) Z-score solvency indicator (as detailed in Agarwal and Taffler, 2003) to indicate turnaround, and seek to match recovery strategy with observed weaknesses in the Z-score profile.

Once immediate stability has been achieved, Robbins and Pearce's (1992, 1993) model suggests a second stage, further addressing the causes of decline, but reversing rather than simply halting the process.

It may be that a company decides, if internal problems have been the major cause of the turnaround situation, to continue its previous strategies, but with reduced resource commitments. However, in most cases the essential work of continuing to maintain or improve efficiency will be coupled with a gradual move towards a more dynamic approach. As the model indicates, particularly if external factors were the more dominant causes of decline, entrepreneurial reconfiguration strategies such as developing new products or markets, acquisitions etc. will be more appropriate.

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The completion of the turnaround process is represented by the achievement of specific economic measures which indicate that the company had at least regained its original levels of performance achieved before the onset of decline. Robbins and Pearce (1992, 1993) also then addressed a number of problems perceived to be impeding further progress in turnaround research, notably the absence of consistent definitions and terminology. Smith and Gunalan (1996) and Smith and Graves (2005) illustrate the lack of consensus between researchers as to exactly what constitutes a 'turnaround situation' or 'turnaround success': there are almost as many definitions as researchers, varying in time span from 2 to 4 years of decline for the former and 2 to 6 years of improvement for the latter; a wide variety of financial measures or 'thresholds' for entry into either phase had also been suggested. One specific problem for companies in highly cyclical industries is that they might have actually faced and overcome turnaround situations within each cycle of the economy, while still remaining market leaders in their industry even in the 'down' periods. It might therefore be wise to adopt industry-based definitions, as suggested by Hambrick and Schecter (1983), Ramanujam and Grant (1989) and Robbins and Pearce (1992, 1993).

A Refined Two-Stage Model

In their 1995 research, Arogyaswamy, Barker and Yasai-Ardekani developed a model that represented turnaround companies as showing two groups of responses to decline; those strategies aiming to halt or reverse the adverse results of poor performance and those strategies aiming at recovery by achieving a better competitive position. They also suggested that both of these strategy sets were essential to recovery, and that all strategies had to be effectively managed and adequately supported. This necessarily included successful management of the company's external stakeholders together with its internal climate (specifically information flows and decision-making processes). They viewed the current literature as placing too much emphasis on the role of 'retrenchment' as an immediate response, to the detriment of alternatives.

A substantial literature tests the value of retrenching (defined as asset and cost reduction) to turnaround. However, this has not yet succeeded in establishing a strong positive empirical link between retrenchment and successful turnaround. The financial ratios used measure significantly

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lower cost of goods sold/sales (e.g., Ramanujam, 1984; Schendel and Patton, 1976), lower inventory/sales and lower receivables/sales (e.g., Hambrick and Schecter, 1983; Ramanujam, 1984), lower marketing expenditure/sales, lower R&D expenditure/sales and increased sales per employee (e.g., Hambrick and Schecter, 1983) in successful turnaround companies. However, use of these ratios means that the improvements can also be caused by greater sales gains. The existing evidence does not therefore make explicit whether increased efficiency is a result of asset or cost reduction, of sales gain, or of a combination of the two.

Hence there would appear to be more to the early stages of the turnaround process, and that further investigation is necessary. Certainly there is already some evidence that other problems existed in declining firms. For example Gilson (1990) and Sutton (1990) found reduced or withdrawn support by external stakeholders, whilst Mohrman and Mohrman (1983), Krantz (1985), Cameron, Whetten and Kim (1987) demonstrated difficulties in the internal corporate climate, and Bozeman and Slusher (1979), Staw, Sandelands and Dutton (1981) and D'Aunno and Sutton (1992) noted links with poor decision-making processes. Cost and asset reduction alone are unlikely to cure all of these problems. Therefore retrenchment as the sole initial response is likely to be a necessary, but not a sufficient initiator of turnaround. Barker and Mone (1994) argue that exclusive focus on retrenchment activities may obscure or even exacerbate other problems and actually reduce chances of recovery. Cost or asset cutting strategies may reduce company morale to the extent of losing quality employees, even from management level.

