

STRATEGIC BUSINESS MANAGEMENT

Final Test of Professional Competence stage examination

PRE-SEEN MATERIAL

Students will receive the pre-seen material for the Strategic Business Management examination a month in advance of the examination.

Students will be expected to undertake research on the articles as a basis for the questions related to the case in Section A of the examination. As such, students will be allowed to take into the examination room one sheet of A4 notes, special stationery for which will be provided by CIPFA.

At the end of the examination, students should append their sheet of A4 notes to their exam script. Students failing to do this will automatically be deemed to have failed this assessment.



Article 1

Organisational Failure And Turnaround: Lessons For Public Services From The For-Profit Sector

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As the performance of public services is increasingly scrutinized, it is now commonplace for some schools, hospitals, local authorities and other public organizations to be deemed 'failing' and for attempts to be made at creating a turnaround in their performance. This article explores the literature on failure and turnaround in for-profit organizations, presents a number of models or frameworks for describing and categorizing failure and turnaround, and examines the relevance and transferability of theoretical and empirical studies in the for-profit sector to the emerging field of failure and turnaround in public services.

In recent years, the performance of public organizations and services has been increasingly scrutinized and subject to public debate. It has become commonplace for politicians, government departments and others to label some organizations, like schools, hospitals, or local authorities, as 'failing' and to embark on measures aimed at bringing about a turnaround in their performance. Those involved are drawing, perhaps unconsciously, on the well-established vocabulary and ideology of failure and turnaround in for profit organizations—in which high-profile examples like IBM, Marks & Spencer, or Chrysler Motors often figure. This article reviews the existing literature on failure and turnaround in the for-profit sector. It identifies some of the models and typologies which have been developed and proven useful in exploring failure and turnaround in for profit organizations, and discusses the extent to which theoretical and empirical findings from other sectors can be helpful in informing research, policy or practice in public and not for-profit organizations.

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Defining and Researching Organizational Failure and Turnaround

There are no generally accepted definitions of what constitutes 'organizational failure': it is a subjective and often contested term. While there are some established quantitative measures which for-profit organizations may use to track performance, such as return on investment/assets or trends in profitability, the point at which poor performance becomes failure is difficult to define.

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Organizational failure has been defined as an 'existence-threatening decline' in performance (Pandit, 2000) but that decline may be sudden or gradual, and can be precipitated by internal actions or inactions or by external circumstances and environmental factors. It rapidly becomes evident that organizational failure is a symptomatic rather than a diagnostic term, in other words it describes a situation facing an organization but does little to help us understand how that situation was caused or came about, or what could or should happen next.

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Organizational turnaround can be simply defined as the actions taken to bring about a recovery in performance in a failing organization (Pandit, 2000). In practice, it usually consists of a collection of concerted or co-ordinated activities which may include the replacement of key individuals in the organization's management and leadership, immediate attention to major operational problems seeking short-term solutions, and the longer term, but often radical, redesign or re-profiling of the organization and its business.

There is an extensive, though rather variable quality, literature on organizational failure and turnaround in for-profit organizations (with useful overviews or reviews in Hoffman, 1989; Pearce and Robbins, 1993; Ketchen, 1998; Anheier, 1999; Slatter and Lovett, 1999; Pandit, 2000; Chowdhury, 2002; and McKiernan, 2002).

The literature falls into three main areas:

- Empirical quantitative research, which uses data often on a large number of firms or organizations across a sector to analyse performance cross-sectionally or longitudinally. This approach is often used to try to discern patterns in or test theories about either the causes of failure or the use and impact of intervention strategies.
- Empirical qualitative research, which tends to use small numbers of case study organizations and to draw mainly on data from interviews, documents, observation and other sources to provide a 'rich description' of individual instances of failure and turnaround and sometimes to use them to develop theories or models which might then be tested in other settings.
- Theoretical papers, which attempt to develop 'middle range' theories (Pawson and Tilley, 1997) to describe and explain empirical findings and to locate the discourse of failure and turnaround in a wider theoretical context.

There are also many anecdotal accounts of failure and turnaround, provided by both academics and practitioners. These reports are often highly readable, but they tend to accentuate the more dramatic and visible characteristics of such situations; to focus particularly on the individuals involved in leadership and to ascribe changes to their actions; to provide a somewhat uncritical account which accepts things at face value; and to focus solely on examples of successful turnarounds.

