

# Organizational crisis: The logic of failure

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## Executive Overview

*Organizational crisis, which includes both bankruptcy and a dramatic fall in market value, has increasingly affected blue chip companies in recent years. Yet existing theory views failure as typical of declining companies at the end of their lifecycle. This article explains why once prosperous companies collapse at the height of their success. In an in-depth analysis of the 100 largest organizational crises of the last five years, a mutual logic behind these crises has been identified. In general the problems lay in the four areas of growth, change, leadership and organizational culture. In most cases the companies grew and changed too quickly, had too powerful managers and nurtured an excessive success culture. Conversely, if these factors were insufficiently developed, companies aged prematurely, which likewise led to failure. In order to sustain success, companies need to keep a balance between these extremes. In this article we present company examples and research-based findings that illustrate behaviors to avoid and practices for managers to follow within their own organizations.*

Reports of crises in once highly regarded companies dominated the business news during the first three years of the new millennium. WorldCom, Enron, Conoco, Global Crossing, United Airlines, Kmart . . . each month brought the sound of another titan crashing to earth. The six bankruptcies mentioned above alone caused over 125,000 layoffs and destroyed assets valued at US\$ 300 billion.

The use of "failure" when referring to a company doesn't necessarily mean bankruptcy. A dramatic fall from grace qualifies too. Former stock market stars such as ABB, AT&T, DaimlerChrysler, France Telecom, TimeWarner, and VivendiUniversal share the pillory of shame as value destroyers. These six companies lost more than half their value, or US\$510 billion, between 1998 and 2003. What took decades to create was lost within months.

Despite numerous practical examples of the failure of successful organizations, the phenomenon has to date raised less interest in the management literature than the ubiquitous search for their success factors.<sup>1</sup> In general, failure is regarded as part of a natural process. Companies experience various life cycles at the end of which awaits the death of the old and weak organization.<sup>2</sup> Failure is understood as the culmination of decades of decline and deteriorating financial performance.<sup>3</sup>

Unfortunately this view fails to explain the spectacular collapse of organizations over the past years. Until their collapse, companies such as ABB, Enron, Swissair, or WorldCom belonged to the most successful of their kind. Supposedly weaker organizations of the same kind are currently faring far better than the previously acclaimed companies. The failure did not come at the end of the "natural life cycle," but rather at the zenith. Companies that were healthy just months ago, it seems, are suddenly on the brink of death. And not just any companies: large, important blue chip companies that aren't expected to collapse.

## The Role of Market and Industry Effects

Managers have been quick to blame their failure on external conditions such as declining stock markets or intensifying competition. It is certainly true that the general market decline over the past years contributed to the failure of so many once respected companies. The large number of failures in the airline business and in the telecom industry shows that industry-specific effects such as increasing fuel prices or technological changes play an important role in explaining corporate failure. However, industry effects alone cannot explain

why some companies within these industries failed, while others continued to be successful. For example, the telecom giants AT&T and Worldcom figure prominently on our list of failed companies, while competitors such as SBC Communications and Swisscom remained highly profitable. In order to explain such differences, we focused our analysis on firm-specific reasons for failure – factors that firm managers can actively influence.

### Why Do Successful Companies Suddenly Crash?

Why precisely do organizations that for years were among the most successful and coveted get into difficulties so often? Is there a common logic explaining these failures? We researched these questions and analyzed the 100 largest organizational crises of the last five years.

The list is first comprised of the 50 largest firm bankruptcies according to pre-bankruptcy assets in Europe and the USA between 1998 and 2002.<sup>4</sup> Then the 50 largest “crashes” were considered. Companies were classified as “crashes” if they met three selection criteria: First, we selected all companies from the most relevant stock indices<sup>5</sup> that had, between November 1998 and October 2003, forfeited at least 40 percent of their company value. We chose this particular period to circumvent the peak of the boom (1999 and 2000), as well as the market low (2001 and 2002) that could have biased our results. Second, from these companies, we selected those that had either showed billion-dollar losses in 2001 or 2002, or had accumulated debts that seriously threatened their survival. This additional selection criterion was necessary, since a simple drop in market value is not a sufficient indicator of a crisis. Finally, we reduced the list to the 50 largest in terms of total value destroyed during the time under consideration.

The resulting 100 firms have, within five years, destroyed a total worth of US\$ 2,500 billion. This sum is equivalent to the gross national product of Australia during the same period. A first analysis of this list revealed that more than half of the researched organizations were decidedly successful up to the time of their failure. Companies were classified “successful” if they were considered market leaders in their particular industry and had shown a net profit for at least five consecutive years up to the time of their failure. In total, 43 companies failed to classify as “successful” and were excluded from further analysis. Next we focused on the remaining 57 previously successful organizations.

