Chapter 7
Navigating through Organizational Life Cycle and Longevity: Restructuring as a Business Transformation Strategy

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Introduction

Management's primary task is to ensure that organization acts efficiently in performing its tasks and achieving its goals. Long-term competitiveness and longevity have always been one of the most important goals that organizations deal with. However, especially in today's business environment, many organizations fail to be capable of providing its product or services in the long run. Financial problems and bankruptcy often emerge as phases in organizational life (Koh et al., 2015). Companies that survive these downturns and show long-term sustainability seem to be more successful in recognizing the needs of the organization on time and avoided negative performance cycles as opposed to other numerous companies whose lifespan was very short. If they did go through crisis, they were able to overcome them. In other words, they were successful in managing their life cycle and implementing strategies that lead to enhanced organizational performance and sustainability.

This chapter presents restructuring as a strategic response to organizational crisis, and one of the solutions that can lead to improved performance and renewal for organizations found in financial distress or decline as a phase of their life cycle. The case study presented in this chapter gives an example of Pevex Ltd., as a company that has successfully gone through restructuring after bankruptcy, and today presents one of the leaders in the segment of retail of non-food goods in Croatia.

The chapter structure is as follows: first part covers theoretical aspects of organizational life cycle and decline, together with characteristics of restructuring as a transformation strategy. Then presented is the case of Pevex Ltd., followed by questions and topics for discussion. The chapter ends with suggestions for further reading and a list of references.

Keywords: organizational life cycle, longevity, organizational decline, business crises, restructuring

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Organizational life cycle and restructuring as a business transformation strategy

Understanding how organizations work and develop, presents a starting point for creating effective and sustainable organizations (Jones, 2004). One of the frameworks to follow is the organizational life cycle. As organizations grow, they go through a sequence of different developmental stages (Mosca et al., 2021) and these predictable phases of behavior form the life cycle of the organization. As a business grows in size and the organization matures, the very nature of the business changes, as well as the nature of challenges and crisis that occur inside organization. Each stage of the organizational life cycle includes specific organizational priorities, a unique structure, systems, and leadership (Greiner, 1998). Moreover, every phase of the organizational life cycle is characterized by predictable set of problems and crisis that need to be managed and controlled for organization to further prosper and grow. If not properly managed, crisis are not seen as opportunities for growth, but rather represent a start of an organizational decline, and ultimately the death, i.e. shutdown of the organization as the next phase of the life cycle.

The term organizational decline describes a state with a significant reduction in the organizational resources and decline in the performance over a longer period (Serra et al., 2017). The organization will often have a wide range of processes that destroy organizational effectiveness and reduce employee satisfaction and loyalty (Cameron et al., 1987). This life cycle stage "occurs when an organization fails to anticipate, recognize, avoid, neutralize or adopt to external or internal pressures that threaten its long-term survival" (Weitzel & Jonsson, 1989, p. 94).

When examining life cycles of the long living organizations, they appear to have an innate ability to exploit crises that arise and transform them into new business opportunities. These organizations typically could identify the upcoming downturn trend ahead of time and recognize the momentum as a new opportunity to create alternative avenues for company growth and profitability (de Geus, 2002). All of the long living companies encountered problems and made mistakes during their life, yet they display a notable resiliency and ability to bounce back, leading to their longevity (Collins & Porass, 1994).

In case of a crisis, especially a financial one, organizations can apply a set of strategies for their revival and avoidance of liquidation. Restructuring is one of those business strategies that can help organizations fight current internal and external pressures threatening its longevity. Restructuring can be defined as act of reorganizing the legal, ownership, operational or other structures of a company for the purpose of making it more profitable and better organized for its present needs (Norley et al., 2008). It is a complex and long-term process, which often brings changes in the ownership and management structure, business processes, internal capacities, as well as the introduction of new technologies and investments, but also employee motivation (Trstenjak & Altaras Penda, 2018). Restructuring can encompass a broad range of transactions, including the ones related to organizational assets (portfolio restructuring), structure of capital (financial restructuring) or organizational structure (organizational restructuring) (Bowman & Singh, 1993).

