Why do Companies Fail?

Survey Results 2014

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Participants: **Corporate Restructuring Experts & Turnaround Managers**

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About the Research Project

The Turnaround Management Society (TMS) asked 405 turnaround managers and restructuring experts about what factors, in their experience, lead to corporate crises. The last survey on this subject was carried out in 1990. The 2014 TMS survey highlights the internal and external causes that corporate restructuring specialists have witnessed in their assignments over the last five years. The results are then compared to previous surveys in order to identify changes over the last 40 years in the reasons for company failure.

Most corporate crises are only recognized once they become obvious in reduced sales figures or the continuous loss of money. There are internal and external reasons for corporate crisis; the internal causes, however, are often not sudden, but build up until they reach a point where they can no longer be ignored. This point often occurs when a company runs out of cash, does not pay its bills on time, and reduces communication with its stakeholders.

Crises that have external causes are often more sudden and, if the management did not prepare sufficiently, the company may be plunged into a sudden crisis. If the management is not experienced in dealing with this kind of crisis and the company does not have sufficient resources the company might end up in insolvency before the management has a chance to react properly. External reasons are often cited as the cause of difficult situations, but most of the time the reasons are internal.

Internal Crisis Factors

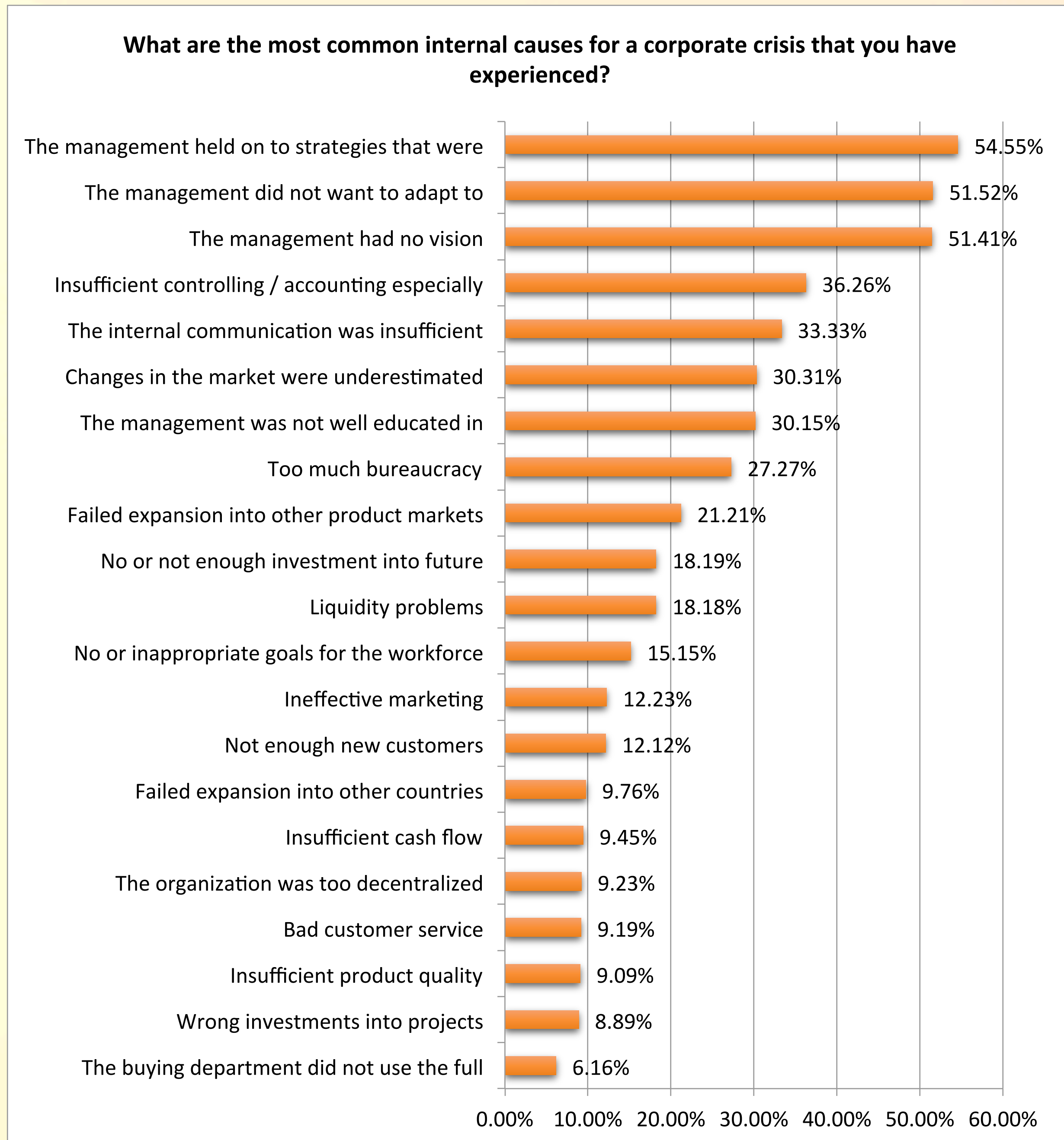
Management, Vision, and Strategy

The TMS survey reveals that most crises are caused by the mistakes of top management. The most prominent causes of a crisis are that the management continued with a strategy that was no longer working for the company (54.6%), and that they lost touch with the market and their customers and did want to adapt to changes occurring around them (51.6%). Having a clear strategy that is communicated well to all operational areas, one that uses and builds USPs, is desirable for every company but is often not the case. Incorrect strategic decisions (39.4%) are often made because of the lack of a clear strategy, and they can have a significant impact on a company's financial position in the market.

Quite often the management underestimates changes in the market (30.3%) and does not adapt to them appropriately.

We can see that crises may be caused by a combination of factors. If the management holds on to its ideas for too long and is not flexible enough to adopt to changes, competitors might be quicker to adapt to the demands of the customer or to changes in the market. Other threats might be new entrants with lower production costs that where underestimated for to long, and so on.