It is therefore important that models of the turnaround process recognize and address the intricacies of the many factors involved, that they are often interdependent and that strategies to address them may need to be simultaneous or overlapping. A major design fault in many studies has also been the assumption that the stages in responses are, or should be, linear in occurrence, whereas in reality the relationships between strategies are likely to be complex. To be more useful, models should therefore allow for overlapping, feedback loops, and the impacts of one strategy on another.

Yet by 1990 no large-sample study had produced evidence of the effectiveness of any turnaround strategies other than those to do with increasing efficiency. Arogyaswamy et al. (1995) suggested that this might be due to lack of examination of the interdependence of the

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causes of, and response to, decline. Current study design had meant that very heterogeneous samples were used, chosen regardless of the causes of the decline of the companies involved. These might have been widely divergent and might therefore have indicated very widely varying needs for strategic change. As a result, they emphasised the need for recognition in model and research design of the importance of the cause/causes of a company's decline. This close matching of strategy with apparent causes of financial decline is still missing from most studies, and represents a future research opportunity.

Another so far unaddressed issue was the role of management in the turnaround process, particularly at top level. Although this had been frequently mentioned, there was so far little empirical evidence from large sample studies that changes in top management are linked to recovery (e.g., Lubatkin and Chung, 1985; Castrogiovanni, Baliga and Kidwell, 1992). This may be either because management replacement is not an effective response, or because ways have not been found to measure potential results. Recent evidence suggests a complete reappraisal of the consideration of CEO turnover strategies, and the abandonment of the simple measures currently so often used, in favour of a consideration of the turnover process. The revised Arogyaswamy et al. (1995) model aimed to describe how declining companies recovered, restricting its application to low diversity companies; that is, those that could only reverse decline through their existing operations. This suggested specific strategies that might be adopted in the turnaround process.

The literature still provides opportunities for developing a sounder understanding of the alignment between distress-inducing factors and the most appropriate strategies for dealing with such factors. Research devoted to a careful definition of distress, embracing more than simply financial factors, should help in the specification of a more precise strategy alignment.

Decline-Stemming Strategies

A number of authors (e.g., Slatter, 1984; Smith and Graves, 2005) highlight poor adaptation to the environment, an increase in hostile circumstances, or a combination of both as predictors of performance decline. If unchecked, this leads in turn to erosion of external financial sources, a growth in internal problems and inefficiencies and declining

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internal company climate, information flows and decision processes, and eventual exhaustion of financial resources and outside support.

This downward spiral may be halted or reversed by the uptake of decline-stemming strategies to create efficiency, stabilize the company's internal environment and renew external confidence and hence stakeholder support. Through feedback these strategies will take into consideration the severity of the situation, the level of available resources, and the resource needs of future strategies.

Arogyaswamy et al. (1995) identified three related consequences of decline: self-interest, inefficiency and a deteriorating internal climate.

Self-interest will lead stakeholders to either withdraw, reduce their commitment or re-negotiate higher interest rates, so decreasing company revenues, or increasing costs, which will threaten flexibility at the very time it is most needed. Customers may be lost if there is a fear that quality or delivery may be compromised, whereas suppliers may also withdraw, increase costs or reduce flexibility by demanding rigid terms such as cash-on-delivery etc. Hence damage to relationships with stakeholders can lead to a hard-to-reverse downward spiral of further performance reduction. 'Slack' financial resources and the support of creditors can therefore be a critical, factor if successful turnaround is to be achieved.

Inefficiency can be a consequence of decline as well as a cause. As an industry contracts or competitors win over customers, demand may fall, so a company's fixed cost and asset base become under-utilized, even further restricting ability to compete on price.

A matching deterioration in the company's internal 'climate' is likely. Here decline is characterized by a marked increase in levels of conflict, which may occur between individuals, between groups or even between departments as responsibility and blame are dodged and aggression rises. D'Aunno and Sutton (1992) highlight the consequent downward spiral of inefficiency and time and wasted energy; Bozeman and Slusher (1979) and Cameron et al. (1987) also noted the associated low worker morale and lack of belief in the company itself, which will tend to increase inefficiency and decrease input and energy levels; simultaneously, they found that there is a growing tendency to form self-protective cliques or alliances, jockeying for perceived power at many levels and increasing resistance to change of any sort.

