Turnaround strategies for distressed Zimbabwean companies operating under judicial management

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ABSTRACT

Many Zimbabwean companies facing financial distress and having gone under judicial management, which is supposed to be recuperative, have failed to recover. Studies indicate that more than 80% of companies under judicial management end up in liquidation, raising the concern of the judicial managers' skills and competencies. This study, therefore, sought to assess the efficacy of strategies implemented by Zimbabwean companies placed under judicial management and the judicial manager's skills and competencies in turning around companies within a reasonable time.

Data was collected from a stratified random sample of seventy-six respondents consisting of: judicial managers, senior and junior managers and owners of companies under judicial management in Harare. The findings revealed that only financial and operational strategies were shown to have significant and positive impact on post judicial management order performance. The skills and competencies of the incumbent judicial manager seemed to have an insignificant impact on the post judicial management order performance, possibly because in many cases, the top management team is replaced by new managers.

Keywords: Corporate turnaround strategy, judicial management, post judicial management order performance, liquidation

1.0 INTRODUCTION

The study examines the range of strategies employed by distressed companies under judicial management in terms of Sections 299-321 of the Zimbabwean Companies Act [Chapter 24:03]. The literature on judicial management, especially that pertaining the effectiveness of the turnaround strategies, is very scarce. It is, therefore, argued in this study that many companies under judicial management in Zimbabwe end up being liquidated, partly because of the strategies being implemented and partly due to lack of managerial skills and competencies of the judicial managers. To this end, a valuable contribution to research in this field must seek to redress this shortcoming, providing evidence based strategic frameworks that policy makers and business rescue practitioners can utilise in order to make informed decisions.

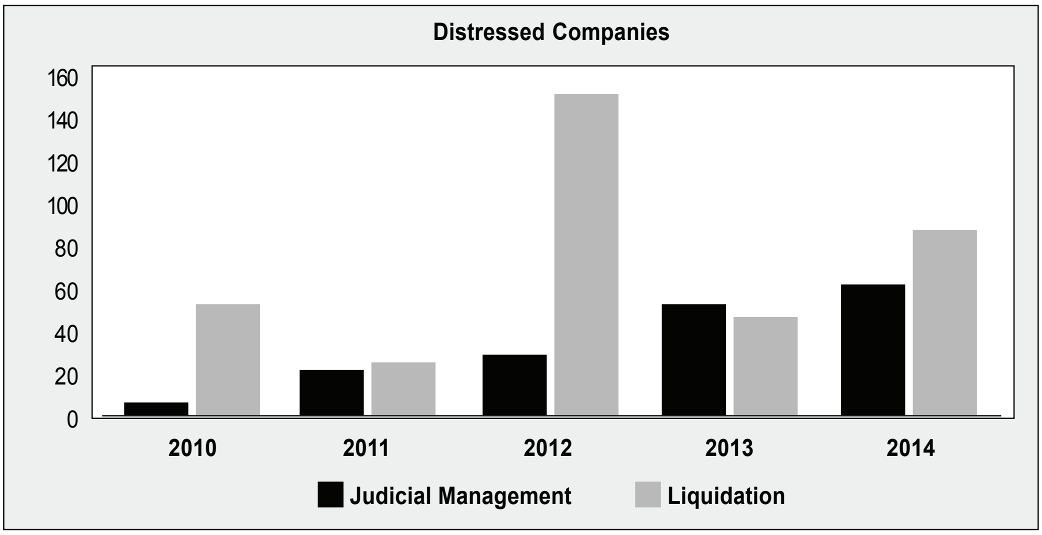
2.0 STUDY BACKGROUND

The interwoven economic challenges that include harsh economic conditions characterised by absence of cheap capital for recapitalization, stiff competition from imports and subdued consumer demand have seen hundreds of firms tethering on the brink of collapse. Most Zimbabwean products have become uncompetitive in terms of quality and price, and many companies are failing to meet their obligations as they become due and payable. This has led to the widespread corporate ill-health afflicting many Zimbabwean companies. To escape attachment of the companies' assets for failure to meet their obligations to creditors, the majority of stressed firms approach the Courts seeking temporary relief from marauding creditors through a voluntary application for placement under Judicial Management.

Judicial Management is a combinatorial process whereby the principles of company law regarding the management of a normal company, as well as the principles appertaining to the liquidation of a company, are fused to ensure the optimum benefit of creditors and members. The purpose of Judicial Management is to enable companies suffering a temporary setback due to mismanagement or other special circumstances to return to viability (Cilliers *et al.*, 2007). In Zimbabwe, the procedure is governed by sections 299-321 of the Companies Act {Chapter 24:03}.

