

*Full Length Research Paper*

# Recovery strategies in Serbian mature companies

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**The main purpose of this study was to assess the impact of key influencing factors on four different recovery strategies such as management changes, financial restructuring, internal and external strategies. The research sample comprised 48 mature companies in Serbia. The Empirical results show that top management would select financial restructuring if inadequate financial control and policy caused acute crisis in mature company, which had medium competitive position in mature industry. The managers in all observed companies implemented internal strategies, especially divestment, regardless the key influencing factors. If competitive weakness caused crisis in a company with medium competitive position, top management would select external strategies.**

**Key words:** Strategy, crisis, recovery, management, Serbia.

## INTRODUCTION

The investigation of business decline and recovery included various fields and disciplines, such as finance, organization behavior, strategic management and organization theory (Alam et al., 2010a). This study investigates the factors contributing to decline and recovery of mature companies in Serbia. The healthy mature companies deliver most of the current output and employment in an economy.

Empirical researches of companies in crises are more complex than researches of successful companies. Management of companies in crises have no time or willingness to talk with researchers because they are focusing on survival, and as a consequence, it is necessary to invest great effort in order to select relevant information about companies in crisis.

Successful recovery can be defined as the reversal of a company's pattern of performance decline. The recovery strategy involves a comprehensive analysis that brings numerous dilemmas and demands resolving important strategic, organizational, financial, and technical issues. Selection of appropriate strategy is relevant for creating

conditions for corporate revitalization. Recovery strategies are not singular actions, but are interrelated with the prevalent contextual factors. Focusing this research in one transition country makes its scope a manageable one in the terms of data accessibility and comparability.

## Research problem

There are numerous relevant studies of business decline and recovery (Hambrick and Schecter, 1983; Sudarsanam and Lai, 2001; Slatter and Lovett, 1999; Barker and Duhaime, 1997; Bibeault, 1982; D'Aveni, 1989). The vast majority of relevant studies on revitalizations and corporate recovery have been conducted in the United States and the United Kingdom. The results of Bruton et al. (2003) revealed that different recovery strategies work in different national, political, and cultural contexts. This raises important question about the transferability and relevance of Western Europe and United States studies to an explanation of the corporate recovery process in transition economies.

Former researches by other authors in the area of corporate recovery in Serbian companies were exclusively theoretical. The motivation to investigate mature

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companies in Serbia is dictated by absence of empirical research.

### Research aim and objectives

The main aim of this study is to offer strategic model for sustainable recovery for mature companies. The research objectives were:

1. To identify the main causes of decline and the recovery strategies of mature companies in Serbian industry using the questionnaire,
2. To investigate the influence of key factors on strategy choice in mature companies in Serbia,
3. Based on identifying the key factors and recovery strategies, that is, to conceptualize an adequate model for strategic choice adapted to Serbian industrial companies.

### Research questions

Regarding recovery strategies of the mature companies in Serbia a number research questions arise. In this study, two questions are of special interest: (1) which internal and external factors influence the strategy choice for a company recovery? (2) Which are the key stakeholders in recovery process?

This paper is structured as follows: First, in order to define the main categories for empirical research, an overview of the relevant literature is presented. The paper then introduces the research context, presents the results, discusses them, and draws some conclusions and implications for primarily Serbian management in the industry. Finally, the contributions and some possible directions for further research are presented.

## LITERATURE REVIEW

### The failure of mature companies

The failure of large companies is characteristic for enterprises that have existed over a longer period and show the characteristics of inertia in relation to changes in the environment. The managers are preoccupied with daily operations while once successful companies declined. The managers are preoccupied with daily operations while once successful companies decline. The competitor takes over the market demand for the products, while not investing in new technology makes the company uncompetitive (Alam et al., 2010b). The fall is inevitable. This is a broad analysis, the generic form of business failure rooted in the tendency of managers to become trapped in their own "boiled frog syndrome" (Richardson et al., 1994). The leaders are satisfied, like a frog sitting motionless while the environment is heated.