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These factors, and the threat of job losses through cost-cutting, may combine to increase the exit of employees, and those most likely to go may be of the highest quality, with valuable, intangible skills or equally valuable company-specific and possibly undocumented or irreplaceable experience and knowledge about routines, processes or products (e.g., Hirschman, 1970; Greenhalgh, 1983; Perry, 1986). At the same time, a failing company is unlikely to be able to attract new personnel of a sufficiently high standard, so that lines of communication are likely to be adversely affected.

Problems to do with management may also increase. Bozeman and Slusher (1979), Mohrman and Mohrman (1983) and Krantz (1985) all found evidence of a link between decline in morale and a growth of negative, critical attitudes. This often resulted in a loss of belief in the abilities of company leaders at many levels, producing further inefficiencies, time-wasting, lack of direction and possibly even 'under-mining' activities.

The lack of trust may in certain circumstances be justified, as studies by both Whetten (1980) and Staw et al. (1981) suggested that managers of failing companies face increased stress and, as a result, become more erratic in their judgements and decision-making, a common reaction to anxiety. The latter study echoed the findings of Burns and Stalker (1961) and Sutton and D'Aunno (1989) in concluding that stressed managers were decreasingly able to demonstrate flexibility or adaptability to change. This loss of confidence can be a two-way process. Several of the above researchers also noted a marked increase in over-centralised authority and decision-making in failing companies, as stressed management reacted by trying to maintain or extend their power base and showed lack of trust in their subordinates or colleagues.

Attempts to achieve successful turnaround must address all of these probable consequences, and realize also that they may have some reciprocal causality. Decline-stemming strategies targeting improvements in one area may yield improvements in another.

Stakeholder Support

Slatter (1984), Hambrick (1985) and Slatter and Lovett (1999) suggested that specific strategies for maintaining, renewing or even increasing stakeholder support are important to successful turnaround. These may

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involve manipulative, substantive or even purely symbolic actions to increase stakeholders' perception of their power and participation in the company's activities, to highlight or clarify the benefits rather than the potential costs of continued commitment and to improve their general perception/concept of the company and its credibility. Past research (e.g., Chaffee, 1984; Rosenblatt, Rogers and Nord, 1993, Rosenblatt and Mannheim, 1996) has shown that such redefinition is possible. It is has also shown that failure to do so produces the ultimate risk of powerful stakeholders actually taking over control of a company that they perceive as being in severe decline, to protect their own interests (e.g., Gopinath, 1991).

Effects of Capital Structure

Ofek (1993) aimed to analyse differing company responses to short-term distress, looking for ways to speed up company reactions and so preserve value. This concentrated on the relationship between capital structure and company response, building on Jensen's (1989) work which concluded that highly-leveraged companies will respond more quickly to a decline in company value than their less-leveraged equivalents, because even a small decline in value might, for them, lead to default. The implication here is that lower-leveraged companies are less likely to react to short-term operational distress, and will likely lose more of their going-concern value before taking action.

Several other theoretical models had investigated the relationship between a poorly performing company's capital structure (as characterized by its debt-to-equity ratio plus managerial holdings) and its reactions to distress. These fall into two groups, according to whether or not the actions taken generated cash. Some models (e.g., Harris and Raviv, 1990) predicted a positive relationship between leverage and actions that resulted in short-term cash flow, the implication being that the obligation to service debts required sale of assets and operations divestment.

Leverage has an effect on the probability of debt restructuring or bankruptcy, but overall capital structure will likely determine which of the two is chosen. Jensen (1989) argues that highly leveraged companies are more likely to restructure their debt as their company value falls, particularly if the going-concern value is significantly greater than potential liquidation value. Conversely, as increased leverage results in going-concern value nearing liquidation value, bankruptcy becomes

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more likely. Some 'cut-off point' here may be reflected in turnaround selection.

