

# **DECISION MAKING IN NON-PROFIT ORGANIZATIONS DURING TIMES OF TURNAROUND**

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## **ABSTRACT**

Non-profit organizations differ in many respects from traditional industrial organizations, with a fundamental discriminate being the absence of a pure economic motivation. There is abundant research on decision making orientation in corporations during organizational declines and subsequent turnarounds. This paper contributes to the research on decision making by investigating how non-profits, when faced with potential for bankruptcy or closure, create decisions and strategically respond to financial distress. While there is a fair amount of research on management for non-profits in conventional times, there is a complete void in the research on the decision making orientation during declines and turnarounds.

The purpose of this research is to more fully understand the decision making orientation involved in non-profit turnarounds. Not-for-profits hospitals were studied on a longitudinal basis for four years. Initial data was collected qualitatively using field research methods. Ongoing research is incorporating additional quantitative methods, surveys, and data collection to augment findings. Initial results suggest that non-profits' decisions had a significantly more operational orientation than strategic, which is inconsistent with previous literature on corporate turnarounds. Not-for-profits exhibited decision making orientation primarily geared towards execution and efficiency.

## **DECLINES AND TURNAROUNDS**

Significant research exists on organizational and corporate life cycles (Dodge, Fullerton, & Robbins, 1994; Churchill & Lewis, 1983). Several distinct stages have been proven to exist, including introduction, maturity, decline, and death. While maturity may last for many decades, some organizations eventually begin the period of decline due to a lack of financing, high debt leverage, labor struggles, or numerous other factors. Some percentage of these will be able to

reverse the downward spiral and potentially revive or turn around. It is this last phase which is of interest in this research.

A turnaround has been defined many ways: as strategies to stabilize operations and restore profitability (Pearce & Doh, 2002); as performance declines (Krueger & Willard, 1991); as an upturn in financial performance (Schendel et al, 1975); or a significant change in policy or practice that brings an organization back from near collapse (Langabeer, 2007). Turnarounds have been studied intensely in industrial organizations for years, dating back to the late '70's and early '80's in some landmark research on corporate turnarounds (Hofer, 1980). There has been continued interest in determining if turnarounds are related to changes in strategy (Hambrick & Schechter, 1983), leadership (Frayne & Callahan, 2004), financial structure (Pearce & Doh, 2002), operations (Hofer), or other factors.

Three distinct stages have been discussed within the turnaround phase (Pearce & Doh, 2002). These include decline, redirection, and re-establishment. Each of these requires different leadership, strategies, and decisions, but ultimately is integrated into an on-going process and not a single event.

There has been virtually no research on turnaround decision processes in non-profit organizations, to understand if decision making processes or strategies differ from other forms of enterprise. This research chose one type of historically non-profit organization—hospitals and the healthcare sector. Nearly 6,600 hospitals operate today in the US, and over 85% of them are non-profit in nature, controlled by local or state governments, churches, and universities. The unique environment and operating characteristics make hospitals a very good choice for non-profit research.

Historically hospitals were provided revenues to fully cover costs and small profit margins, and thus never faced a decline phase and had no need for turnarounds. Today, hospitals are failing faster than any other non-profit organization, since healthcare is considered a competitive industry where organizations must earn a reasonable return on investment in order to invest in technology, to grow, and to recruit successfully. Healthcare has not been exempt from free market forces, despite a continuous debate about whether market forces really should be the governing force in healthcare (Herzlinger, 2006).

Decisions making often becomes significantly more challenging during corporate turnarounds. Researchers have shown that once decline sets in, decisions are often much more complex and should be carefully aligned with the environment (Castrogiavanni et al, 1992), and many theories emphasize leadership skills and competencies as they impact decision making processes (Useem et al, 2005). There has also been significant research on the decision processes under stress, risk, and hyper-competition, but no empirical research exists on this subject in non-profit environments.

### **RESEARCH QUESTION**

This research attempts to start analyzing why and how non-profit organizations make decisions in times of organizational decline. Primary focus is on the strategic versus operational orientation of decision making, and to determine if non-profit organizations focus their decision processes more on one or the other during times of decline. At this time, no distinction will be made on successful versus unsuccessful decisions, or the outcomes of the turnaround, although this is currently being incorporated for future ongoing research.