So common have Judicial Management applications become (see Figure 1 below) that the High Court of Zimbabwe expressed concern on possible abuse by companies of this Court sanctioned process, which allows beleaguered companies to pursue alternate survival routes without harassment from creditors and avert liquidation (The Source, 23 January 2015, "Don't rush for Judicial Management, Bankers plead with ailing firms").

Figure 1: Judicial management 2010-2014 Master's Log



Given the growing number of company closures, Judicial Management applications and liquidation cases, there is a heightened need for studies to be conducted in the area of Judicial Management in order to avert imminent economic collapse emanating from rampant company failures. The companies that were placed under judicial management constituted both small and large-sized companies.

When a company is placed under judicial management, the directors are divested of all their powers and the judicial manager takes custody of the company's assets. It is imperative to not only preserve the company's assets, but put them to the most effective and efficient use for the benefit of all the stakeholders. Judicial Managers are individuals who are appointed on the basis of their accounting, legal or estate administration background, suggesting that these are not management or strategy experts *per se*. Despite, their lack of immense exposure in the management field, judicial managers are required to craft turnaround strategies to transform the ailing companies. Nevertheless, their influence in rendering corporate surgery has hardly been analysed.

3.0 PROBLEM STATEMENT

Information obtained from the Office of the Master of the High Court of Zimbabwe suggests that a total of eighty-seven companies were liquidated in 2014 compared to forty-four in the previous year and on the other hand, companies under Judicial Management rose to sixty from forty-four during the same period. The rate of success in turning around companies under judicial management is so low such that there is an urgent need to understand the cause of this low rate of success.

Furthermore, the joint research study conducted by the Zimbabwe Economic Policy Analysis and Research Unit (ZEPARU) and Competition and Tariff Commission (CTC) (2013) reported that; a) judicial management proceedings were taking too long, b) judicial management proceedings in Zimbabwe always have a very low rate of success, and c) once a company is placed under judicial management, it is difficult to put it back on a solid financial footing. The paradox is that, the very same stakeholders who are intended to benefit when companies placed under judiciary management recover, such as creditors, shareholders, employees and the community, end up being the greatest losers, because judiciary management proceedings always fail. If companies under Judicial Management are not carefully monitored to adopt the right corporate renewal strategies then the government initiatives such as Distressed Industries and Marginalised Areas Fund (DIMAF) may be doomed.

The main objective of this study was *to determine the turnaround strategies that have the greatest impact on improving the performance of companies placed under judicial management.* The main research question was: *Which are the main turnaround strategies being implemented by companies under Judicial Management have the biggest impact on performance post judicial management?*

4.0 LITERATURE REVIEW

Smith and Graves (2005) make a significant contribution to literature by defining a turnaround process as a series of integrated steps involving the decline stemming and the recovery phase. A commonly held viewpoint is that, a company can be considered to have been turned around when it has recovered from a decline that threatened its existence to resume normal operations and achieve performance acceptable to its stakeholders.

Several categorisations of turnaround actions have been proposed in the literature such as: financial strategies, operational strategies and managerial or human resource strategies (Panicker and Manimala, 2015; Sudarsanam and Lai, 2001).

Financial strategies in corporate turnaround entail developing the financial strength of the business as a resource that can generate competitive advantage (Scherrer, 2003). The literature identifies financial strategies as strategies that address how the business is funded. The strategies involve choosing between financing the business through debt or equity (Sudarsanam and Lai, 2001). It is about improving the company's capital structure to relieve it of the burden of interest charges and debt repayments. Therefore, these strategies are separated into two strategies namely: equity-based and debt-based strategies.

Operational or efficiency strategies may involve both revenue maximisation and input minimising (Pretorius, 2008). Revenue generation is pursued by focusing on existing lines of products, initiating price-cuts (or raising prices where products are price insensitive) and increasing marketing expenditure to stimulate demand.

Managerial strategies generally involve re-invigorating the firm's leadership as studies show that only 9% of failures are due to influences beyond management's control and sheer bad luck (Collard, 2011). The actions may entail reduction of wages, salaries and other incentives, which may be referred to as belt tightening or decline stemming strategies (Arogyaswamy *et al.*, 1995; Schoenberg *et al.*, 2013; Smith and Graves, 2005). Cost-cutting and financial restructuring leading to lean management, forms the bedrock of any successful recovery bid (Igor & Steve, 2006).