Another common financial response to distress is that of cutting dividends (which will affect both the value of various claims and the cash flow distribution to the company's owners). DeAngelo and DeAngelo (1990), for example, concluded that 67% of companies that experienced decline over at least three years cut dividends in the first year of distress, which may be taken as an alarm signal. Ofek (1993) found that private debt had a stronger effect on a company's actions than public debt, supporting the findings of Gilson et al. (1990), who had concluded that companies with a high ratio of bank debt were more likely to successfully restructure their debt.

Ofek (1993) also reported that, whereas managerial holdings had no effect on cash-generating restructuring, there was a negative relation between managerial holdings and operational actions with no immediate cash flow effects, implying the avoidance of actions such as closing plants, discontinuing operations, laying-off employees or replacing other executive officers. This may be due to inertia or psychological self-interest as much as financial self-interest, but it highlights the fact that larger managerial holdings may actually discourage value-maximizing decisions, another important point for consideration in turnaround selection.

One surprising result was that, while the size of outside stockholding did not significantly increase the probability of operational action, the existence of a large non-managerial investor even reduced the probability of such action. To discover whether this was true of all investors, Ofek (1993) tested seven different types, and found that only investment management firms had any positive impact on the probability of general operational action, or even individual actions. So, overall, a company's reactions to distress can be said to be largely unrelated to the type of outside stockholder, possibly because even large non-managerial stockholders cannot control company actions. Ofek's (1993) findings were largely consistent with those of Jensen (1989): highly-leveraged companies are more likely to react to distress with operational and financial change than their less-leveraged equivalents and this reaction is also more rapid. The implication is that the choice of high leverage by a company during 'normal' operations actually provides a certain discipline so that the existence of debt may help to preserve the

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firm's going-concern value, and may be a positive indicator of potential success in turnaround.

Management Reaction to Financial Distress

Bibeault (1982) characterized success by high energy (supporting research) and intense anticipatory policies aimed at restating 'fit' to changing markets by repositioning, through decreasing activities rather than expanding, plus many mutually coherent internal adjustments and decentralization. Schreuder (1993) sought to provide empirical support through a study of companies selected from industry sectors suffering from lengthy and serious problems. 'Successful' companies maintained fairly stable development over the first five years, followed by increasing profitability in the next three. Of the 'less successful' companies, 90% reported reduced profit levels in the first five years, with almost one third going bankrupt or being taken over, and none regained their initial profit levels within the study period.

Schreuder (1993) compared the number, areas and timing of measures taken by the two groups in response to the crises in their industries, finding that the successful companies took more measures overall, with altered market strategies and product ranges; only 60% and 80% respectively of the unsuccessful groups did likewise. The less successful companies were much more active in taking cost cutting measures. Schreuder (1993) noted that about 30% of both groups replaced their top management, but that at the same time successful companies tended to expand middle management, while the less successful cut back. As a result the successful group combined intensely market-orientated policies with decentralization and a decreased range of activities, whilst the less successful matched cost-orientated policies with centralization and diversification outside their industry.

Timing was also found to be a crucial factor; successful companies took their measures in management, market and production on average one year before the start of the industry crisis, apparently anticipating problems. Less successful companies were characterized by a lag in response to deteriorating conditions, with measures being taken to adjust organization and management, on average, a full two years after the onset of crisis. Thus successful companies were characterized by changing top management and empowering middle management at the

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start of their series of measures, whilst less successful companies did so at the end, perhaps when all other possibilities had been exhausted.

At the same time specific effective strategies to stabilize the company's internal climate and decision processes should be implemented. Hedberg, Nystrom and Starbuck (1976), Cameron (1983), and Mohrman and Mohrman (1983), among others, advocate a corporate culture emphasizing, encouraging and supporting participation, decentralization, flexibility, experimentation and ease of communication. Sutton, Eisenhardt and Jucker (1986) also suggest that the important problem, the loss of talented employees wishing to avoid the stigma of association with decline, be addressed through human resource strategies which motivate remaining employees. The impact of human resource strategies is a grossly under-researched area in accounting (see for example Jazayeri and Cuthbert, 2004). The turnaround context, and the examination of the relationship between alternative HR strategies, turnaround success and financial outcomes, would appear to be a particularly fruitful area for further research.

