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Turnaround in Large Complex Legacy Organizations

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ABSTRACT

Corporate turnaround in the context of large, complex legacy (LCL) organizations appears to be qualitatively different from turnaround in simpler, smaller, and/or newer firms. Although the context is thought to strongly influence turnarounds, the LCL organizational context has yet to be studied specifically. We examine the successful turnaround of IBM, a representative LCL organization. We identify retrenchment and reorientation actions taken, in agreement with existing literature. We also find that IBM undertook repositioning actions, and that cultural change played a major role in successful implementation. These drivers of success have not been emphasized in the current turnaround research.

KEYWORDS: Corporate Turnaround, Organizational Behavior/Strategic Management, Organizational Change, Strategy Process

INTRODUCTION

In the midst of decline in the years 2004 to 2006, Kodak replaced its CEO, and initiated retrenchment and reorientation efforts (Snyder, 2013). These efforts appear to be consistent with the generally accepted prescriptions of the turnaround literature, which suggests first retrenchment and then reorientation (e.g., Bibeault, 1982; Pearce & Robbins, 1993, 1994). Yet, the company's efforts failed. Kodak declared Chapter 11 bankruptcy in 2012. IBM, on the other hand, was successfully turned around in the mid 1990s, after also facing severe decline. Why was IBM's approach successful while Kodak's was not? The turnaround literature does not yield a ready answer. Although calls have been made for context to be studied more thoroughly in the turnaround literature (e.g., Arogyaswamy, Barker, & Ysai-Ardekani, 1995), turnaround in large complex legacy (LCL) organizations, such as Kodak or IBM, has not been fully examined. In this paper, we explore the case of IBM's successful turnaround under CEO Lou Gerstner. Consistent with common prescriptions in the literature, IBM changed its CEO and pursued retrenchment and reorientation initiatives. Departing from the current emphasis in the turnaround literature, we also find that IBM implemented repositioning strategies, and that cultural change played a critical role in realizing these strategic changes and achieving operational success. This paper contributes to the turnaround literature by highlighting that LCL organizations in decline are a unique turnaround context and by identifying repositioning as a mid-term strategy in turnaround, which may not be necessary for turnaround efforts in typical

non-LCL organizational contexts. In addition, this paper identifies the potential moderating effect of cultural change in turnaround attempts of LCL organizations.

RETRENCHMENT, REORIENTATION, AND LCL ORGANIZATIONS AS A TURNAROUND CONTEXT

Corporate turnaround denotes the situation where a firm experiences a performance decline of sufficient magnitude to threaten its ongoing existence (Hofer, 1980; Slatter, 1984), after which it recovers and then sustains a satisfactory level of performance (Arogyaswamy et al., 1995; Barker & Duhaime, 1997). Extant turnaround research has sought to identify drivers of success and failure in turnaround efforts. Two primary turnaround strategies discussed in the literature are retrenchment and reorientation (Arogyaswamy, et al., 1995). Retrenchment, which acts to stem further decline through realizing efficiency improvements (e.g., Pearce & Robbins, 2008), has been argued to be the first step in turnaround (Bibeault, 1982; Hambrick & Schecter, 1983; Pearce & Robbins, 1994; Lohrke et al, 2012; Morrow et al., 2004). Reorientation, on the other hand, aims to return the company to health and improve longer term firm financial performance, and has been characterized as the second stage leading to recovery (Boyne & Meier, 2009; Hofer, 1980; Pearce & Robbins, 1993; Robbins & Pearce, 1992). Despite several decades of research, the literature reports some mixed findings on the impact of retrenchment and reorientation (Castrogiovanni & Bruton, 2000; Filatotchev & Toms, 2006; Trahms, Ndofor, & Sirmon, 2013). Calls have been made to study different contexts which may impact the effectiveness of these strategies (e.g., Arogyaswamy et al, 1995).

We contend that LCL organizations are unique contexts for turnaround efforts. These large entities, incorporate the element of legacy and long history because they have developed and been successful over long periods of time. They tend to have complex organizational structure to handle complex product/service portfolios that have evolved over time (Daft, 2012), and across broad geographies.