There is a further literature on organizational mergers, acquisitions, takeovers, buy-outs and similar changes which are brought about by a range of circumstances but which are sometimes seen in situations of organizational failure. Such reorganization strategies are not reviewed directly in this article, but often feature some of the mechanisms and behaviours to be found in failure and turnaround situations (Paton, 1989; Cartwright and Cooper, 1995; Krieger, 1994).

Symptoms, Causes or Characteristics of Organizational Failure

Organizational failure has many possible symptoms and causes. These two terms are often used almost interchangeably in the literature, signifying a lack of certainty about causal relationships, and so we refer to 'characteristics' of organizational failure instead. It can be helpful to categorize these characteristics of failure, in one or more ways:

- *Chronic and acute characteristics of failure.* There are often both chronic causes of failure, which are present over an extended period of time and contribute to a gradual decline in performance; and acute causes which are sometimes also called 'triggers' and which may force or precipitate a crisis and the recognition or explicit acknowledgement of failure.
- *Types or categories of failure.* McKiernan (2002) suggests four groupings or categories including physical, managerial, behavioural and financial symptoms of decline. For example, a lack of leadership and poor decision-making is a managerial characteristic of decline, while product failures or supply problems are physical characteristics. The behavioural problems concern culture, attitudes, language and insight into the situation, while the financial

characteristics include falling profits and market shares, increasing debt burdens, failed attempts to raise finance and increasing financial competition.

- *Internal and external characteristics of failure.* Some of the often-cited symptoms or causes of failure are primarily internal to the organization, such as poor leadership, while others are primarily external and concerned with its environment, such as increased competition, product or service innovation, or changes in customer expectations (Slatter and Lovett, 1999; Balgobin and Pandit, 2001).

McKiernan (2002) argues that the basic cause of most of these symptoms or secondary causes of organizational failure is dysfunction in organizational learning and describes a range of ways in which organizations fail to learn about themselves and their environment and through that enter a performance decline which may result in organizational failure.

Perhaps one of the most useful features of empirical work on the causes or characteristics of decline is that it emphasises the multidimensional and interactive nature of the phenomenon. Each of the circumstances outlined above rarely exists in isolation, and they develop together or even co-evolve, as one problem leads to another. For example, it can be tempting to see all declines and failures as stemming from poor management (and hence to see replacing the management as the primary or even the sole strategy for turnaround). While many studies concur that poor management and leadership are important characteristics of organizational failure (Hoffman, 1989), they are rarely present alone and may be as much a symptom of failure as a cause. Organizational decline can lead high-performing managers to leave for careers elsewhere—a flight of talent which may speed up failure but may not necessarily have caused it.

It is also clear that the heterogeneous nature of the characteristics of organizational failure means that turnaround strategies or interventions need to take proper account of and be focused on the known characteristics of organizational failure if they are to succeed. In other words, turnaround strategies or interventions need to be tailored and matched to the individual causes of organizational failure rather than seen and used as 'one-size-fits-all' approaches which are useful in most or all circumstances.

Diagnosing and Predicting Failure

The diagnosis or labelling of organizational failure is usually preceded by an often extended period of declining performance. Indeed, it is commonplace for the actual diagnosis to be delayed by both internal and external stakeholders failing to perceive the problem, ignoring it, or even covering it up. For example, quantitative measures of performance often give a misleadingly positive assessment of performance before failure because managers and others have concealed or mitigated known problems (Griffiths, 1992). Organizations may have a history of slow progressive decline, or of a series of cycles of decline and partial recovery stretching back some years, before—for a variety of reasons—they become formally labelled as 'failing' (Slatter, 1984; Meyer and Zucker, 1989).

On the whole, the formal diagnosis of organizational failure rarely comes as a surprise to most stakeholders in the organization, particularly to those within the organization, who know formally, or more usually informally, about the seriousness of the problems at hand. For some, the diagnosis of failure may even be a relief and a source of encouragement because it forces acknowledgement of long-standing problems and demands action, which though it may be unpleasant at least may lead to better longer term prospects. In a sense, the diagnosis of organizational failure may simply confirm and acknowledge publicly what is already known quite widely.