Another significant cause is a management that has lost its vision (51.4%). In a fast-changing environment the entrepreneurial vision to drive a company becomes more and more important in order to maintain a competitive edge and to beat the competition in the race for customers. A management without a vision has a tendency to cling to the status quo; they don't invest in ideas and have no clear strategic direction. Very few companies have the luxury of being able to keep their market share and profitability over the long term by not growing or investing in a vision. The only companies that this applies to are usually operating in niche markets with very high barriers to entry, or are monopolists with a high level of bureaucracy.



Internal Communication

In almost a third of all situations, insufficient internal communication played a big part in fostering the crisis. Often the management does not communicate much once a crisis becomes obvious, or the communication is not clear enough. According to the survey a common mistake seems to be that the management plays down the severity of the crisis, or even communicates that everything is okay, while working on job cuts and salary reductions in the background. Insufficient communication in a crisis situation is the best way to lose your most talented employees. They have often invested countless hours of their personal time to satisfy the top management. If they feel abandoned at a difficult time and don't get clear information about what is going on they may take it personally and leave; some may even cause further damage by turning their energy and efforts against the company.

Some employees report situations in which, for example, the management communicate that they have to cut jobs by 30 percent and they will give details about who is to be affected in two months. An experienced restructuring consultant would be very alarmed by this because such a statement can paralyze the whole corporation. During these two months most people will resign or do only what they have to do as they believe they might end up being fired anyway. The intention was probably to threaten the employees into working harder, but that is not how people work and a turnaround consultant knows the psychological effects of threats in times of uncertainty.

There is often no transparency (18.2%) on what's in it for the employees and what it will cost them, and this needs to be communicated clearly. The top management might be surprised at what employees are willing to risk and do if they feel that they are being taken on the restructuring journey alongside the management. It is of vital importance to a successful restructuring and turnaround process that the management is honest about the situation, open to criticism and ideas, and communicates regularly.