The process is called the "boiled frog" syndrome because when you put a frog in hot water it will try to jump when it feels the heat. Put a frog in cold water and slowly warm it up to the boiling point and the frog will sit happily, unaware of dangerous changes in the environment. Saunders (2003) explained the boiled frog syndrome in the following way: the company continues with its operations until it is completely insensitive to changes just like a frog sitting quietly while the temperature increases to the boiling point.

The traditional paradigm presented a set of organization's beliefs and attitudes in which managers play a central role in interpreting the impulses from the environment and creating a strategic response, and the environment is changing and requires a new paradigm and new responses (Argenti, 1965). Over the time, it creates a strategic gap. The introduction of small, incremental changes will not bring the improvement to the situation (Richardson et al., 1994). Strategic gap associated with the financial problems reaches the extent which requires recovery strategy to save the company.

Such large companies have successfully operated for many years, even decades, and one of the causes of the crisis can be described as complacent competitive success. Successful expansion and growth brought the company competitive advantage (Moulton et al., 1996).

When environmental conditions change and a company does not respond to them, it leads to collapse. Rather than accepting the information that suggests the need for a new approach, managers stress the importance of signals that confirm their established positions (Richardson et al., 1994; Argenti, 1965). Self-deception leads to crisis.

Large companies are characterized by a hierarchical organizational structure that directs the decisions of companies to the perceived desires of management rather than market-oriented goals. Large, diversified organizations develop "cultural encounter" in which responsibility for specific projects is shared and it is not clear.

In addition, large companies have a rigid organizational culture that is reflected in the bureaucratic attitude towards innovation. Employees are conformists in order to maintain the existing situation and to act against the changes. Over the time, regular awards are becoming the norm and the motivation of employees and managers declines. In large enterprises, there is an increase in costs for "white collars", as managers seek bureaucracy and size. On the other hand, there is a significant decline in productivity.

Summarizing previous results, the causes of crisis can be the following (Richardson et al., 1994): complacent competitive success, top management is "blind" for a new and different business, hierarchical orientation, the rigid organizational culture, the bureaucratic attitude towards innovation, managers' attempts to keep the status quo, searching for consensus and compromise

solutions, pressure on the growth of the organization rather than on productivity growth, giving rewards without productivity growth, increased cost of "white collar", and low motivation of employees.

Trajectories can be complemented by managerial characteristics from the study of Slatter and Lovett (1999). The worst-performance managerial situation is characterized by insensitivity to the problems of decline and ineffectiveness in dealing with them.

Denying the existence of crisis is the initial phase in which managers are not aware of the existence of crisis due to lack of adequate control systems (not just financial, but also the informal system of monitoring and interpretation of unexpected external events). Managers believe in the ability of companies and a strong market position (Moulton et al., 1996).

"Explaining the crisis" phase occurs when the crisis becomes apparent, and managers try to explain the causes and hope that no actions will be required (Slatter and Lovett, 1999). Their inertia justifies the absence of investments in new products and investments. Managers claim that it is only a matter of time when the performance will improve. Short-term pressures from the environment are the main causes of decline (for example, fluctuations in interest rates and economic recession). In order to alleviate the low financial performances, managers introduce creative ways of calculation.

Disintegration of the organization's performance and prolonging the crisis affects the structure and processes of enterprises (Slatter and Lovett, 1999). Managers accept the existence of crisis and make small changes, but underestimate the need for radical changes. The process of disintegration includes reduced commitment to the objectives of the company and commitment to their own interests, budget reduction and reorganization, leaving of the most capable managers and reduction of the average level of competence in the company.

The collapse of the company occurs when it becomes clear that the prediction was wrong, and managers and the staff appear to doubt the ability to cope with the crisis. After the collapse, the result can be either liquidation or successful recovery (Bibeault, 1982).

The study concludes that in the field of crisis management, the "boiled frog" syndrome is a major aspect of life of large companies. Many companies suffer from this syndrome. Despite the numerous examples in theory and practice, this remains one of the most common crises.