Portfolio strategies include diversification, vertical integration, new market share thrusts and divestment. This strategy entails determining the markets, products and customers that have the potential to generate the greatest profits or alternatively better buying power and refocusing the firm's activities on these areas. There is consensus that successful turnarounds are associated with a focus on product lines for which the firm has a competitive advantage or loyal customers (Sudarsanam and Lai, 2001).

Different and unique sets of leadership skills and competencies are required during turnaround situations in order to effect change. Lymbesky (2011) reiterates that a turnaround leader must have many soft skills such as the ability to lead and motivate people who are frustrated, scared, and often without hope. A synthesis of the literature on turnaround strategies identifies the following key skills and competencies: entrepreneurship, team-building (Burnes, 2009; Lymbesky, 2011). Furthermore, there is a need for leadership with suitable experience and the appropriate academic background (Osthauzen, 2014). The leaders must be able to lead from the front, which requires knowledge of the business in its entirety and not just in specialist areas and an ability to manage through discontinuity (Witzel M, Financial Times, 5 August 2003, in Burnes, 2009).

5.0 RESEARCH METHODOLOGY

The study, therefore, sought to test the following hypotheses:

Hypotheses 1

$H_{1:}$ Financial strategies positively impact the performance of companies under judicial management.

Hypotheses 2

$H_{2:}$ Operational strategies positively impact the performance of companies under judicial management.

Hypotheses 3

$H_{3:}$ Managerial strategies positively impact the performance of companies under judicial management.

Hypotheses 4

$H_{4:}$ Portfolio strategies positively impact the performance of companies under judicial management.

Hypotheses 5

$H_{5:}$ Key competencies and skills of the Judicial Manager positively impact the performance of companies under judicial management.

In order to test the above hypotheses, data were obtained using a structured survey questionnaire, using Likert's 5–Point Scale statements. The Instrument was distributed to seventy-six respondents randomly selected from a population of companies in Zimbabwe that applied for Judicial Management under the Companies Act [Chapter 24:03] section 299, from 2010 – 2013 and fifty-two dully completed and returned the questionnaire.

Table 1: Population and sample framework

Population		Sample			
		Gender			
Category	Size	Male	Female	Size	Selection Method
Companies	96			25	Simple random sampling
Judicial Managers	25	8	0	8	Stratified random sampling
CEO	36	5	1	6	Stratified random sampling
Senior Managers		16	6	22	Stratified random sampling
Junior Managers		9	5	10	Stratified random sampling
Owners	76	1	1	5	Stratified random sampling
Total		**39**	**13**	**76**	**Stratified random sampling**

The questionnaire was administered based on a 'drop and collect' basis, which offered an opportunity to get data from respondents in a cost effective way and enabled them to complete the questionnaire at their own pace (Ibeh, Brock, and Zhou, 2004).

6.0 DATA ANALYSIS, FINDINGS

6.1 Descriptive tests

Out of a sample of 76 structured questionnaires administered, 52 were dully completed thereby giving a response rate of 68.4 % which is satisfactory given that all sectors were represented in this sample, see Table 2 below.