Education

A third (30.3%) of all turnaround consultants found that the management of the company was not very well educated in business matters. This is not a problem if consultants are brought on board at the right time and if the management is open to their advice. However, if no consultant with specialized knowledge of crisis situations is available to compensate for the lack of specific experience and knowledge needed to master the situation this can become an issue. It is alarming that this third are only a sample of the total number of corporate managers who get into corporate crises as they represent a third of the senior managers who hired restructuring consultants and were open to advice. A lot of senior managers who are running companies are still not open to restructuring consultants, therefore the real number who are not educated well enough in leading a company and in finance and strategy is most likely to be a lot higher, but these companies almost certainly tend to die quietly.

Products

Products are often a reason for the crisis. Expansion of an existing product line is not always a success and can lead to a corporate crisis (21.2%). In other cases, investment into future products and technologies was, over the years, not enough (18.2%), leading to missed technological advances to reduce production costs, a lack of features, or new technologies that competitors can provide; this can mean that the company doesn't attract enough new customers (12.1%). In some cases, the product itself is of insufficient quality (9.1%) or there is a high level of product returns (2.1%). Paired with poor customer service (9.2%) this is a dangerous mix.

Financial Difficulties

Quite high up on the list of causes of crises in the questionnaire were liquidity and cash flow problems (9.45% and 18.18% respectively, 27.63% in total), which are often caused by insufficient controlling and accounting processes (21.2%) and no or inappropriate financial planning (15.2%).

Insufficient controlling and accounting processes, especially with regard to financial / liquidity planning (36.4%), are still a very great cause of corporate failure, or at least of a significant crisis. Young companies often find that when they grow quickly and cash keeps rolling in they don't keep track of every dollar spent; more money comes in then goes out without control. Mature companies often have trouble implementing rigorous financial controls because it means changing old and long-standing processes, curtailing some freedom, and investing in expensive experts and changes. However, finance is the blood of every corporation; it is the cardio system that keeps the company flexible and alive. Often people have a tendency to spend money more easily if it is not their own; these expenses need to be controlled otherwise a corporation will end up without enough blood to function properly.

It is surprising that only 18.1 percent of companies had liquidity problems. That means that in the cases where restructuring consultants were on board the decline was not so strong that financial resources were completely used up yet. The research shows that companies that are open to restructuring advice seek it at an early stage during the corporate decline; this also means that they recognize they are in a difficult situation early enough and get specialized advice at the right time. These are very promising numbers bearing in mind that TMS-certified turnaround consultants have a success rate, on average, of 91 percent. This means that companies that hire a turnaround consultant early enough have an extremely high chance of surviving their crisis situation.

Human Resources

No goals or wrong goals for the workforce (15.1%) often contribute to poor performance by employees and accelerate a crisis situation. Setting no goals is as ineffective as too many goals. An employee can only spend so much time on something they are supposed to focus on. If too many goals are set some of them will suffer, or the quality of the work will decrease. I have seen goals systems that are divided into four or even five areas, with up to four sub-goals for each category. Such a system leads to employees either giving up before even trying to reach the goals or trying to manipulate the system. Both too few and too many goals are inadequate systems for aligning employees' efforts, especially in a turnaround situation. In crisis situations each employee should have one, or at most two, goals that are achievable and short term. Usually goals are evaluated annually. In a crisis situation this should increase to every six months or, better still, every three months. At that point the next goal should be set.