Some of the main reasons to restructure are (Szymczyk, 2016, p. 4):

- to make the organization more profitable and integrated;
- to achieve efficiency and effectiveness;
- to reduce unwanted and overwhelming expenses;
- to implement new technologies;
- to open to new markets on a global scale;
- to meet the customers' demands in a quicker and smoother way;
- to be more competitive and achieve the market advantage;
- to raise from the crisis or survive a currently adverse economic climate;
- to move in an entirely new direction and enhance the shareholder value.

Usually restructuring is focused at problems with financing debt, and as such oriented towards prevention of bankruptcy (Akbar et al., 2022). Still, there are situations when organization become unable to pay its debts and thus the bankruptcy occurs (Donaldson et al., 2020). In these situations restructuring in bankruptcy presents an opportunity for an organization to exit bankruptcy while continuing to operate in a modified form. Restructuring in bankruptcy is a process of comprehensive revision and rehabilitation of business, resulting with continuation of business in a more or less modified form (Hrkač, 2021; Sajter, 2010). As such, it constitutes an alternative to a classical or liquidation bankruptcy procedure, after which the sale of the debtor's assets results in the closure and consequently termination (death) of organization (Sajter, 2010). In a regular restructuring (without organizational bankruptcy), usually the company's management, together with the company's owners, decide on all aspects of the implementation of the restructuring. On the other side, in restructuring during bankruptcy, the company's management is replaced and the specially elected trustee starts to manage the company (Sajter, 2010). Often external advisors are also hired in the process of restructuring to provide professional, financial and legal help (Szymczyk, 2016).

Different elements can influence the success of restructuring, but it is mostly considered that successful restructuring is influenced by organizational capability to modify its strategy, structure, and ideology instead of just relying on the cost cutting tactics (e.g., layoffs) and short-term goals (Koh et al., 2015). Research indicates that the increase in business performance can be expected if restructuring strategy is successfully implemented inside organizations (Bišić, 2018).

Restructuring of Pevex – example of a business recovery strategy

PEVEX Ltd is the first Croatian non-food retailer that appeared on the market in the 1990s. Today it operates in all parts of Croatia and is established as the first choice for purchase when it comes to products for building, furnishing and decorating home and garden area. In the PEVEX sales centers it is possible to buy and choose from tens of thousands of different items (Pevex, 2022). However, several years ago, for

Pevex things did not look as good as they do today. Its life cycle was quite turbulent, characterized by bankruptcy and restructuring as an answer to organizational downturn and decline[4].

Company was established as Pevec Plc in Bjelovar, and it was registered for trade of tools for agriculture and landscaping as well as spare parts for agricultural machinery. It was a family owned business with two employees - spouses Zdravko and Višnja Pevec, as company's founders. Owners were strongly focused on expansion and growth, so soon new stores were opened outside Bjelovar. First additional new store was opened in 1994 near Zagreb, followed by additional stores all over Croatia and expansion of existing ones in the following years. For instance, in 2000, the sales center in Zagreb was expanded by 2,500 to 7,000 square meters. This was also a year when the largest growth in the company's business was recorded and the company won the award for the most successful entrepreneurship organization, presented by the Croatian managers and entrepreneurs association - CROMA.

In parallel with the expansion of trade, Pevec also started to deal with transport and took over a lease of 500 trucks, thus becoming one of the largest transportation companies in Croatia. In addition to transportation, Pevec expanded its business to the field of tourism by buying a hotel in Đurđevac. The company also invested in construction. Therefore, a Pevec Group in 2004 was founded, encompassing all of the organizations under the ownership of Pevec and segments of trade, transport, construction and hospitality.

In 2007 and 2008, the company expanded its business to foreign markets as well. Sale centers were opened in Macedonia, Bosnia and Herzegovina and Serbia. In 2008, Pevec had 4,000 employees, 14 sales centers, 500 vehicles and a large number of properties. There was almost no major city in Croatia at the entrance of which there was not a shopping center with a green rooster logo and the green inscription "Pevec".