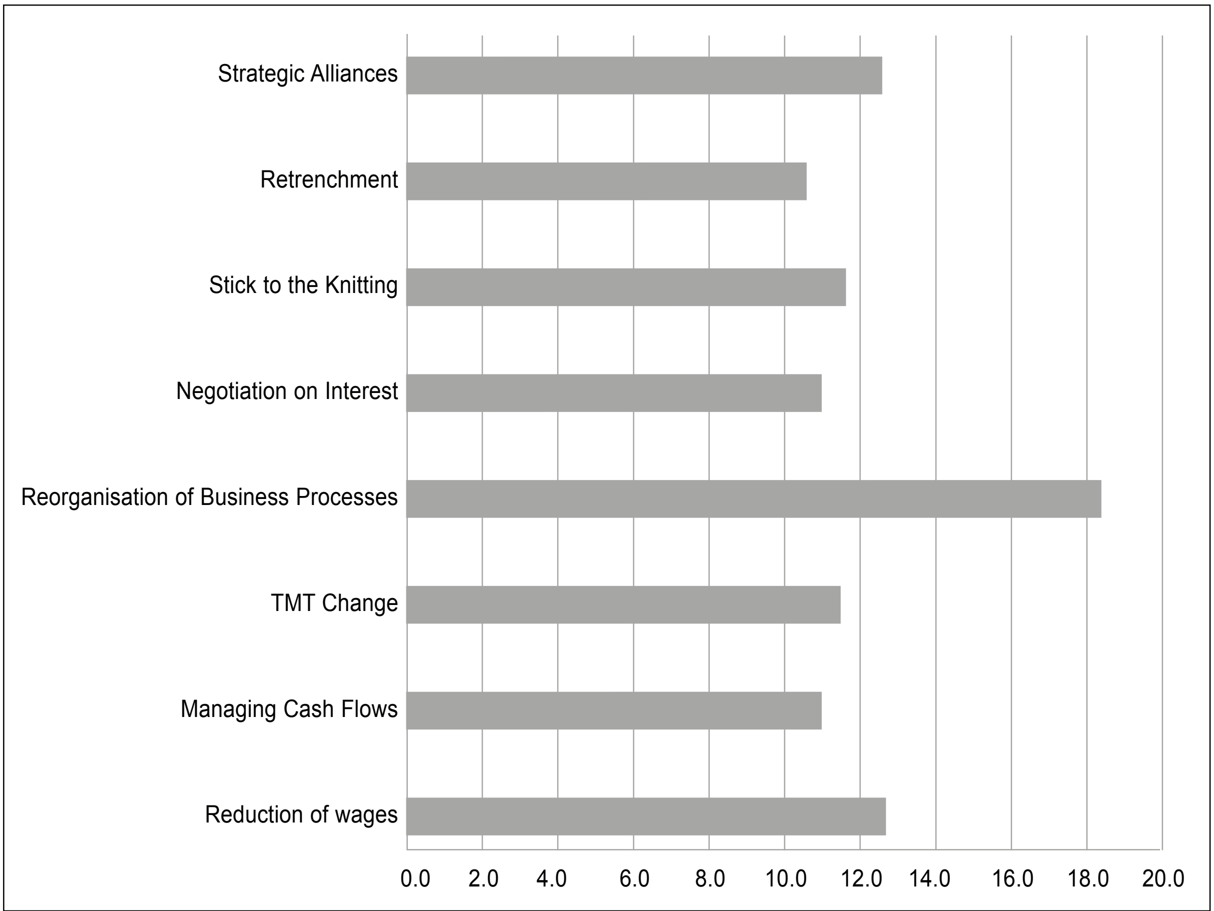
Table 2: Response rate

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Owner	2	3.8	3.8	3.8
	Judicial manager	8	15.4	15.4	19.2
	CEO	6	11.5	11.5	30.8
	Senior manager	22	42.3	42.3	73.1
	Junior manager	14	26.9	26.9	100.0
	Total	**52**	**100.0**	**100.0**	

The majority of the respondents were senior managers who constituted 42.3%, followed by 26.9% junior managers.

Figure 2 below identifies the most commonly used strategies among the companies in judicial management (JM).

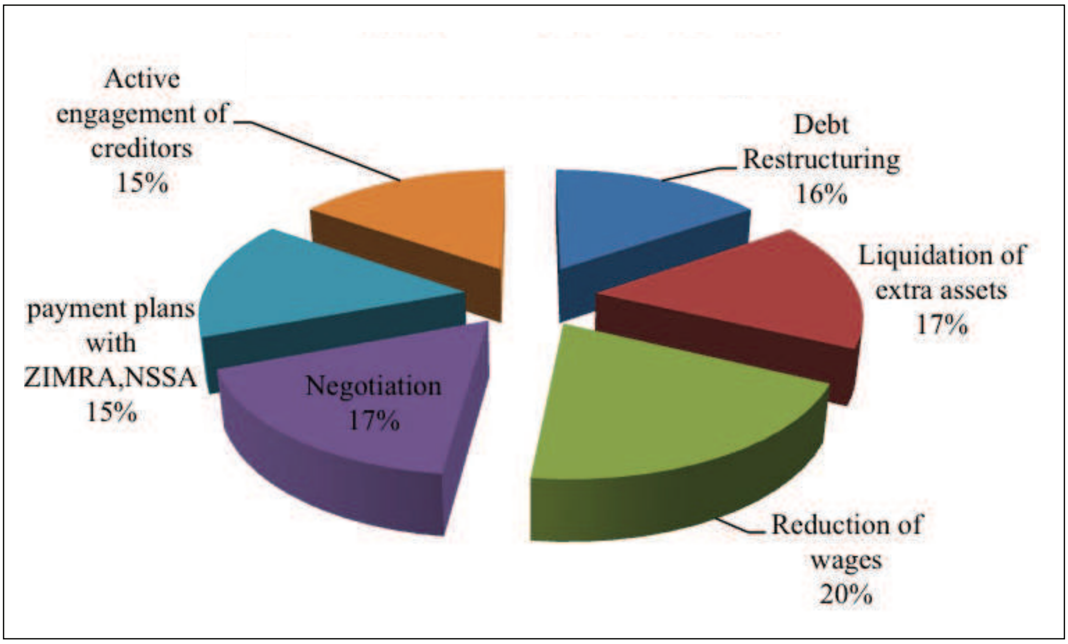
Figure 2: Commonly used strategies



From Figure 2, reorganisation of business processes was the most commonly used strategy by companies under judicial management.