Management Ability to Implement Decline-Stemming Strategies

Several studies (e.g., Hofer, 1980; Robbins and Pearce, 1992) have suggested that the severity of decline largely determines the choice of strategy, between asset or cost reduction, and also the extent and rigour with which associated measures will be applied.

Lohrke, Bedeian and Palmer (2004) suggest that the level of resource 'slack' will be another important influence on corporate response. Hambrick and D'Aveni (1988) suggest that, if this is limited, the company will be more vulnerable. Thus while a company might be expected to initiate vigorous decline-stemming strategies, their implementation and flexibility may be constrained by lack of finance. A large amount of available slack, conversely, may dull perception of, or actually reduce the need for, uptake of decline-stemming strategies, since the spare capacity will allow a certain level of performance variability to be absorbed. This distinction is largely consistent with the outcomes observed by Schreuder (1993) in the previous section, though the relationships do not appear to have been examined empirically.

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Many researchers (e.g., Grinyer and Spender, 1979; Hofer, 1980; Bibeault, 1982; Nystrom and Starbuck, 1984; Slatter, 1984; Slatter and Lovett, 1999) have observed that in declining companies the turnaround process will usually be initiated by the removal of top managers, or even the CEO. However, Frederickson, Hambrick and Baumrin (1988) observe that where company decline is perceived to be attributable to uncontrollable external causes such as political events, specific industry decline or economic recession, then retention of the CEO might retain some corporate credibility. Thus, where the causes of decline are industry contraction based, changes in top management may actually be counter productive, particularly (e.g., Friedman and Saul, 1991) where such changes can be distractingly disruptive.

Where stakeholders regard the incumbent CEO as responsible for the decline, they may be treated as scapegoats. Where such action does not address other possible causes of decline it may contribute to lower employee morale, accentuating internal dysfunction and withdrawal of stakeholder resources, and increase the risk of failure. Barker, Patterson and Mueller (2001) suggest that replacements, particularly if imported, are likely to have fresh perceptions and new perspectives based on differing experiences and knowledge; Kow (2004) and Clapham, Schwenk and Caldwell (2005) support replacement of the CEO as more likely to promote a turnaround. Friedman and Singh (1989), and Worrell, Davidson and Glascock (1993) observe that replacement of the CEO with an outsider has produced rises in company stock prices, but there is considerable disagreement in the results of empirical studies on stock-market reactions to changes in senior management, with Bonnier and Bruner (1989), Khanna and Poulsen (1995), Warner, Watts and Wruck (1988), and Weisbach (1988) reaching opposing conclusions. These conflicting results suggest the need for a reappraisal of the way CEO turnover is researched, so that both board composition and the circumstances surrounding the CEO change are considered in detail. Elloumi and Gueyié (2001) find chief executive change, as a proxy for turnaround strategies, to be associated with corporate governance characteristics in financial distress. Interestingly, they observe that CEO change is not a necessity for successful turnaround, and recommend more research on the dynamics of board composition around the CEO turnover event. In this regard Baird and Rasmussen (2006) note the increasingly important role of US banks in structuring their lending arrangements to effectively give them

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the right to demand the replacement of the CEO in the event of a technical default and as a condition of the loan.

The literature is clear that the specification and 'labelling' of strategies in turnaround research is simply not good enough. Behavioural implications are potentially so important that future research must address implementation strategies, the processes undertaken, and the management styles of those doing the implementing.

Causes of Decline and Loss of Competitive Position

Strategic reorientation will vary in direction and depth according to the causes of the company's loss of performance. Whetten (1987) and Cameron, Sutton and Whetten (1988) note that decline can be caused by either industry-wide contraction (where the market cannot support the original number of companies and intense competition causes deteriorating performance) or by underperformance in an expanding or stable industry. A variety of reasons for the latter have been suggested:

(i) unanticipated changes in the factors providing competitive advantage (e.g., the introduction of new products or services by competitors) as noted by Barney (1991);

(ii) the loss of firm-specific skills (human capital) which were the foundation of the firm's competitive advantage, as noted by Castanias and Helfat (2001);

(iii) the adoption of misplaced strategies, or failure to update its traditional capabilities, experience, knowledge or resources, as noted by Grinyer and Spender (1979).