However, 2008 and 2009 were years of great changes. The expansion heavily funded on debt and the great diversification into non-core activities, together with the emergence of the global financial crisis lead the company Pevec to financial problems and bankruptcy. The bankruptcy was opened after the bank account had been blocked for several months, salaries for over five months had not been payed, and the over-indebtedness of a company towards banks, suppliers, workers and the state. Due to financial difficulties and debts to creditors and suppliers at the end of 2009, the company's sales centers were closed, and thus bankruptcy proceedings were opened against the company Pevec Plc. The proceedings opened at the Commercial Court in Bjelovar and more than 1,000 employees, 800 companies and 11 commercial banks reported their claims for the amount of HRK 1.9 billion (approx. 252,17 million euros).

[4] Information presented in this case study are based on the following sources: Dnevnik.hr, 2009; Hrkač, 2021; Indeks.hr, 2019; Puzak, 2014; Sosa, 2020; Tportal.hr, 2019.

In 2010, a bankruptcy plan was drawn up and the process of company restructuring in bankruptcy began. A trustee was appointed to lead the restructuring. On June 21, 2012 by the decision of the Commercial Court in Bjelovar, the bankruptcy plan was confirmed, whereby Pevec becomes a joint-stock company. The claims from the workers were settled in money, while the banks were settled through a property collateral.

Several reasons seem to have led to bankruptcy, and eventually restructuring for Pevec:

- **Unclear and inadequate business strategy and financial mismangement, together with operational inefficacy in the business model and in the system of internal control**

Company's management did not have a clear and focused strategy for the Group and its development. Non-profitable and large investments in non-core business activities such as transport, logistics, construction and hospitality lead to disruption of liquidity in retail, company's core business activity and the only promising segment of Pevec Group.

- **Business model complexity and inadequate organizational structure**

In general, organizational structure was not well designed. It was dependent on centralization of decisions in the hands of its owners. All of the authority and responsibility for decisions was in the hands of Zdravko and Višnja Pevec. They made all the main decisions, including those on division of labor and work tasks. Tasks were not assigned systematically and there was no control of work performance, which led to inadequate operations and caused poor financial results. Horizontal chain of command lead to bad interpersonal communication among employees. Monitoring of group business operations or establishment of an efficient control system of all related companies within group was highly demanding and almost impossible due to the poor organizational structure of the entire group.

- **Over dimension of sale centers**

In average, every center had over 17,000 m2 of space, significantly higher compared to competitors on the market. Large spaces, along with higher fixed costs, resulted in high cost of work capital, insufficiently focused assortment of sales goods and an unnecessarily large number of suppliers. There was no plan that would define which sales area would be occupied by which products and there were no adequate records of materials in the warehouse. Furthermore, there was no strategy to manage the assortment, nor a good supplier management model. Pevec did not have clearly defined logistics, nor did it have a department and people who dealt exclusively with the quality logistics.

- **Negative effects of global business crises and fall in sales in retail**

Due to global financial crisis in 2009, the company had significant fall in the sales. As it was not possible to proportionately reduce costs, retail sector had a drastic drop in the operating margin and it was unable to service debt and working capital.

The focus of a restructuring process was on designing a new organizational structure that would properly define organizational units, tasks and responsibilities. For instance, Pevex now has a logistics department that deals exclusively with high-quality storage of products and supplies and their transportation. As previously none of the managers in the company had a clearly defined position and function in the organization, through new structure clear line of responsibility and authority had to be defined. Because of a new structure, tasks began to be assigned more systematically and there was no confusion about work roles and tasks, as well as about chain of command and control. One of the employees in Pevex says: “As much as the work in Pevec used to be black, now it is white. That's such a difference.”(Jutarnji.hr, 2019). He says that after the restructuring process he has finally been enjoying his work because he has his own working hours, knows his daily and hourly wages, and receives extra pay for Christmas and Easter (Jutarnji.hr, 2019).