The analysis also examined the various financial strategies used by companies under judicial management as shown in Figure 3 below.

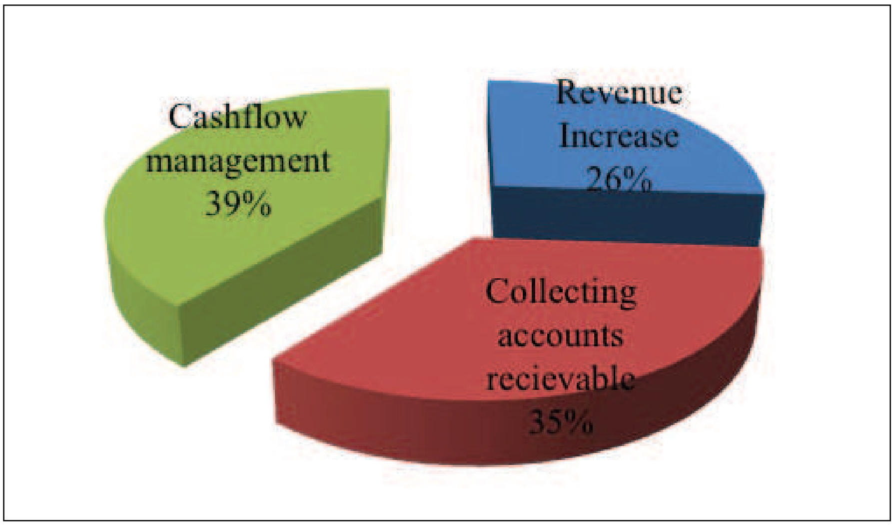
Figure 3: Financial strategies



The majority of the companies used reduction of wages (20%) and liquidation of extra assets (17%) as main financial strategies. This could have been because of the lack of working capital caused by inaccessibility of funding. Engagement of creditors (15%) and debt restructuring (16%) were marginally used.

From an operational perspective, the findings indicated that most Judicial Managers adopted a cash flow management strategy coupled with collecting and reducing accounts receivables, see Figure 4 below.

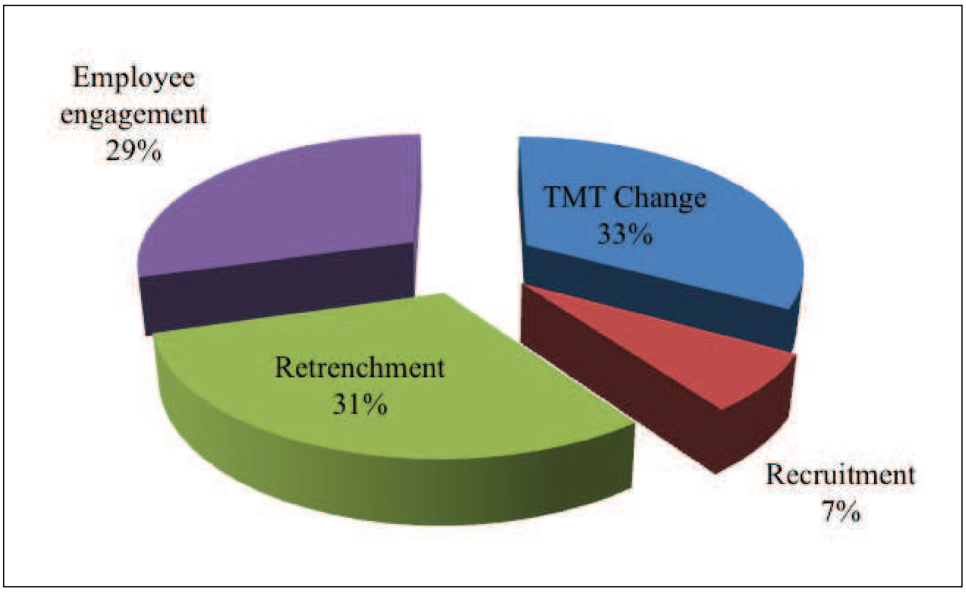
Figure 4: Operational strategies



The job of a Judicial Manager is to stop the haemorrhage, establish a going concern and ensure viability.