Other attributes

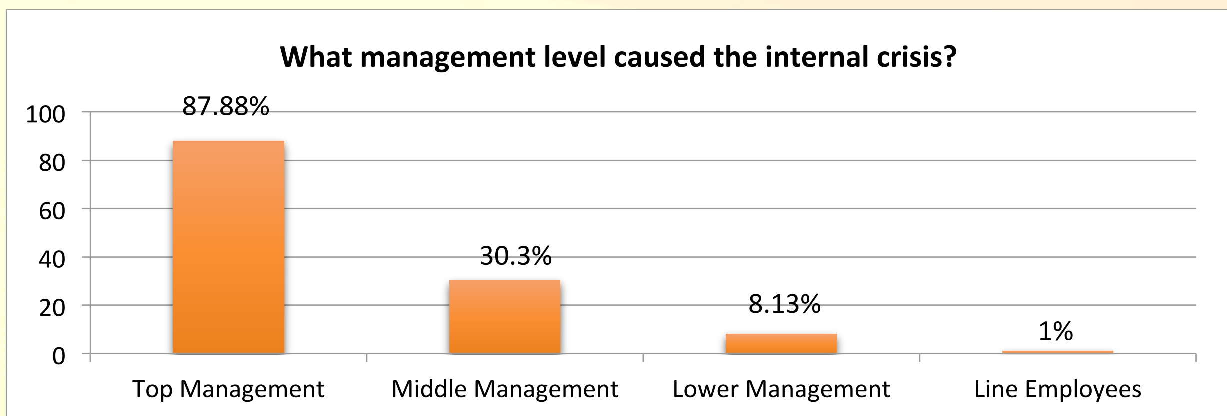
Other attributes of failing companies are:

- The management is not well educated in business matters (30.3%)
- High level of bureaucracy (27.3%)
- Failed expansion into other product markets (21.2%)
- No transparency (18.2%)
- Liquidity problems (18.1%)
- Not enough investment in future products or technologies (18.0%)
- Ineffective marketing (12.1%)
- Not enough new customers (12.1%)

- Decentralized organization (9.2%)
- Wrong investments (9.1%)
- Poor customer service (9.0%)
- Insufficient product quality (9.0%)
- Failed expansion into other countries (9.0%)
- The buying department did not reach its full potential (6.1%)

Business Areas Causing Corporate Crisis

Almost 88 percent of respondents held top management responsible for a crisis situation, and 30.3% blamed middle management. The most commonly cited reason was corporate strategy (45.5%) followed by internal communications (30.2%), marketing (24.3%), sales (24.2%), and customer service (15.2%).



It is surprising to see that the internal communications department contributed significantly to the crisis in over 30 percent of all corporate restructurings. Since statistically a quarter of all companies hit a serious corporate crisis every ten years, making sure that the internal communication department is trained in crisis communication can play a key role in a company's survival. Weak communication contributes to a lack of alignment between strategy and operations; this alignment is even more crucial when changing a strategy that is the most likely cause of the turnaround situation.