The sheer size, complexity, and legacy of the LCL organization may limit the direct impact of leadership change on the turnaround outcomes. Ingrained rituals and practices (e.g., Schein, 2010) may counteract change. Similarly, the context of LCL organizations may also impact the suitability and effectiveness of the established turnaround strategies, and therefore current turnaround literature prescriptions may not apply. Short-term efficiency-based retrenchment strategies may be inadequate to bring the LCL organizations in severe decline back to health, while the size, complexity, and past glory of LCL organizations hinder changes required to successfully implement long-term reorientation strategies in a timely manner. Since LCLs have not been examined in the extant literature, we have a limited understanding regarding: (1) how do declining LCL organizations turn themselves around, and (2) what are key elements critical to LCL organizations' successful turnaround processes? As a step in better understanding turnaround in the context of LCL organizations, we examine IBM's successful turnaround.

CRITICAL ELEMENTS IN SUCCESSFUL TURNAROUND OF IBM

IBM entered into a steep decline in 1991 as sales of mainframe computers, its primary source of revenues and profits, started to fall dramatically. Industry insiders and financial analysts predicted the end of the mainframe computer and the breakup of IBM. The company had grown extremely complex, selling over 25,000 different hardware and software products through 20 different business units (Austin & Nolan, 2000). The company began to retrench, cutting costs and reducing headcount in 1991 and 1992, taking steps towards breaking up the firm, and

replacing its CEO in 1993. The new CEO, Louis Gerstner, an outsider with no prior experience in the information technology industry, has been credited with turning the company around. Gerstner's success at turning around the declining IBM was built on key, interrelated actions, including retrenchment, repositioning, and reorientation, as well as cultural change. We will discuss each of these actions and generalize the IBM's successful turnaround process.

Retrenchment

After his arrival in April of 1993, Gerstner's initial approach was to focus on retrenchment. He commented that the challenge was: "...to focus on day-to-day execution, stabilizing the company..." and to avoid discussing future strategies for a period (Gerstner, 2002: 115). Gerstner aimed to quickly reduce costs. In July, IBM announced a \$2 billion restructuring charge and "launch [of] a massive program of expense reduction... [including]... reducing our employment by 35,000 people..." (ibid: 101-2). As part of the retrenchment efforts, the company also sold unproductive assets to increase cash, and reduced IT expenses. From 1994 to 1998, cost reduction projects saved the company \$9.5 billion.

Repositioning

We consider repositioning to be a mid-term strategy to reposition existing assets and businesses in ways which increase their market relevance and competitiveness. As such, repositioning is about modifying existing strategies and not developing completely new ones. In IBM's case, the mainframe computer was considered outdated, but IBM was able to reposition its mainframe offering to make it more relevant for the changing technological and business environment. The company made some major technological and policy changes in order to reposition its mainframe business. These included making the machines more cost effective by switching to CMOS technology, which was more amenable to large scale production, and a switch from proprietary systems to open systems, which were compatible with those of other producers. Given the strong identification with its historically successful mainframe business and its size, IBM's successful repositioning of its mainframe business was arguably *the* pivotal action that sustained IBM's short- and intermediate-term viability and paved a strong foundation for its longer-term reorientation effort.

Reorientation

IBM's reorientation strategy was a longer-term, complex undertaking involving two important pieces. One of these was the strategy to transform IBM into a service and solution provider. The concept behind this was that IBM's ability to integrate globally and technologically was unmatched by any other firm. Gerstner described this as a bet "to build not just the largest but the most influential services business in the industry" (Gerstner, 2002: 191). The second piece was to reorient the company to become a leader in e-business, and thereby take advantage of the ongoing move towards computing on networks. These decisions, in turn drove subsequent actions such as acquisitions and cultural change efforts needed for the changes to be effective.

Cultural change

Changing IBM's insular culture was "our single most critical and difficult task" in the turnaround (Gerstner, 2000: 171). IBM's culture had developed in the absence of significant competition or external threat. Gerstner began a multiyear ongoing communication effort with consistent emphasis on culture amidst implementation of other actions aimed at changing the culture. He

introduced 8 guiding principles, the first of which stated: "The market place is the driving force behind everything we do." This was a strong statement for a company that had become focused primarily on internal politics and procedures. Performance evaluation and compensation were also changed to include variable rewards, pay for performance, and external benchmarking, again marking significant breaks from former practices. Organizational changes, symbolic and functional, played another role in the efforts to influence the company culture. In winter of 1994, the company began to reorganize its sales organization into a group in charge of customer relationships and another of product specialists. The organizational matrix was also reoriented a global basis as Gerstner "[declared] war on the geographic fiefdoms" (Gerstner, 2002: 135).