Based on corporate models of decision making during turnarounds, the research is fairly conclusive that strategic decisions taken during turnarounds are usually more effective if they are in response to strategic factors, such as changes in competitive landscape or other exogenous factors. Operating decisions are typically emphasized if the decline is due to poor operating health, such as inefficient use of assets or resources. Hambrick & Schechter (1983), in their systematic research of over 260 companies, concurred that the contingency perspective suggests that where the external environment forced the decline, a strategic turnaround would be more effective and vice versa. Most studies however have examined manufacturing organizations which are able to change product mix and industrial decisions in order to allow improved operating efficiency, so it is unclear if these findings would apply to the non-profit sector.

In the not-for-profit hospital sector, most empirical studies have shown that the external environment is contributing significantly to organizational failures. Factors such as a reduction in third-party reimbursement rates, reduced government payments, and increasing competition all are contributing to organizational declines (Becker & Koch, 2006). Based on previous research, the strategic factors forcing declines should consequently require strategic decisions or responses. Therefore, based on previous research findings from the corporate world, this research hypothesis is that:

H1: Non-profit organizations in decline and turnaround modes will emphasize decisions that are more strategic in orientation than operational.

### **METHODOLOGY**

To study non-profit decision processes, 100 non-profit hospitals were randomly selected throughout the US. Data were collected for each organization's key financial indicators for the year 2002-2005, such as profitability, liquidity, and working capital. Data for the most recent year for these financial variables is shown in Table 1.

<b>Variable</b>	<b>Mean</b>	<b>Median</b>	<b>Std. Deviation</b>
Beds	507.341	431.000	406.370
Cash to Debt per Bed	0.150	0.060	0.256
Days Cash	51.180	31.600	56.358
Debt per Bed	711712.402	617355.466	626780.357
Days of Working Capital	22.256	12.700	81.296
Operating efficiency (exp per l	5098.305	3447.539	6737.577
Labor Productivity	160890.000	139810.000	21230.000
Margin %	-0.060	-0.012	0.181
z-score	0.700	0.610	1.150

**Table 1: Descriptive Statistics**

Consistent with other research, this study defined organizational decline as at least three years of continuous decline in financial performance. Using these data, a financial z-score was

calculated for each of the years using Altman's model for service industries (Altman, 1993). This z-score is a model of financial distress where higher scores indicates less likelihood of decline, and lower scores (particularly those less than 1.1 suggest imminent bankruptcy). Unfortunately, since the z-score models were built around for-profit corporations, it is unknown if the exact cutoff for distress in non-profits is really 1.1, but 40% of the hospitals had scores less this cutoff for all years, and these became the sample for this research. The mean z-score for this sample was a .70, which would typically represents significant distress and decline.

Using this sample, longitudinal field research methods were used to explore qualitatively the decision orientation (i.e., strategic versus operational). Decisions were classified as strategic if they involved adding new capacity or market share (e.g., new beds, new markets, or new service lines), replacing executive leadership, focused on competitive positioning, or renewed emphasis on quality and effectiveness. Decisions were classified as operating if they focused on cost reductions, asset utilization, pruning service lines, improved supply chain efficiency, increased bed occupancy strategies, or labor productivity improvements.

Since each hospital might have used a combination of decisions, this researcher assessed which of these decisions were considered or taken by each organization, based on any evidence found in secondary data sources (which involved extensive searches of multiple sources, including annual reports, company websites, press releases, and interviews in magazine and newspaper publications). Therefore each non-profit organization could have multiple decision orientations, both strategic and operational in nature. The percentage of affirmative responses indicates that the secondary sources provide evidence that each type of decision was made over the most recent three year period. This longitudinal field research method allowed for analysis of the stated or deliberate strategies that each organization felt they undertook to combat distress and bankruptcy.

## **RESULTS AND DISCUSSION**

It was hypothesized that non-profit organizations would utilize more of a strategic decision making orientation in declines and turnarounds, since the factors driving healthcare decline is primarily attributed to strategic factors. This was not supported in this research. Nearly 65% (26 of the 40 organizations) of the turnarounds were classified as relying on operational decision making orientation than strategic.