### Recovery strategies

It is evident that every crisis is specific (Hopkins, 2008). There is no unique recovery strategy classification (O'Neil, 1986; Hambrick and Schecter, 1983). The following four major generic strategies have been examined in the previous study of corporate recovery in Serbian:

mature companies

1. Management changes,
2. Financial restructuring,
3. Internal strategies, and
4. External strategies.

**Management changes:** Imply the replacement of the chief executive or the entire senior management team. Top management change is widely quoted as a precondition for successful recoveries (Bibeault, 1982; Hofer, 1980; Schendel and Patton, 1976; Slatter and Lovett, 1999; Fransis and Desai, 2005; Furrer and Pandian, 2007; Clinton et al., 2007; Abebe, 2010). Furthermore, the appointment of new top managers can be a positive signal to bankers and other investors that companies in crisis introduce serious measures in order to generate turnover.

Although, many companies in crisis implement cash generation strategies, for example, asset divestment and equity issues, pay down borrowings, reduce interest cost, and improve cash flows; the extant strategy-based research on recovery has not identified financial restructuring as an integral component of recovery.

**Financial restructuring:** This study incorporates financial restructuring as a key element of the analytical framework and evaluates its importance. Companies' capital structure and financial policy have important role in selecting adequate recovery strategy including the following activities: tight financial control, change debt repayments, and additional financial injection (Sudarsanam and Lai, 2001).

Financial restructuring is the reworking of a company's capital structure, which consists of two strategies: equity-based and debt-based strategies. The final aim of financial restructuring is to reach adequate ratio of own to borrowed capital in order to be solvent and implement recovery strategy. Previous empirical results showed that financial restructuring is an effective recovery strategy (Sudarsanam and Lai, 2001; Smith and Graves, 2005).

**Internal strategies:** This consists of reductions in the scope or size of a company, with the aim of increasing efficiency. The emphasis is on making cuts in parts of the business that are unproductive and unprofitable. This in turn can release resources for investment in areas that seem likely to deliver higher performance.

The impact of internal strategies on recovery has been analyzed in numerous empirical studies (O'Neil, 1986; Hambrick and Schecter, 1983; Slatter and Lovett, 1999). Key components of internal strategies are cost and assets reduction, divestments, and liquidation. Cost reduction may be sufficient where the company is weak operationally (Khandwalla, 2001). Where the company is in severe crisis and where strategic health is weak, asset reduction is deemed imperative for successful recovery.

Divestment of subsidiaries is perhaps the most common recovery strategy by all but the smallest companies.

Internal strategies are primarily designed to generate, in the short term, cash flow, and profit improvement.

**External strategies:** The empirical evidence showed relatively low performance when management selects for company in crisis (Slatter and Lovett, 1999). The main aim of external strategies is to improve effectiveness and embody growth strategies (for example, growth through internal and external methods), product/market refocusing, and revenue generation. Revenue generating strategies focus on existing lines of products, initiating price-cuts (or raising prices where products are price insensitive) and increasing marketing expenditure to stimulate demand.

Capital structure determines selection of external recovery strategies (Morrow et al., 2007). Implementation of those strategies requires capital, time, and knowledge, which are usually missing in the crisis. By implementing external strategies, companies can reach temporary recovery, but in long term, those strategies lead to stagnation and further decline. Product/market refocusing is better choice for some companies in studies of Slatter and Lovett (1999) and Khandwalla (2001).

Previous research conducted by authors indicated that following factors determined the choice of strategy in large Serbian companies: causes of crisis, crisis phase, and phase in organizational life cycles, competition position, industry level, and banks attitudes. Recommendations for implementing certain recovery strategy in relation to key influencing factors are drawn from empirical evidence. It is worth emphasizing that some strategies can be implemented simultaneously (for example, financial restructuring and internal strategies), while others are implemented in sequence (for example, after business stabilization managers can implement external strategies). The study briefly elaborates those key factors.

The aim of the recovery phase is to ensure that the causes of the crisis are addressed and overcome. Adequate response, for example, recovery strategy depends on principal cause of crisis determines. Regarding the influence of causes of crisis on recovery strategies, the following hypotheses can be stated as follows:

**H<sub>1</sub>:** The causes of decline will determine different recovery strategies.

Inadequate management indicates selection of change management and internal strategies. Inadequate financial control can be resolved by implementation of change management, financial restructuring, and internal strategies. In case of high costs, all four strategies can be effective. Crisis due to big project failure indicates selection of internal strategies, but external strategies are not recommended. Inadequate financial policy can be

Overcome through financial restructuring, and internal strategies. In case of low competitiveness, adequate recovery strategy may be internal and/or external strategies.