The diagnosis of organizational failure may be triggered or precipitated in three main ways. First, there may be a severe or accelerating performance decline which stakeholders increasingly recognize is unsustainable. In other words, the *status quo* becomes less and less tenable and it is no longer possible to disguise or ignore the performance decline. However, for this to happen can require things to become very bad indeed, which then makes the prospects for turnaround less good than they would have been if action were taken earlier (Balgobin and Pandit, 2001). The second trigger for diagnosis and change can be a change of ownership or leadership—the arrival of a new chief executive or other stakeholders who bring a fresh perspective and, because they are not associated with past decision-making, are more able to be honest about the situation (Grinyer *et al.*, 1990). A third trigger may be what has been called the ‘egregious event’ (Rosenthal, 1995): a significant failure in organizational performance, such as a major incident or accident, which simply cannot be ignored and which may draw attention to wider organizational failings (Walshe, 2003; Walshe and Shortell, 2004).

The prediction of organizational failure is made more difficult by the tendency for quantitative measures of performance to be distorted in the period leading up to failure. However, a number of studies have shown that failure can be predicted, particularly in the short to medium term (up to two years) using widely available quantitative data (Altman, 1971; Yates and Davidge, 1984; Trussel *et al.*, 2002). At the least, it would seem feasible to use such data to identify a subset of ‘at risk’ organizations for more detailed scrutiny or oversight in the interests of preventing some organizational failures.

Stage Theories of Failure and Turnaround

Many ‘stage’ theories or models have been proposed which describe the process of failure and turnaround as taking place in a number of phases or stages (for example Arogyaswamy *et al.*, 1995; Balgobin and Pandit, 2001; Chowdhury, 2002; McKiernan, 2002). While the definitions and terminology used vary, they all describe the process in terms of four or five basic phases:

- *Decline and crisis*—an often long and gradual period of performance decline, which may be characterized by a progressive loss of business, market position, resources, reputation and external support.
- *Triggers for change*—the events or circumstances which mean that the extent and seriousness of decline is eventually recognized and explicitly acknowledged by internal and external stakeholders in the organization, which may be a particular financial, operational or leadership crisis.
- *Recovery strategy formulation*—the production of a plan to deal with the organizational failure which explicitly acknowledges the scale and nature of the problems and sets out strategies or methods for dealing with them.
- *Retrenchment and stabilization*—the shorter term actions aimed at turnaround which are often concerned with dealing with operational management problems, sorting out the finances, preventing any further decline or deterioration, and securing ‘quick wins’ in performance which will aid survival.
- *Return to growth*—the longer term and ongoing actions aimed at turnaround which tend to be concerned with setting out the new vision for the purpose and objectives of the organization, establishing a longer-term strategy for investment and development, and securing its long-term success.

Stage theories like this are useful normatively because they help us to conceptualize the linked processes of failure and turnaround and to map, or track, the progress of

organizations through them. However, they may encourage us to be 'over sequential' in our thinking about how failure and turnaround work (Arogyaswamy *et al.*, 1995). In practice, organizations do not necessarily progress through all the stages in the same order, can move backwards as well as forwards, and may get grounded or stuck in one part of the process. Stage theories implicitly suggest that turnarounds are successful and that the natural end point of the process is a final stage of return to growth, but there is empirical evidence that organizational failure can be a long term or even permanent state for some organizations (Meyer and Zucker, 1989; Meyer, 1999).

Turnaround Interventions

Most turnarounds have some form of external or exogenous leadership or sponsorship. It may be that external stakeholders such as shareholders, major customers/users, auditors, regulators or government have forced the recognition of organizational failure and imposed or encouraged a change of leadership, or the organization's board may have brought in external advice or a new leader itself. From a combination of this external input and the organization itself, a diagnosis of the problems and causes of failure emerges and a turnaround strategy is established (Boyne, 2004).