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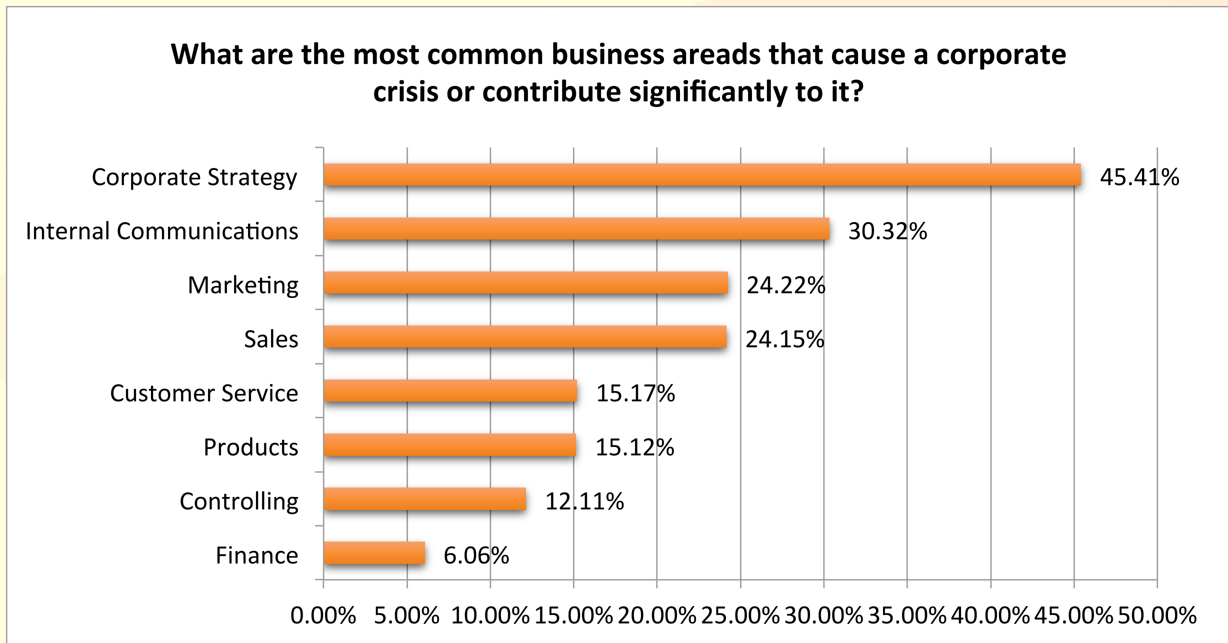
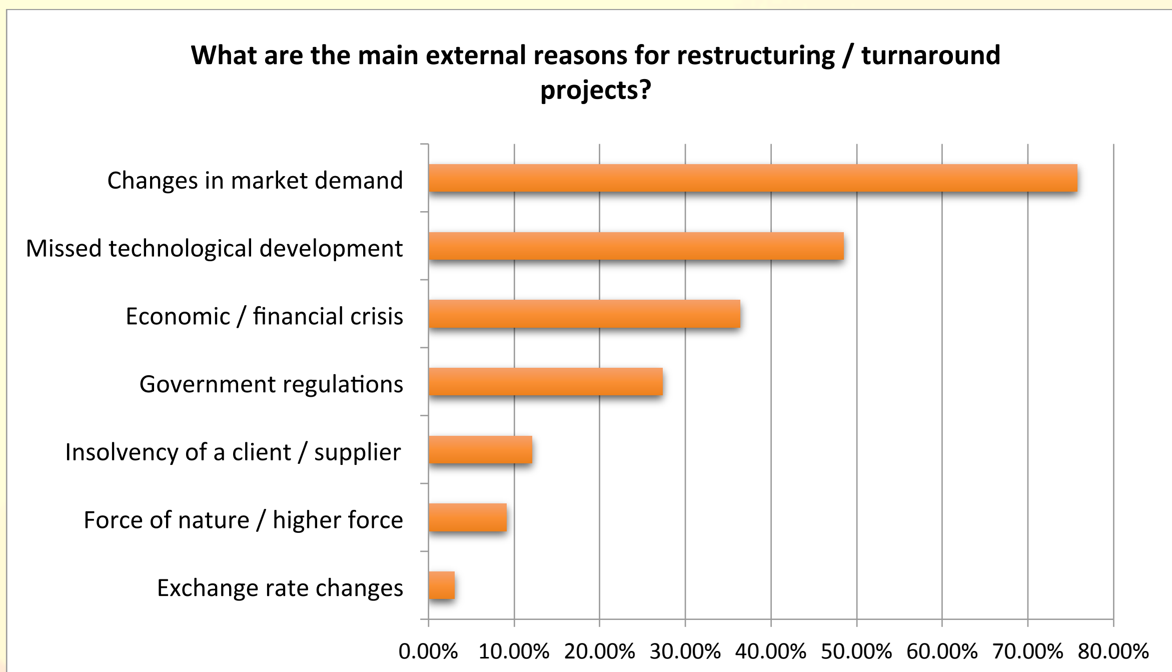


External Crisis Factors

External crisis factors create pressure to act strategically to react to a sudden event that was not foreseen by the management.

Often external events make internal crisis factors more obvious; hence they are not the only reason a company gets into a crisis.