The challenge is not just to recognize the crises, but also to recognize them in a timely fashion and address the issues they represent. A typical company goes through stages of crisis development, although in a fragile company some of the stages may be very short. There are four stages of crisis development: (1) initial stage; (2) acute stage; (3) chronic stage and (4) crisis resolution stage. According to those phases, we can make the following hypotheses:

**H<sub>2</sub>:** An adequate solution for acute stage is internal strategies. The chronic stage indicates the use of all strategies except external.

Adequate strategies in mature stage are financial restructuring and internal strategies, but external strategies are not recommended. Some strategies can be used when a company enters into decline stage (for example, financial restructuring and/or internal strategies).

Competitive position and stage in industrial development can eliminate some recovery strategies. In proposed analytical framework, three competition positions are presented: strong, medium, and weak. Strong competitive position implicates the use of change management and/or internal strategies, but external strategies are not recommended. The weak competitive position implicates internal recovery strategies.

The study introduces a three-phase model of industry development, which differs growth stage, mature, and decline stage. For a company in crisis, which operates in industry in growth stage, adequate recovery strategies would be internal and external strategies. In mature industry, recovery will be reached by implementation of internal strategies. In decline industry, selection of external strategies is not solution to crisis. A company in crisis must ensure the support of the key stakeholders. Therefore, we can make the following hypotheses:

**H<sub>3</sub>:** The banks and other creditors will prefer internal strategies and financial restructuring.

Often, banks and creditors will continue providing financial support only if they are confident that the management team can manage the crisis (Pajunen, 2006). Banks may dictate the selection of internal strategies. Creditors are interested in all forms of financial restructuring. Effective negotiation with creditors might be an indicator of the sustained support needed to survive the times of crisis.

## RESEARCH CONTEXT

Serbia has been chosen as the research context for the

following key reasons. Serbia is one of the transition countries. After a decade of declining economic performances, Serbia as well as other countries in the region has experienced renewed economic growth. The Serbian economy adopted a structural adjustment programme in October 2000. During the period 2000 to 2008, privatization and restructuring processes have been dominated in Serbian industry.

At the end of 2008 due to the impact of the global economic crisis, industrial output was decline. High level of decline was evidenced in manufacturing sector (-15.8%). The major problems are low competitiveness of national economy and weak export performance. Insufficient restructuring of key industries, weak innovation performance and low level of human capital are the main constrains of productivity growth in Serbian industry. The major problems evidenced in the manufacturing companies, which motivated author to conduct this study.

## RESEARCH METHODS

The research was based on the interviews with top and medium-level managers from 48 large companies from the industry. The sample was representative for two main reasons. First, characteristics of selected companies are significant due to their regional importance, capital and employee number. Second, during the previous research, top managers gave numerous and relevant data about proposed recovery strategies and key factors. In two observed companies, top managers successfully implemented recovery strategies and those companies are in crisis resolving stage.

Therefore the industry structure of the selected sample is: manufacture of machinery and equipment (12 companies); manufacture of other non-metallic mineral products (5 companies); manufacture of textiles and textile products (5 companies); manufacture of rubber and plastic products (4 companies); manufacture of motor vehicles and trailers (4 companies); manufacture of paper (4 companies); manufacture of metal products (4 companies); manufacture of chemicals and chemical products (3 companies); manufacture of electrical equipment (3 companies); manufacture of leather and related products (2 companies) and manufacture of food products and beverages (2 companies).

The research took place during September and December 2009. The survey was carried out using a structured questionnaire based upon proposed key factors in selection of corporate recovery strategy.

### Data analysis

Descriptive statistics, Spearman's rho coefficient and relevant tests (Related samples Friedman's two-way analysis of variance by ranks, Independent samples Mann-Whitney U test) were computed. Data analysis was conducted using SPSS Statistics 19.

## RESEARCH FINDINGS AND DISCUSSION

The research findings confirm the theoretical premises regarding the strategic behavior of companies during

recovery process. Main results of the study are presented in Table 1. The participants in the survey were asked to choose, with ranking, six offered main causes of crisis. Based on mean and frequencies of their answers, the ranking of causes of crisis was acquired in observed companies. Majority of respondents identified external factor - competitive weakness as the main cause of crisis.