A functional analysis of the content of turnaround programmes or strategies in cases of organizational failure generally identifies three main groups or types of intervention:

- *Replacement* involves the removal of key members of the leadership and management of the organization, and their replacement either with others from within the organization or with others drawn externally. Replacement can focus solely on the chief executive and one or two other senior directors, or it can involve the wholesale replacement of the board and management team (Slatter, 1984; Mueller and Barker, 1997).
- *Retrenchment* is a term used to describe a wide range of largely short-term actions taken to stabilize the organization, to stem its losses and to deal with the immediate problems which have precipitated its crisis. Retrenchment may involve immediate steps to control finances and reduce costs (like cutting inventory, changing prices, reducing overheads, or reducing staffing) or to improve operational management (for example restructuring work processes, reducing waiting or idle times, or increasing throughput) (Robbins and Pearce, 1992).
- *Renewal* involves longer-term actions aimed at re-establishing the strategic direction, vision and overall purpose of the organization and placing it on a longer-term pathway to successful performance. It may involve a fundamental review of the activities of the organization and their long-term prospects, which can lead to the closure of some areas, expansion in others, and the opening of new markets or ventures. It may also involve a detailed analysis of the culture and leadership of the organization and a concerted effort to change the way that it works (Slatter and Lovett, 1999).

Replacement forms a part of the great majority of turnaround strategies, for reasons which can be as much political and symbolic as purely functional. Replacing the chief executive and other senior leaders may be a necessary step in attributing responsibility for the organization's predicament and providing a scapegoat. It may be necessary in order to secure the confidence and support of external stakeholders (like major customers, shareholders, or regulators) in the feasibility and likely success of turnaround efforts. It may be important internally too, in sending a message to the organization about a fundamental change of direction ('under new

management') and new expectations of performance on individuals, as well as the organization as a whole. However, replacement also often serves a simple, functional purpose: removing managers who simply lack the necessary leadership skills and competencies, or whose managerial performance has declined over time, and who are not suited or not able to take on the challenges of turnaround. Of course, replacement carries with it significant risks as well, in that it can mean the loss of key expertise and business understanding and knowledge.

The timescale for turnaround strategies can be long, but activity is often concentrated towards the start. The diagnostic phase of turnaround is often very short—major replacement and retrenchment actions may be taken within days or a few weeks, in part because timing may be critical to stemming further losses or problems. An early focus on implementing and delivering turnaround actions may also serve a purpose in establishing credibility: demonstrating, internally and externally, that those leading turnaround are serious about their intentions and are willing to tackle the problems which have led to organizational failure head-on. Early actions (and particularly early wins) may be important to creating a momentum for change and breaking down resistance. The timescale for renewal activities may be rather longer—stretching to months or even years—but, again, the process of renewal often commences early in turnaround, alongside the immediate actions being taken to stabilize and save the business.

It is important to see these interventions—replacement, retrenchment and renewal—as complementary, parallel and interacting approaches, rather than as consecutive stages in turnaround (Arogaswamy *et al.*, 1995). The results of turnaround, and any assessment of its success, take some time to emerge. Immediate improvements resulting from replacement and retrenchment interventions can often be discerned within a matter of weeks or months, but the longer-term success of renewal is likely to take a matter of years to materialize (Chowdhury, 2002). It is important to recognize that there is a difference between the time taken to establish and initiate a turnaround and the time needed to complete it and see a return to growth and longer-term successful performance.

This brief review of turnaround interventions has been largely focused on their functional content—what is actually done. However, research suggests that the success of turnaround may be equally dependent on the context for these interventions (and particularly how well the interventions are matched to the specific circumstances or characteristics of organizational decline and failure) and on the process of intervention (in other words, how they are used and by whom). This means that universal prescriptions about the effectiveness of different turnaround interventions are almost certainly misleading and that our understanding of effective turnarounds needs to address content, context and process issues (Pandit, 2000).

One final point should be borne in mind. While it can be difficult to define what we mean by 'success' in turnaround, there is little research or data available on the rates of success or failure in turnaround efforts. However, it is evident from a number of studies that some turnarounds do 'fail', and as a consequence there are either repeated attempts at turnaround (with, for example, yet another round of management and leadership changes), a period of continuing decline, or some other form of structural change (such as merger with or more likely acquisition by another organization).

Failure and Turnaround in Not-for-Profit and Public Services

Most of the literature on organizational failure and turnaround is wholly or primarily focused on the for-profit sector, though there are papers on failure and turnaround in schools (Willmott, 1999), health care providers (Edwards *et al.*, 2003; Walshe, 2003), local authorities (Skelcher, 2003) and other not-for-profit organizations (Mordaunt, 2002). While it seems likely that many of the ideas, concepts and models developed there have at least some application to public, not-for-profit services and organizations like the National Health Service (NHS), a number of important differences can be identified and highlighted.