Hofer (1980), O'Neill (1986) and Thietart (1988) all emphasise the importance of a company's market share in the choice and effectiveness of its recovery strategies. If performance decline is due to short-term or long-term contraction of the whole industry, the company may actually still be in a good position relative to others. Conversely, firm-based decline usually indicates a poor market position, although this may mask potentially valuable capabilities or resources that are simply being under utilized. These findings highlight the importance of matching turnaround strategies to the cause of decline.

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Arogyaswamy et al. (1995) suggested that where decline could be attributed to a short-term, cyclical contraction, recovery strategies that did not make major changes to its strategic orientation would be the most effective. This extends the work of Hannan and Freeman (1984) and O'Neill (1986). Hannan and Freeman (1984) note that reorientations involving new routines, skills or even structures and reorganization entail considerable cost, which is particularly difficult to absorb in times of increased competition, and may actually produce a greater risk of failure. O'Neill (1986) suggested that this situation should be met by small-scale and gradual strategy changes, with the objective of further reducing costs while maintaining and strengthening the existing market advantages.

For long-lasting industry contraction Harrigan (1980), for example, recommends that companies in a good position should adopt incremental strategy changes that expand or hold this position by further investment to exploit or strengthen already existing resources and capabilities, hopefully 'freezing out' weaker competitors or forcing them to specialize in small customer segments. Harrigan (1980, 1985) suggests that already weakly positioned companies should adopt this 'niching' strategy anyway. For firm-based declining companies, many researchers (e.g., Schendel et al., 1976; Grinyer and Spender, 1979; Hofer, 1980; O'Neill, 1986; Arogyaswamy et al., 1995) agree that strategic reorientation and fundamental changes in strategy and structure are needed to produce resources and capabilities better fitted to the needs of the environment. Where such decline-stemming strategies are implemented too late and with insufficient strength, then failure is likely to follow. Hedberg and Jonsson (1977), Starbuck et al., (1978) and Ford (1985) all suggest that this may be largely due to managers failing to differentiate between company-based causes and temporary industry-contraction causes, preferring to choose the latter and so failing to react. Even if the causes of decline are industry based, managers may fail to recognize when the hostile external situation extends in duration or becomes permanent rather than a temporary phase that requires little or no adaptation.

This misdiagnosis may be due to a lack of willingness on the part of managers to accept responsibility for failure, particularly if they have previously been successful. Hedberg and Jonsson (1977), Nystrom and Starbuck (1984), and Barr, Stempert and Huff (1992) observe that managers may block their perceptions of new problems or situations,

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resulting in problem-solving methods being adopted which are no longer appropriate. Yet even if correct diagnosis of cause occurs, Tushman, Virany and Romomelli (1985) show how both individuals within an organization and influential stakeholders may block moves that they perceive as threatening their resources or power.

Further Refinement of Turnaround Models

Sudarsanam and Lai (2001) summarized the current research on corporate turnaround from financial distress, and compared the practical applicability and effectiveness of the more important proposed turnaround strategies on a large sample of 166 potentially bankrupt companies (1985–1993). This focused on the relative significance of the timing, intensity and form of implementation of the various suggested procedures, tracking their success over a 3-year period from distress. Sudarsanam and Lai examined restructuring responses, categorized as managerial, asset or strategic, financial, operational or organizational, and inappropriate response, embracing managerial inaction or poor choice of strategy, poor timing, lack of focus and concentration or intensity and/or poor implementation of chosen turnaround strategies. They tested empirically the effectiveness of each restructuring strategy, as well as the overall effectiveness of a combination of identified strategies, and concluded that an assessment of financial restructuring, as a key element of corporate restructuring, was important. This might involve examining dividend cuts or omissions (often the choice of larger firms) and equity issues, or the replacement of existing debts with new contracts (reducing interest or capital, extending maturity or a debt-equity exchange); in other words equity and/or debt-based strategies.