After the new organizational structure was established, focus was on sale centers that were reopened, but only in locations that had a growth potential. In order to make the stores more efficient, each store had appointed managers in charge of sale and control of merchandise, managers in charge of price policy that also took care of margins, and managers who took care of the operational processes of the sales centers. A new strategy for products and assortments was offered too. Each products’ performance was monitored and tracked based on a basic set of predefined criteria (e.g., average income and margin). After the analyses, company made decisions regarding the most appropriate assortment of products that can be offered in order to ensure long-term sustainability. Today, Pevex offers products in eight different programs - household appliances, electronics, garden equipment, ceramics and sanitary ware, hardware, home and design equipment, building materials and colors and consumer goods. Performance analysis for each sales program are carried out regularly. In line with the reduction of products offered, sale areas were reduced leading to lower fixed costs.

It was also important to create a new relation among Pevex and its suppliers based on trust and fulfillment of Pevex’s obligations toward them in a timely manner. With major suppliers Pevex made agreements that ensured the highest possible margins were achieved. In addition, Pevex joined the international alliance A.R.E.N.A. that allowed Pevex to purchase quality goods at the same prices as some of the leading retail chains in Europe, making Pevex more competitive on the Croatian market.

A new IT and business system was implemented, which enabled better process and cost management. Internet shop was also introduced, together with completely new marketing process and rebranding. A new much stronger focus on customers and their loyalty is emphasized.

After the successful restructuring of the company, in 2014, the bankruptcy trustee Davor Šket then stated - "I would say that almost everything is different and improved, standards have been raised and strictly defined procedures have been introduced. It may sound strange to you, but Pevec used to improvise in many ways. Today, the company operates according to all models and standards of the profession, and beyond. We standardized business centers that were oversized, although this is a continuous process. Currently the implementation of Oracle Hyperion Planning, a superior business system for planning, budgeting and forecasting is in the final phase, which will shorten the time to work on analyses, monitor the realization of budgets and costs, and make decisions of a higher quality. In Zagreb, we opened a centralized IT-equipped warehouse, so we can monitor the state of stock at any time, and quickly deliver the necessary goods to our centers. We conduct employee training at all levels." (Jutarnji.hr, 2014).

Interestingly, bankruptcy and restructuring process also revealed malversation regarding company finance done by its founders. Therefore, The Supreme Court in Croatia blamed Višnja and Zdravko Pevec for abuse of trust in business operations as well as tax evasion and sentenced them to prison in 2015.

Today, Pevex continues to operate successfully, as one of the leaders in their business sector, strongly showing that the days of crisis are far behind them and that the crisis that occurred was an opportunity for further development and growth in its life cycle.

Questions/Tasks/Debate topics for classroom discussion

- Why is the concept of organizational life cycle and its management important for organizations?
- The concept of organizational life cycle was created by comparing social systems with natural systems, more precisely with living organisms that also go through different stages of development. What would be similarities, and what would be differences between the life cycle of organizations and living organism?
- For some organizations, crisis are opportunities for growth, while for others a beginning of their decline. What are the reasons for this and which factors affect successful crisis management?
- Is it possible to build a long living and sustainable organization? What are the main challenges in building and managing long living organizations?
- Does management of family owned business differ from management of other types of organizations? What are the specifics of a family owned business?
- In the organizational life cycle and its management what is the role of owners? Can they effectively lead the organization through every phase of its life cycle and crisis that occur? What is the role of professional management and when should they be included in organizational management?
- What is the role of owners in building a sustainable and globally responsible organization? What should be the main business values driving their business, personal or more global goals and values? Can a family owned organization be a good corporate citizen?
- Does expansion and diversification of business always present a good business growth strategy? What elements need to be considered when implementing this business strategy?
- What are the main benefits of restructuring for organizations? Are there any downsides of restructuring?

- For organizations faced with financial distress and bankruptcy, does restructuring present a good recovery strategy? Why?
- In the case presented, what do you consider as the main reason that led to the restructuring of Pevex? How would you evaluate the overall restructuring process and its outcomes?

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