It appears that management either failed to acquire the necessary management skills, through finance (inadequate financial policy, inadequate financial control) or failed in big projects and thereby had a high impact on developing crisis in observed Serbian companies. Inadequate management was the second ranking factor. These results go in line with relevant empirical studies (Bibeault, 1982; Slatter and Lowett, 1999; Khandwalla 2001). Third ranking factor was high cost.

### Influence of causes of crisis on recovery strategies

Then hypothesis  $H_1$  was tested using related samples Friedman's two-way analysis of variance by ranks. The results showed that causes of crisis determine the implementation of different recovery strategy. Based on Spearman's rho coefficient, the study identified correlations between the causes of crisis and recovery strategies. If inadequate management causes the crisis, proposed strategies for industrial companies are management changes and internal strategies. For resolving crisis caused by inadequate financial control, three of four strategies can be used (except external strategies). Same strategies will be adequate for crisis caused by inadequate financial policy. If failure in big projects causes the crisis, proposed strategies for industrial companies are management changes and internal strategies. For resolving crisis caused by high costs, all four strategies can be used. The competitive weakness can be treated by internal and/or external strategies.

The challenge is not just to recognize crises, but to recognize them at an early stage. The results of empirical research conducted with 48 companies in Serbia indicated that the vast majority of companies were in chronic crisis stage (75% of observed companies). Chronic phase is usually called the clean-up phase because it may be either the beginning of recovery or path to liquidation. During this phase, the symptoms are quite evident and always present. In the acute stage, top management of more than 20% observed Serbian companies could only take action to control the damage. The remaining companies were in resolving crisis stage.

### Impact of crisis phase on strategic recovery choice

Then hypothesis  $H_2$  was tested using Independent samples Mann - Whitney U test. The results showed that

**Table 1.** Summary of research findings.

<b>Factor 1. Causes of crisis</b>	<b>Mean (standard deviation)</b>	<b>Influence (percent)</b>		
		<b>Low</b>	<b>Medium</b>	<b>High</b>
Inadequate management	4.33 (2.770)	41.7	37.5	20.9
Inadequate financial control	5.27 (3.086)	35.4	29.2	35.4
High costs	3.96 (2.729)	47.9	31.3	20.8
Big projects	3.40 (2.826)	66.7	18.8	14.5
Financial policy	4.50 (2.806)	45.8	25.0	29.2
Competitive weakness	5.71 (2.873)	25.0	33.3	41.7
<b>Factor 2. Crisis stage</b>		<b>Percent of companies</b>		
Acute stage		20.83		
Chronic stage		75		
Resolving crisis		4.17		
<b>Factor 3. Competitive position</b>				
Strong		10		
Medium		46		
Weak		44		
<b>Factor 4. Industrial life cycle</b>				
Mature		62		
Decline		37		
<b>Recovery strategies</b>				
<b>Strategy</b>	<b>Rank (percent of companies)</b>			
	<b>Rank 1</b>	<b>Rank 2</b>	<b>Rank 3</b>	<b>Rank 4</b>
Management changes	0	0	41.7	58.3
Financial restructuring	62.5	37.5	0	0
Internal strategies	18.8	62.5	18.8	0
External strategies	18.8	37.5	0	43.8
Probability of bankruptcy				
	2009	2008	2007	2006
z-score	1.22	1.36	1.41	1.43

Authors' calculations.

the implementation of management changes, financial restructuring and external strategies depend on crisis phase. Internal strategies were used during acute and chronic phase of crisis in observed industrial companies. In all four years, overall Z score was lower than 1.8, which indicates that the probability of the bankruptcy is high.

Approximately the same number of companies had medium and weak competitive position while the minority had strong position. The competitive position determined the choice of recovery strategies in observed companies.

The majority of observed companies operated in mature industries. There were no companies in growth industry, which represents one limitation of our research. The phase in industrial life cycle determined the choice of following strategies: management changes, financial

restructuring and external strategies. The internal strategies can be implemented regardless of industry stage.