Figure 5 below shows the most commonly used managerial strategies used and it shows that retrenchment and top management team (TMT) change were the most common managerial strategies employed by Judicial Managers.

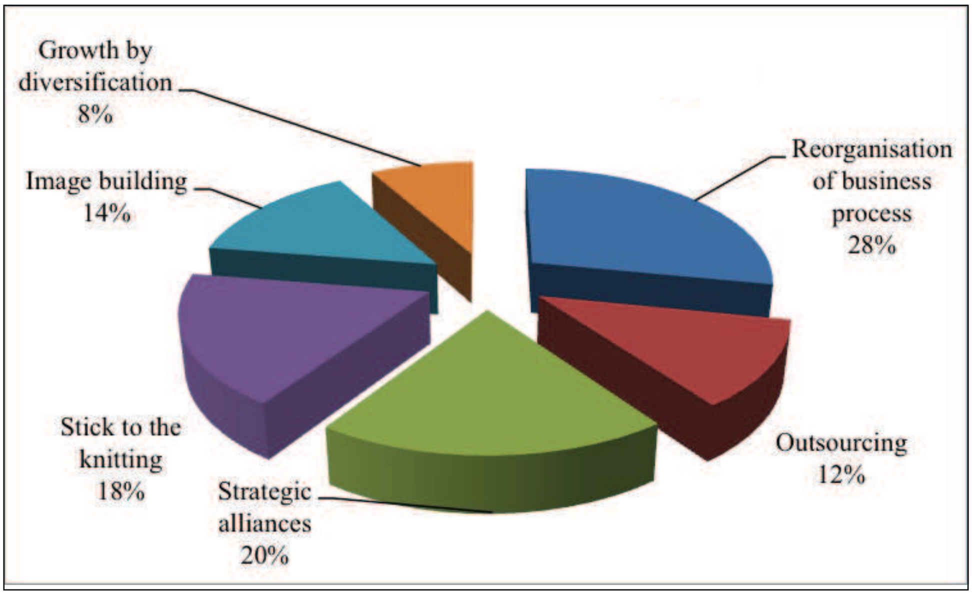
Figure 5: Managerial strategies



The idea of retrenchment and TMT change stems from the principle that those who brought the company the current demise cannot be authors of the turnaround. Such is the argument for the management displacement insolvency regimes. It is widely accepted in turnaround literature that one of the most effective ways of initiating and managing a successful turnaround is a change in leadership.

Of the various portfolio strategies used, most companies adopted reorganisation of business processes (28%) and strategic alliances (20%) as the main portfolio strategy, see Figure 6 below.

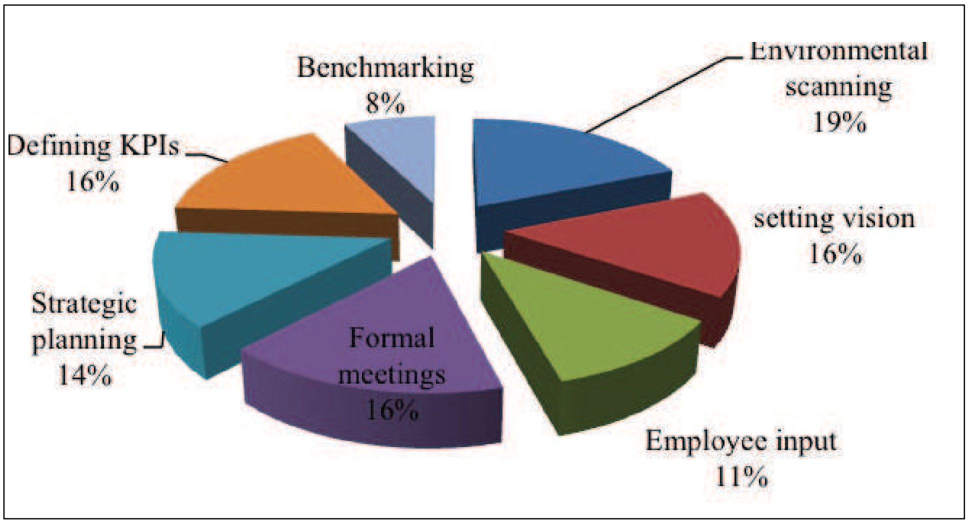
Figure 6: Portfolio strategies



It has been established that companies experiencing corporate ill-health have become uncompetitive and their business models require corporate surgery.

Figure 7 below shows an almost equal spread of the essential skills and competencies with none significantly more pronounced or prominent.