However, they were still of the opinion that the adoption of turnaround strategies alone could be no guarantee of recovery. Even though strategies might be simultaneous, sequential or overlapping in application, affecting turnaround to a different extent, or depending for their influence on each other, both recovery and non-recovery companies actually adopted very similar sets of strategies immediately after financial distress, though their choices differed as time went on. Recovery companies tended towards investment and acquisition, whereas non-recovery companies were more inward-looking, concentrating on financial and operational restructuring. However, evidence suggested that actual choice of strategy was not as important as the effectiveness of the strategy chosen, which depended on speed,

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intensity and competence. Recent findings from Boyne and Meier (2006) even suggest that 'good luck' may play just as an important role as 'good management' in determining the success of particular strategies. They operationalise good luck as a favourable change in a constraining variable (e.g., environmental) despite the adopted strategies, and show it to be a significant variable in successful turnaround.

Future research might include such environmental changes as well as embracing the impact of potential conflict and support between simultaneously implemented strategies. Again the consideration of behavioural implications is vital here if success is to be assured.

Discussion and Research Agenda

Turnaround research has traditionally addressed three key aspects of recovery:

(i) the identification of causes of firm decline – internal and external;

(ii) recognition of the consequences – financial and behavioural, and

(iii) responses to the decline – control of cash flows, retrenchment strategies, CEO change and specific turnaround measures.

As Pandit (2000) observes, researchers have focused largely on turnover variables (i.e., what to do) at the expense of strategy implementation and the turnover process (i.e., how to do it). Perhaps as a result, empirical content based models of turnaround have poor predictive power: they fail to match responses with causes, and fail to identify in any reliable way, which distressed companies are equipped to effect successful recoveries. There are more opportunities for work of this nature, embracing relevant managerial variables (e.g., Smith and Graves, 2005), but they may be doomed to failure without increased attention to the turnaround process, and the circumstances surrounding the turnaround event.

Much of the above literature has agreed that top management change is a precondition for successful turnarounds, particularly to establish bank and creditor confidence in the ability of the company to manage the crisis and to re-motivate employees. This is likely to be so even if the cause of poor performance is beyond management control since, as

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Grinyer, Mayes and McKiernan (1988) note, one of the major differences between recovering and non-recovering firms is that the former make more management changes. The effectiveness of managerial restructuring in turnaround, and the manner in which it is conducted, remains an avenue for further research. Elloumi and Gueyié (2001) demonstrate that the composition of the board of directors explains financial distress, without reference to ratios of financial performance, though without the same degree of explanatory power.

Several factors determine choice of strategy: the company's capital structure necessitates consideration of its relationship with its bank, and the influence and desires of block shareholders and managerial shareholders; the company's leverage position, as detailed by John, Lang and Netter (1992), Ofek (1993) and Kang and Shivdasani (1997), is clearly critical to the success of any restructuring. Although many distressed companies make it a priority to reduce borrowings and interest costs, financial restructuring had not been identified as a necessary component of turnaround strategy until relatively recently, notably following Grinyer et al., (1988).

The literature provides some support for an overlapping, two-stage approach to turnaround strategy, which can be categorized as the

i) operating/efficiency turnaround stage, and the

ii) ii) entrepreneurial/strategic stage, where the latter eludes the non-recovering firms. The former aims to stabilize operations, the latter seeks to restore profitability, where both address cost reduction, revenue generation and operation-asset reduction programmes to cut down direct costs and overheads whilst maintaining or improving production.

Depending on the severity of the distress, divestment of subsidiaries or divisions may even be imperative. Assets which are not providing positive returns must be sacrificed to stop the cash drain, and even 'profitable' assets may have to be converted into cash. This is the most common turnaround strategy for all but the smallest companies; even so, Sudarsanam and Lai (2001) suggest that further empirical research is required to assess its significance in achieving successful turnaround.