Most of these non-profit turnarounds describe their decision strategies as oriented towards increasing efficiency, through across the board cost reductions and cuts and increased resource utilization. Approximately 45% of the sample described the use of broad cost cuts to streamline expenses and get financials back in line. Nearly one-third of the sample used service line pruning, or rationing, to reduce costs in a more focused way. Bed management strategies, which attempt to decrease the time between patients in rooms, was also common decision strategy to increase occupancy rates and utilization. Cost cutting programs initiated by Finance executives were also common, such as salary and hiring freezes. Supply chain savings, through reduced procurement costs of medical supplies and pharmaceuticals, is another often cited decision during operational turnarounds. Table 2 shows a summary of the major decisions and their orientation below.

<b>Decision</b>	<b>Strategic Orientation (n=14)</b>	<b>Operational Orientation (n=26)</b>
Across the board cuts		45%
Service line pruning		32%
Supply chain cost reductions		27%
Salary freezes		18%
Increased bed utilization		12%
Other Operational		7%
Change in CEO/leadership	18%	
Increased quality/service	13%	
Expansion of service lines	5%	
Geographic market expansion	3%	
Competitive positioning	3%	
Other Strategic	8%	

\* Note: Responses do not sum to 100% due to multiple classification

**Table 2: Decision Orientation During Turnarounds**

Only around 35% of the sample used strategic decisions to attempt to turnaround the declining non-profit organization. The most commonly cited decision was a change in the chief executive officer or other senior leadership position. This is similar to strategic changes made in for-profit organizations, albeit the utilization of this decision was significantly less than in corporate turnarounds. Change in board composition was also rarely discussed. The next most common strategic decision was to focus more on quality and service, followed by an expansion of specific service lines. Overall, the decision making orientation in non-profits leaned significantly more towards operating than strategic.

While many corporations in similar situations incorporate decisions that emphasize new geographic markets, increased speed, or creating a new competitive advantage, the non-profits in this sample responded primarily with an operational focus. This might have been expected if the operating environment was the major factor influencing the decline, but as previously stated, most healthcare research continues to point towards strategic and policy level influences that is causing healthcare distress.

### **IMPLICATIONS AND LIMITATIONS**

The study of non-profit decline and turnaround is increasingly becoming an important topic, as more non-profits are facing this problem than ever. Based on findings from the corporate world, it would have been expected that since strategic factors are driving organizational declines, research would support that decision making should have a strategic orientation. Actual results however from this sample of non-profits suggest that operational decisions are much more common during turnarounds today. Of course, this does not suggest that operational decisions or strategy will result in success. This present study made no attempt to classify the turnaround as successful or unsuccessful, but purely to assess the current state of

decision making in non-profits during organizational declines.

There are several limitations to this research. Primarily, it is based on qualitative research conducted on stated strategies as expressed by hospital leadership and others, and it is well understood that stated strategy can diverge significantly from actual. More importantly, the sample size needs to be expanded greatly to ensure generalization across the entire population. Future research should incorporate survey instruments to more quantitatively assess leadership decision making orientation.

On-going research should examine the for-profit hospitals as well, and compare the decision orientations for these organizations to the non-profit responses, to assess if differences exist. Alternatively, future research should separate samples into both successful and unsuccessful turnarounds in order to see if decision making orientation differs in these two groups. Finally, understanding if all non-profits respond similar to the non-profit healthcare organizations in decline is another interesting dimension to continue this research stream.

There are several implications for policy and practice. Since many non-profit hospitals are in the decline phase, there is a need to study the decision making processes and orientation for these organizations. Many of these organizations have remained in decline phase from five to ten years, and if these non-profits could re-shape their strategic orientations towards improved effectiveness they might be more likely to emerge out of this decline phase. Future research that decomposes successful turnarounds and decision orientation should be encouraged, as this will help to improve the state of managerial practice.

Overall, this research has contributed to a very limited literature on non-profit decision making orientation in declines and turnaround. Much more can be done in this area to study the similarities and differences between non-profit decisions and strategies and those of corporate turnarounds. This will be of particular benefit to both practitioners facing this difficult challenge, and academicians who study non-profit organizations.

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