Figure 7: Skills and competencies of Judicial Managers



There appears to be a low usage of benchmarking and other strategic planning tools possibly due to lack of resources to implement the strategies.

6.2 Regression test

Regression analysis was deemed appropriate in testing the hypothesis in order to establish the main strategies that determine the performance of companies under judicial management.

Table 3: Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.649[a]	.421	.243	.68109

a. Predictors: (Constant), Number of years in business, Managerial strategies, portfolio strategies, Age of respondent, Gender of respondent, Financial strategies, Qualification of respondent, Operational strategies, Position in organisation, Type of industry, Number of employees in organisation, JMskillsandcompetencies
b. Dependent Variable: PostJMorderperformance

Table 3 above shows that the model explains 42.1% variance of post judicial management performance. The remaining 57.9 % is explained by other factors which are outside the scope of this research; such as the legal framework that governs the process of judicial management or the perceptions of stakeholders of companies in judicial management.

The test of overall significance of the regression model (F), also known as analysis of variance (ANOVA), determines the ratio of the explained to the unexplained variance, and, therefore, tests if the regression model is statistically significant. This is shown in Table 4 below.

Table 4: Anova Test[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	13.146	12	1.095	2.362	.021[b]
1	Residual	18.092	39	.464		
	Total	**31.238**	**51**			

a. Dependent Variable: PostJMorderperformance
b. Predictors: (Constant), Number of years in business, Managerial strategies, portfolio strategies, Age of respondent, Gender of respondent, Financial strategies, Qualification of respondent, Operational strategies, Position in organisation, Type of industry, Number of employees in organisation, JMskillsandcompetencies

The F- value ($F_{(12; 39)} = 2.362$, $p < 0.05$) demonstrates that the overall model is statistically significant, meaning that the variables have a significant combined predictive effect on the dependent variable.

Table 5 below shows the regression coefficients of the model proposed above.

Table 5: Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	.328	1.569		.209	.835		
Financial strategies	.485	.209	.372	2.320	.026	.577	1.732
Operational strategies	.507	.167	.644	3.036	.004	.330	3.028
Managerial strategies	-.082	.177	-.068	-.461	.647	.681	1.469
Portfolio strategies	-.019	.171	-.019	-.112	.912	.488	2.048
JMskillsandcompetencies	-.320	.242	-.348	-1.323	.194	.215	4.657
Gender of respondent	-.341	.320	-.191	-1.067	.292	.466	2.146
Age of respondent	-.193	.178	-.197	-1.081	.286	.449	2.227
Position in organisation	-.096	.125	-.140	-.769	.446	.446	2.242
Qualification of respondent	.252	.199	.226	1.269	.212	.468	2.137
Number of employees in organisation	.328	.233	.281	1.413	.166	.376	2.660
Type of industry	.067	.047	.299	1.432	.160	.340	2.941
Number of years in business	.016	.144	.023	.114	.910	.376	2.660

Given the p values of only two of the determinants (financial strategies and operational strategies) are less than 0.05, the revised model becomes Post JM order performance= 1.569 + 0.209FINs+ 0.167Ops. This means that the performance of companies under judicial management is positively impacted by financial strategies and operational strategies. It is also worth pointing out that gender was not a statistically significant variable to effect the results.

7.0 DISCUSSION

A critical review of both theoretical and empirical literature formed the basis for a conceptual framework that suggested ways of improving the success rate of corporate turnaround attempts (Pretorius, 2008; Smith and Graves, 2005). The factors that were proposed as essential variables in determining the success of corporate turnaround were the context of the turnaround, severity of decline and types strategies employed (Sudarsanam and Lai, 2001). The study narrowed down the focus to the turnaround strategies and the skills and competencies of the judicial managers forming the basis of hypotheses formulation.

The regression model shows that the important predictors of post judicial management order performance are financial and operational strategies. Such a finding is in conformity with the literature on turnaround strategies of distressed companies under judicial management (Holthauzen, 2011).

The following table summaries the results of the hypothesis testing:

Table 6: Hypotheses testing summary

Hypothesis	t-value	Sig	Result
$H_{1:}$ Financial strategies positively impact post Judicial Management order performance.	2.320	p=0.026;p<0.05	Accepted
H_2 : Operational strategies positively impact post Judicial Management order performance	3.036	p=0.004;p<0.05	Accepted
$H_{3:}$ Managerial strategies positively impact post judicial management order performance.	-0.461	p=-0.019;p>0.05	Rejected
$H_{4:}$ Portfolio strategies have a positive impact on post judicial order performance.	-0.112	p=0.912;p>0.05	Rejected
H_5: Key competencies and skills of the Judicial Manager have a positive impact on post Judicial Management order performance.	-1.323	p=0.194;p>0.05	Rejected

The majority of the companies used reduction of wages and liquidation of extra assets as a main strategy. This could have been because of the lack of working capital caused by inaccessibility of funding. This corroborates with Thompson *et al.* (2010) and Gladwell (2002) who stress that although a company's assets are profitable, sometimes they must be liquidated to contribute to the strategic focus.