An examination of asset investment might include both internal capital expenditure (designed to improve productivity and reduce costs) and

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acquisitions (where companies have mature or declining markets or products). Both might enhance the company's competitive advantage, but can only be undertaken after very careful planning, and when the extremity of financial distress has been overcome or before it occurs. One danger is that acquisitions might be undertaken to promote apparent growth, but without being sustainable. Pearce and Robbins (1993) suggest the need for further work in this area.

A number of researchers (e.g., Robbins and Pearce, 1992; Barker and Mone, 1994; Hoffman 1989) have suggested that how managers tackle the company's problems could be just as, or even more important than, whether they take action at all, indicating that turnaround success or failure depends more on strategy implementation than on strategy choice. This issue also requires further empirical investigation.

Most of the turnaround literature is derived from US and UK studies; hence the focus of this paper. However, we must not neglect the development of turnaround studies elsewhere. Most interestingly, studies from Asia (notably Bruton, Ahlstrom and Wan, 2001, 2003) cast doubt on the efficacy of Western turnaround models when applied in East Asia. They found that pressure from institutions and the impact of the Chinese business culture made these models inapplicable; strategies considered important in the West to effect turnarounds were not implemented. However, Fisher, Lee and Johns (2004) found no difference between Australia and Singapore on a number of turnaround aspects: change of Chairman, change of CEO, change of ownership, speed and commencement of retrenchment. They concluded that governance transparency issues, rather than culture, were the key factors impacting on behaviour, and suggested further research examining institutional environments in other East Asian countries. Ahlstrom and Bruton (2004) note that Western studies assume that firm management has a great deal of autonomy in implementing asset reduction, retrenchment and CEO change strategies. They emphasise that such assumptions are unlikely to be the case in developing economies with different institutional arrangements and additional stakeholder pressures. Ahlstrom et al. (2004) note that the absence of professional managers and the persistence of owner-managers in China makes CEO removal a difficult strategy. Chen (2001) likens the situation in Asia, outside of Japan, to the family business, whether or not they are publicly traded companies! Within Japan, Hoshi, Kashyap and Scharfstein (1990, 1991) highlight differences in financial distress

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associated with closeness to the financial institutions, and greater access to finance. They provide further evidence of country differences which might be attributable to institutional environment rather than national culture.

Gupta and Wang (2004) provide case-based evidence from China on the success of an entrepreneurial-leadership approach to the implementation of turnaround strategies. These findings contrast somewhat with the outcomes of prior studies (e.g., Tan, Luo and Zhang 1998; Chen, 2001) which suggest that the risk-averse nature of Chinese entrepreneurs and fear of failure, are associated with low-risk entrepreneurial strategies.

Just as the expansion of the scope of turnaround studies to address cultural and institutional issues provides a fruitful research area, so does the extension of research into the public sector. Boyne (2006) suggests that the lessons from the private sector might be applied to public sector turnarounds, even though there is currently very little empirical work in the area. Such an extension would amplify all the problems already identified (e.g., multiple performance goals; 'failure' which will be difficult to specify, and failure conditions which may differ according to geographical area) especially since 'failures' are unlikely to disappear, but will be absorbed by other agencies.

The foregoing literature suggests that traditional statistical models developed for discriminating between successful and unsuccessful companies still give cause for optimism in future research. The examination of different financial ratio combinations, especially those incorporating trends, should improve the classification accuracy of these models, as should the inclusion of relevant non-financial ratios, such as managerial behaviour. The latter implies the need for better definition and measurement of external factors. The literature also still provides further opportunities for research which develops a sounder understanding of the alignment between distress-inducing factors and the most appropriate turnaround strategies.

The impact of human resource strategies remains under-researched in accounting generally; in the turnaround context an examination of alternative HR strategies and their implications for financial outcomes and turnaround success should be a particularly fruitful area for further research.

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The literature is clear that the specification and 'labelling' of strategies in turnaround research is simply not good enough. Behavioural implications are potentially so important that future research must address implementation strategies, the processes undertaken, and the management styles of those doing the implementing. Such research might embrace the impact of potential conflict for financial and behavioural outcomes of simultaneously implemented strategies. These would appear to be challenges to be welcomed by accounting researchers.

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