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Historical Comparison

Some findings in this research are completely new; however, other factors that led to corporate crises came up in past research as well. We have therefore compared our 2014 survey results with research done almost 40 years ago. Interestingly, leadership was the main business area causing corporate crises in both. Therefore educating managers in how to deal with a crisis is the best way to reduce the number of insolvencies. Turnaround managers know how to deal with these difficulties, and it is not impossible for the top management team to learn the signs of a crisis and how to respond properly. The TMS, as a not-for-profit organization, has implemented numerous projects to target this problem. The TMS certification program, “Certified International Turnaround Manager”, is divided into four levels from Level A, the foundation level in turnaround management, to Level D, which is for very experienced turnaround managers with more than 15 years’ work experience in corporate restructuring and turnaround management. A certificate is only valid for two years, and in those two years the participant needs to prove that they have stayed up to date with the industry. Only then are they issued with a certificate valid for another two years. The TMS also advises universities on how to set up turnaround management courses and integrate relevant theory into their existing classes in order to educate the leaders of tomorrow as early as possible.

Business areas that cause a corporate crisis (ranked)	**Lymbersky (2014)**	**Reske et al. (1978)**
Leadership	1	1
Internal communications	2	-
Marketing	3	-
Sales	4	3
Customer service	5	-
Own products	6	-
Controlling	7	8
Finance	8	2
Buying	9	11

A second area that has stayed in almost the same position in the rankings is the sales department; being in third or fourth place is still fairly high. One possible reason could be that it is often blamed for low sales; however, this could be the result of factors other than the sales force itself. Another area that stands out is the finance department, which dropped from second place in 1978 to eighth in our current survey. The many possible reasons for this are open to speculation, one being that finance today is highly computerized and financial software gives us a permanent, live overview of the state of the company, forcing financial managers to uphold certain regulatory and reporting standards that could have been ignored more easily 40 years ago.

Internal causes for corporate decline	**Lymbersky (2014)**	**Schendel et al. (1976)**	**Slater (1984)**	**Grinyer et al. (1990)**
Poor management	52%*	-	73%	45%
Inadequate financial control	36%	-	75%	45%
High cost structure	-	67%	35%	65%
Poor marketing	12%	4%	22%	30%

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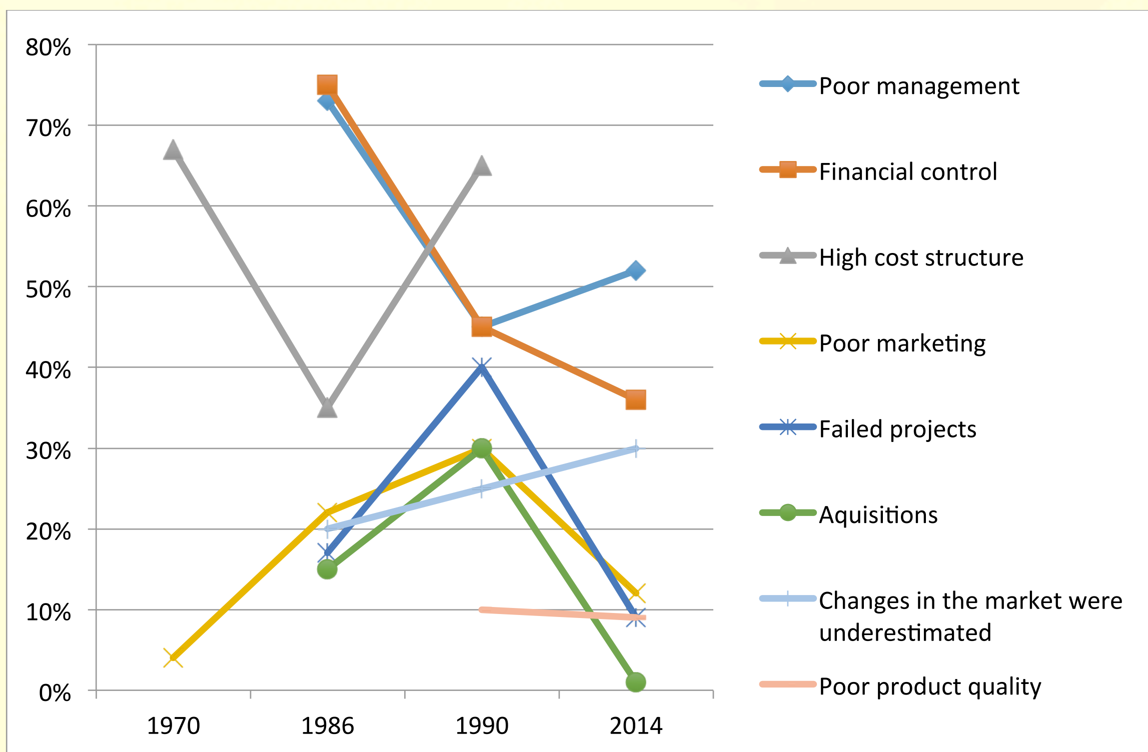
Failed projects	9%	-	17%	40%
Acquisitions	<1%	-	15%	30%
Changes in the market were underestimated	30%	-	20%	-
Poor product quality	9%	-	-	10%