First, organizational failure was earlier defined as 'existence-threatening decline' in performance, but for many public service organizations a performance decline poses only a limited or nominal threat to organizational existence or to individuals' careers. Fundamentally, failing schools, hospitals or other public organizations are very rarely closed down because their provision is a social necessity and this means that the cost of failure may often be quite low for some stakeholders. In other words, the concept of organizational failure and the ideas on which much theory and practice in turnaround management are based may be challenged, and turnaround may actually be more difficult to achieve (Meyer, 1999).

Second, defining decline and failure in public services may be more complex and subjective. Without the established metrics of for-profit organizations (such as return on investment and profit on sales) and largely without the competitive pressures of an open market-place, the performance of public service organizations like health care providers is more likely to be managed through mechanisms such as bureaucratic direction, regulation, and the use of performance indicators or league tables. Public service organizations also have a different and arguably more complex set of stakeholders in their performance—no shareholders, but users, customers, the wider public, professions, employees, funders, regulators and government all taking a legitimate interest. The net result of this may be that defining failure is more complex, subjective and open to challenge. In some circumstances, performance failure may be a political as much as a managerial issue.

Third, the symptoms and causes of organizational failure in public services are also likely to be somewhat different, in part because of the limited extent to which they operate in a market-place. Mostly obviously, decline in demand is the most commonly cited cause of for-profit failures, while public service failures are more likely to involve an inability to meet or satisfy demand. More generally, failures resulting from high levels of price competition, new market entrants, or poor product technology and a lack of innovation are less likely, while failures concerned with stringent cost constraints and uncontrolled workload may be more likely.

Fourth, most turnarounds in the for-profit sector are part exogenous, part endogenous. They are often started or precipitated by external interests (such as concerns raised by major shareholders, or a newly-appointed chair or chief executive), but the process of turnaround is essentially led by the organization itself and its (often newly-appointed) leadership. In contrast, failure and turnaround in public service organizations seems to be a more externally initiated and managed process. Government departments, agencies and regulators often play a substantial role, not just in precipitating the diagnosis of failure and initiation of turnaround, but in managing and directing the subsequent turnaround process and monitoring progress until the organization is deemed to have succeeded.

Fifth, the process of turnaround in public services, and particularly the use of turnaround interventions like replacement, retrenchment and renewal, may be quite different in many public services where both the practical challenges and the political environment, governance and accountability arrangements are different. Commercial turnarounds are often characterized as involving rapid and radical change, especially in the early stages of retrenchment but also in the more strategic phase of renewal. A company may, through its turnaround, be transformed to focus on new and different markets, products or services. In contrast, both the pace and scope for change in public organizations may be more constrained by a range of factors related both to the nature of the organizations themselves and the services they provide. For example, a public hospital with major problems in a service area like accident and emergency cannot simply choose to withdraw from that market. Public service rationalizations in the name of efficiency such as merging duplicate services or reducing multisite operations have to be achieved through painstaking negotiation with professionals, service users, and other stakeholders.

Sixth, aspects of turnaround which may seem analogous in the for-profit and not-for-profit sectors may actually be rather different in practice. For example, replacement strategies in both sectors tend to involve changes at board level and in the senior executive team. But in many public and not-for-profit organizations, with complex professional or political hierarchies, organizational leadership may reside elsewhere—among senior doctors in hospitals, for example, or among elected members in local authorities. In general terms, for-profit organizations may exhibit greater singularity of leadership, and less reliance on consensus and negotiated decision-making among stakeholder interests, and these differences mean that apparently similar replacement strategies are likely to have different effects.

Conclusions

The existing research on organizational failure and turnaround in for-profit organizations has some drawbacks. It tends to treat as homogeneous 'black boxes' situations and circumstances of organizational failure and strategies for turnaround which are clearly heterogeneous and quite complicated phenomena. It is also largely relatively atheoretical, with little attempt to move beyond empirical descriptions of what happens in failure and turnaround towards building, testing or using credible theories and models to help explain what is going on. However, it contains a number of ideas, theories and findings which are almost certainly relevant to the study of failure and turnaround in public organizations. While the empirical experience of turnaround in public services may be quite different from that in for-profit organizations, there are sufficient similarities for ideas about the causes and characteristics of failure; about the measurement, prediction and diagnosis of failure; about the stages of failure and turnaround; and about the nature and effects of turnaround interventions to have at least some currency, especially when they have a high face validity.