ANALYSIS

We generalize the key elements in the IBM successful turnaround case into a generic model of turnaround in the context of LCL organizations incorporating leadership change, retrenchment, repositioning, reorientation, and cultural change. Leadership change is an important step in initiating the turnaround process. New leaders who do not have vested interest in the current status quo are more likely to take necessary actions to turn their declining around (Miller, 1991; Ford & Baucus, 1987). Important for LCL turnarounds, Schein (2010) suggests that leaders in mature, established organizations have less direct personal influence on organizational change compared to leaders at earlier stage organizations, and therefore need to rely on more systematic approaches to affect organizational change.

In the turnaround context of LCL organizations, the IBM case provides partial support for the literature's 'first-retrenchment-then-reorientation' (e.g., Bibeault, 1982; Pearce & Robbins, 1993, 1994) prescription, with the addition of repositioning as the intermediary step between retrenchment and reorientation. We contend that this intermediate step is crucial in the LCL context, as suggested by the IBM case. First, retrenchment is needed to mitigate the severity of the decline. With the size and complexity of declining LCL organizations, cost-cutting and pruning down some less profitable product/service lines may not be adequate to fully stop the gravitational momentum of sinking LCL organizations. Some upward movement from profitably repositioning existing core products/services becomes crucial to stabilizing the declining LCL organizations. Once retrenchment and repositioning have successfully paved a stable foundation for the companies, reorientation will have a better chance of being successful. More importantly, repositioning the existing core products/services may act to increase the organization's ability to accept greater levels of change. Repositioning introduces some degree of change but within the existing core products/services, which represent the status quo. This type and degree of change is not only more acceptable to LCL organizations, but also prepares them to accept higher-magnitude changes necessary during the reorientation effort.

Finally, LCL organizations are known for their establishment and legacy, thus often possessing strong organizational culture. A key attribute of strong culture is resistance to change (Schein, 2010). Therefore, parallel efforts to increase the alignment of organizational culture with the firm's goals and competitive context are vital to the turnaround success.

DISCUSSION AND CONCLUSION

This paper contributes to the turnaround literature by examining an exploratory case to better understand how LCL organizations turn themselves around and by identifying key elements critical to the process. Through this exploratory study, we identified repositioning as an important mid-term strategy, which may enable LCL organizations to adjust existing businesses and

thereby gain time and momentum for longer-term reorientation strategies. This paper also identified the moderating role of cultural change in turnaround of LCL organizations. IBM's case provides evidence that top management can improve the potential for turnaround by taking actions to promote cultural changes to better align it with the organization's goals.

This research has important implications for top managers of LCL organizations in decline. These managers should place a high priority on identifying and implementing repositioning actions, aimed at improving the situation in the mid-term, and supporting momentum after the benefits of short-term retrenchment actions have been realized. Such momentum may be especially critical because long-term reorientation actions may need extra time to be fully implemented in LCL organizations. Cultural change is another important aspect in LCL turnarounds. The long historical, and embedded nature of LCL organizational culture means long-term, persistent and comprehensive efforts to influence the culture are key to achieving successful cultural change outcomes. Being in crisis may make it easier for top managers to change these aspects of the firm. Managers should not waste these necessary opportunities.

This paper focused primarily on IBM's turnaround. Future research may examine the generalizability to other situations by examining successful turnarounds in LCLs in situations divergent from IBM's. We have made arguments about why the LCL organizational context is unique for turnaround efforts and how it may affect turnaround processes and outcomes. However, we do not clearly and quantitatively state the thresholds dividing LCLs from non-LCLs or perhaps pre-LCLs, which may be a topic for research in the future when our understanding of this area becomes more mature. Additionally, we feel there is an important potential impact of future research on not-for-profit LCL institutions such as academic and government institutions.

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