*average of top three factors regarding management in this study

The comparison of internal causes over a timeline of 38 years also shows that the lack of financial control is becoming less and less relevant as a crisis factor. In 1984 inadequate financial control still contributed to 75 percent of all corporate crises. Today, in our 2014 survey, only 36 percent reported this to be a cause of decline. We can see a reduction in the contribution of poor management, poor marketing, failing projects, and failing acquisitions to corporate crises.

The following graphic shows a comparison of crisis factors over a timespan of 38 years. The comparison can only be done to a very limited extent as the research varies in sample size, quality, time, and respondents. The graphic simply aims to illustrate general tendencies.



The only factor that grew over the last 20 years is management underestimation of changes in the market. This could be because markets are changing more rapidly, product lifecycles are getting shorter, and new technologies evolve quickly and with more impact on existing processes within the company and structures in the market.

In the coming decades corporations will need to develop new products and services faster and in shorter cycles. The time between major innovations decreases every year, lifecycles are shortening, and the possibility of creating new companies and conquering markets is becoming easier and less

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expensive. Today, a small three-person startup such as Whatsapp can cost big telecommunications companies around the world millions within a few months. Not even global corporations are safe from companies born in someone's garage. The management therefore needs to be more aware of changes in the market and more open to change within the corporation in order to adapt and remain competitive in the future.

Former entry barriers to markets don't exist anymore. Anyone with a great idea can take on Google, eBay, AT&T, or Deutsche Telekom, so a constant eye to competitiveness is essential. The basis for competitiveness is creativity; if Apple wants to remain the most valuable company in the world, tomorrow's most innovative and popular phone will need to come from Apple. Tomorrow's competition may be sitting behind a dusty workbench in his grandma's garage, so everyone is a potential competitor. The only way to keep up is to provide employees with the best possible environment in which to be both productive and creative.

Companies need this dual focus on productivity and creativity in order to survive in the long term. Their level of productivity, creativity, and innovation must be continuously higher than the competition's level of productivity, creativity, and innovation. If a company fails to innovate, its products become old and reach the end of their lifecycles. Only continuous innovation can ensure that the company will stay ahead of its competition. For more information please see the article "The TMS innovation matrix" by Dr. Christoph Lymbersky.

About the Author

Dr. Christoph Lymbersky is Executive Director of the Turnaround Management Society.

Dr. Lymbersky is author of the "International Turnaround Management Standard", "Corporate Turnaround: Best Practice", editor of the "Turnaround Management Journal" and speaker at various conferences around the world.

About the Turnaround Management Society

The Turnaround Management Society is an industry-specific organization that aims to promote best practice in turnaround management. Its members are turnaround professionals, distressed debt investors, and academics.

It is the objective of the Turnaround Management Society to bring together the knowledge of turnaround management academics and the experience of turnaround management professionals. The TMS provides a link between academics who are engaged in research and the professional community that seeks research outcomes and, in turn, provides academics with professional insight, guidance, and feedback.

As well as supporting academics around the world and providing them with a forum to exchange information with other academics and practitioners, we are also engaged in our own research. Our two ongoing projects are the International Turnaround Management Standard and a database of successful turnaround management strategies and cases.

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Selected Participants

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