Engagement of creditors and debt restructuring were marginally used. The low usage of these strategies stems from the fact that such strategies are reserved for large companies which have stakes high enough to warrant schemes of arrangement or debt equity swap. The smaller companies can only negotiate for interest on outstanding debt and make payment plans. This is in line with the findings by Collet *et al.* (2013) in their research on the Finnish restructuring Act. The researchers note that Finnish firms threatened by imminent bankruptcy can either apply for liquidation, sell the firm or enter into voluntary agreement with creditors. The authors further add that voluntary agreement with creditors seemed to be available mainly to large firms that had the power to bargain with creditors. Gumbe and Kaseke in their study of survival options available for Zimbabwe manufacturers in the hyperinflationary period (2005-2008), also reckon that most frequently used strategies were the marketing and financial strategies. The implication for management is that, for enhanced performance, judicial managers should strongly consider adopting financial strategies such as debt- restructuring, retrenchment and stakeholder management.

In addition, the findings reveal that some Judicial Managers adopted a cash flow management strategy coupled with collecting and reducing accounts receivables. Such strategies are adopted to meet the initial requirements of Judicial Management, which is to establish a going concern. Schmitt and Raisch (2013) identify a two stage recuperative model which starts by stabilising the organisation before adopting strategies for revenue generation and ultimately increase. The managerial implication here is that judicial managers should prioritise operational strategies such as increasing revenue, cash flow management and reducing and collecting accounts receivable.

8.0 CONCLUSION AND RECOMMENDATIONS

The researchers make the conclusion that the most common strategies are reorganisation of business processes, reduction of wages and salaries, strategic alliances, TMT changes, managing cash flows and streamlining of business operations to stick to core business. Another conclusion is that, most companies under judicial management are mature organisations that had previously taken up too many activities and dissipated their energies hence the need for re-focusing on the core activities through reorganisation of business processes and retrenchment.

The researchers conclude that the strategies that top the list of judicial management strategies in practice are those that have been shown to have a statistically insignificant impact on the performance of companies under judicial management. These strategies include reorganisation of business processes, strategic alliances and reduction of wages, salaries and other incentives. This could explain why most of the companies have failed to turnaround because there is so much of movement as regards strategy but no progress.

The strategies being used seemed ineffective as 90% of the companies were unable to pay their creditors and the image of the business failed to improve in 90% of the companies. The implication is that Judicial Managers need to consider operational strategies first followed by financial strategies. There is a need to consider stabilising the firm by efficiency oriented strategies working in tandem with other strategic choices of financing for sustainability.

1) Post judicial management order performance is impacted more by financial and operational strategies hence management should concentrate on debt restructuring, liquidation of extra assets, active engagement of creditors and cash flow management.
2) Managerial strategies such as changes in top management and retrenchment of employees have a negative impact on post judicial management order performance. Management should, therefore, consider employee engagement to retain some tacit knowledge inherent in long serving employees.
3) It is imperative for management to determine major causes of the corporate decline to avoid taking on companies that are liquidation candidates which will not respond to the prescribed strategies. Having concluded the research findings above, the researchers hereby propose the following recommendations for policy makers, managers and turn around practitioners:
4) Companies under Judicial management are failing to access funding and improve their image due to the stigma associated to Judicial Management. Policy makers should, therefore, consider renaming the process to a more palatable business term such as business restructuring or enterprise restructuring.
5) The current Insolvency Act should be amended to provide a timeframe for turnaround

The competencies of the judicial managers could not be easily examined possibly because in the majority of cases, the existing managers are replaced.

9.0 AREAS FOR FURTHER RESEARCH

Further research needs to understand the Judicial Management process and outcome and reasons why companies apply for Judicial Management. It is also worth conducting comparative studies between companies run by men compared to those run by women to see if gender may be an explanatory variable. The length of time a company spends in Judicial Management seems dependent on a number of factors, some attributed to the judicial manager. Furthermore, a thorough study is required to consider those companies that were revived as a result of Judicial Management. Future research may also need to refine its methodology and understand why companies are taking long in judicial management.

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