The research indicates the following ranking of recovery strategies in large Serbian companies:

1. Financial restructuring,
2. Internal strategies,
3. External strategies, and
4. Management change.

Financial restructuring of companies can take a number of forms (for example, debt forgiveness, reprogramming debts, etc.). According to results of our empirical research, the vast majority of observed top managers expect debt forgiveness. Large-scale debt forgiveness

**Table 2.** Analytical framework for recovery strategy choice in Serbian industrial companies.

Key factors	Recovery strategies			
	Management change	Financial restructuring	Internal strategies	External strategies
Causes of crisis				
Poor management	+		+	
Inadequate financial control	+	+	+	
High costs	+	+	+	+
Big projects	+		+	
Financial policy	+	+	+	
Competitive weakness			+	+
Crisis stage				
Initial			+	+
Acute			+	
Chronic	+	+	+	-
Competitive position				
Strong	+		+	-
Medium			+	+
Weak			+	
Industry life cycle				
Growth			+	+
Mature			+	
Decline			+	-
Attitudes of banks and other creditors		+	+	

Adopted from Kontic (2007).

could lead to relaxing the financial discipline of companies. Managers and government may have a greater incentive to find ways to restructure companies' operation and improve cash flow.

Nearly all-successful recoveries involve significant use of internal strategies (Slatter and Lovett, 1999). According to results of our research, internal strategies were used in all observed companies.

Observed top managers in 25% companies chose external strategies, primarily product/market refocusing. Those managers assessed competitive weakness as major cause of crisis as well as medium competitive position of their companies.

According to relevant empirical studies, management changes seem to be a factor in the improvement of a number of companies (Bibeault, 1982; Slatter and Lowett, 1999; Khandwalla, 2001). Respondents in our research were top managers therefore; change of management was the last ranking strategy.

According to the results, banks and other creditors were supporting the implementation of internal strategies in observed companies. The main reason why creditors' withheld support to strategy of financial restructuring is the fact that top managers were expecting debt forgiveness. In addition, banks were not providing additional credits to those companies. In resolving crises, top managers expected Government participation.

Summarizing all results, top management selected financial restructuring if inadequate financial control and policy caused an acute crisis in mature company, which had medium competitive position in mature industry. Internal strategies, especially divestment, were conducted in all observed companies. If competitive weakness caused crisis in a company with medium competitive position, top management would select external strategies.

### **A model for recovery strategy choice in Serbian industrial companies**

The results of preliminary testing of proposed recovery strategies on six large industrial companies in Serbia show that different recovery strategies work in transition contexts (Kontic, 2007). Observed managers have no problems with understanding proposed recovery strategies. The results show practical usefulness of key factors for strategic choice, which indicated a necessity for further testing with more companies.

The results of factor analysis showed that the questionnaire is adequate for investigating phenomena of crisis and corporate recovery (Cronbach's alpha is 0.826). Strategic model can be used in selection of recovery strategies in the Serbian industry (Table 2).

## Conclusions

The selection of appropriate strategy is relevant for creating conditions for corporate revitalization. Management changes, financial restructuring, and internal strategies are key strategies for recovery. Recovery strategies are not singular actions, but are interrelated with the key factors such as cause of crisis, crisis stage, and competitive position. Only internal strategies can be conducted regardless of key influencing factors.

The results also offer a new insight for managers regarding the consequences of prior success or decline. The findings suggest that managers should consider key factors in order to select adequate recovery strategy. The attributes of successful recovery strategies are often inferred from the actions taken in high profile successes: quick and forceful decision-making, deep cost cutting, and divestitures. While interesting, such perceptions are neither universally accurate nor consistently beneficial. They do provide recommendations for managers of companies facing declining business performances.

As in any other research, the study has limitations. Presented results, may have limited generalisability, since the study focused on Serbian companies in the manufacturing sector; other variables may be statistically significant in discriminating recovered and failed companies in other industries and countries. In addition, there is no company in initial stage of crisis or in growth industry.

The paper raises important questions of further study. First, additional analysis is necessary to include companies in initial stage of crisis as well as growth industries. Second, additional research is needed for the findings on recovery efficiency. Finally, the results represent a basis for future research that should expand into all industries and embody a large sample of companies from different transition economies.

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