However, the fundamental differences in purpose, mission, culture and environment between for-profit and not-for-profit or public service organizations mean that the translation of lessons from one sector to another is probably not straightforward (Pollitt, 2003). There is a risk that politicians, government officials and others, newly enamoured of the language of failure and turnaround and inadequately informed of the empirical evidence and practical experience in the for-profit sector, will resort too readily to deeming schools, local authorities, hospitals and other organizations to be 'failing', and will have unrealistic expectations of the transformative power of the turnaround process.

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Article 2

Extract from Public Finance 26-11-2004

News analysis – CSA faces prospect of Revenue takeover (Paul Gosling)

Doug Smith's resignation as chief executive of the Child Support Agency is not so much a solution to a crisis, more the beginning of a new chapter in an 11-year saga. Now there is doubt over the future of the CSA itself, with calls for its abolition and the absorption of its functions into the Inland Revenue.

Work and Pensions Secretary Alan Johnson has not explicitly said that the CSA could go, but in his appearance at the work and pensions select committee he told angry MPs that a radical solution was needed. He spoke of a 'quick decision' being necessary on the future of the £456m, 18-month-old IT system, supplied by computer giant EDS, which is blamed for much of the chaos.

Of 478,000 applications for child support received since April last year, just 140,000 have had maintenance contributions calculated and a mere 61,000 have been paid. Amazingly, performance standards have fallen by a third since the 'improved' system was installed. Three-quarters of a million claimants are still waiting to have their cases migrated from the old system.

MPs are furious that an agency intended to ease poverty among lone parents has instead become a bureaucratic nightmare. Two years ago it was revealed that £1bn in maintenance payments arrears had been written off.

According to Johnson, EDS has admitted its system is 'badly designed, badly tested, badly implemented'. 'No comment,' said EDS, when asked for its view, although it is thought that it believes much of the problem lies with the DWP requiring many changes – the figure of 2,500 system alterations has been quoted.

There is a growing recognition, however, that simply replacing the IT infrastructure might not be enough. Liberal Democrats' work and pensions spokesman Steve Webb says: 'Successive governments have failed to get a grip on the whole child support system. It is now like a worn tyre that has been patched so many times it is beyond repair and should be scrapped. The Inland Revenue already holds information about family incomes and about children, so could easily take over the assessment of child maintenance. The Inland Revenue would also be far more effective than the CSA at collecting child maintenance.'

A few weeks ago the DWP dismissed any such suggestions as irrelevant speculation. Johnson's appointment as work and pensions secretary, however, makes it clear that things have changed quickly – the idea is now at least thinkable.

A DWP spokeswoman seems to acknowledge this. 'People think that [the Revenue] is the natural place for this, but a lot of clients are on benefits,' she says. 'Another consideration is that if it is moved to the Inland Revenue, it would still have the same system of child support to deliver, just provided by another department.'

'Our secretary of state did say he would talk to EDS about the computer system. There is no point in speculating until this is resolved. There are a lot of options around.'

Nor is there unanimity that the Revenue is the right place to administer child support. It continues to bed in its takeover of the Contributions Agency, it is still integrating tax credits into the department and is about to go through the massive job of joining with Customs & Excise.

Ruth Lister, professor of social policy at Loughborough University, is sceptical about the Revenue taking over another problem area. 'It's not as if tax credits are a success,' she suggests. 'Child support is more like the traditional role of getting money in, but there seem to be an awful lot of problems with tax credits and I would think one would want to see those ironed out first. But the CSA does seem to be beyond reform.'

Despite the DWP's optimistic claims that there are many options, few, if any, seem attractive. Mark Serwotka, Public and Commercial Services union general secretary, argues that the DWP must abandon plans to axe 4,000 staff from the CSA. While this might prevent the chaos getting worse, it hardly counts as a solution.

Of course, it is not the job of a union to provide the answers. The trouble is that there are no signs, as yet, that the government knows what to do either.

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