Because of our objective to establish a more complete theoretical explanation of the failure of suc-

cessful firms, we chose a multiple-case study method of analysis.<sup>6</sup> This case-study method allows for in-depth analysis along with the use of a relatively large sample to enhance the generalizability of the findings. We used the ABI/Inform, Factiva, and Thomson One Banker databases, as well as annual reports, SEC filings, and other sources to identify all published materials on the 57 companies for the relevant period.<sup>7</sup> In some cases we completed the acquired information through personal interviews with senior managers at the respective firms. Three raters (members of the research team) then independently evaluated the data of all the cases.<sup>8</sup> A list of characteristics of failing firms was identified during the first analysis. Based on the presence of these characteristics, each case was then evaluated. Agreement among all three raters was required to classify each case.

The result of the study is astonishing: however different the individual cases are, most examples have the same failure logic in common. In all cases the crash was home-made and not at all inevitable. We distinguished two different variations of this logic into which most companies fall in a crisis. We shall first introduce what we called the Burnout Syndrome to which 40 (or 70 percent) of the examined companies owe their failure. Thereafter we examine a second syndrome, called the Premature Aging Syndrome, which explains the failure of a further 12 (or 20 percent) of the examined companies. Finally, we provide recommendations on how managers can recognize and effectively prevent a latent crisis.

### The Burnout Syndrome

Over the last few years it has scarcely been possible to read a book on management without encountering four key factors of success: a high growth rate; the ability to change continuously; a highly visionary company leadership; and a success-oriented company culture. The great majority of the failed organizations that we examined possessed these success factors in abundance — and exactly here lay their problem. It seems that there is a boundary outside of which these success factors have a counterproductive effect. Companies that classify as “burnouts” owe their failure to at least three of the following four characteristics: excessive growth; uncontrolled change; autocratic leadership; and an excessive success culture.<sup>9</sup> Table 1 provides a list of all 40 companies that qualified for the Burnout Syndrome.<sup>10</sup> Table 2 provides an overview of the different indicators that were used to classify the 40 companies according to the four characteristics of a burnout.

**Table 1**  
**Companies with the Burn-out Syndrome**

	Type of Crisis		Selection Criteria			Traits of Burn-out			Sales Growth		
	Bankr.	Crash	Losses	Debt	Success	Growth	Change	Leader	Culture	CAGR	SGR
ABB Asea Brown Boveri		x	x	x	x		x	x	x	1.7%	12.0%
Abbey National		x	x	x	x	x	x	x	x	15.9%	9.9%
AES Corporation		x	x	x	x	x	x	x	x	60.3%	12.5%
Allianz		x	x	x	x	x	x	x		15.6%	10.1%
Alstom		x	x	x	x	x	x	x	x	27.5%	0.3%
AT&T		x	x	x	x	x	x	x		6.5%	8.2%
British Telecom		x	x	x	x	x	x	x		6.7%	6.6%
Cable & Wireless		x	x	x	x	x	x	x		11.5%	8.8%
Clariant		x	x	x	x	x	x		x	45.9%	11.7%
CMS Energy		x	x	x	x	x	x	x		20.0%	4.0%
Comdisco	x		x	x	x	x	x	x		16.7%	10.5%
Conseco	x		x	x	x	x	x	x	x	30.7%	7.4%
DaimlerChrysler		x	x	x	x	x	x	x	x	23.8%	6.0%
Deutsche Telekom		x	x	x	x	x	x	x		6.2%	2.7%
Duke Energy		x		x	x	x	x	x	x	78.9%	3.7%
El Paso Corporation		x	x	x	x	x	x	x	x	78.7%	1.4%
Enron	x		x	x	x	x	x	x	x	65.9%	4.6%
Finova Group	x		x	x	x	x	x	x	x	21.6%	9.7%
France Telecom		x	x	x	x	x	x	x		9.9%	7.6%
Genesis Health Ventures	x		x	x	x	x	x	x		38.0%	6.2%
Hayes Lemmerz	x		x	x	x	x	x	x		39.2%	10.8%
Heilig-Meyers Co.	x		x	x	x	x	x	x	x	24.8%	8.0%
Integr. Health Services	x		x	x	x	x	x	x		44.5%	4.1%
Interpublic Group		x	x	x	x	x	x	x	x	22.0%	15.0%
JC Penney		x	x	x	x	x	x	x		11.0%	0.5%
Koninklijke Ahold		x	x	x	x	x	x	x	x	24.0%	28.6%
Koninklijke KPN		x	x	x	x	x	x	x		14.1%	1.6%
Laidlaw	x		x	x	x	x	x	x		16.4%	5.8%
Loewen Group	x		x	x	x	x	x	x		40.5%	0.4%
Marconi		x	x	x	x		x	x	x	4.5%	9.5%
Solectron Corporation		x	x		x	x	x	x	x	49.7%	15.0%
Suez		x	x	x	x	x	x	x		25.5%	5.7%
Swiss Air	x		x	x	x	x	x	x	x	16.4%	0.8%
Time Warner		x	x	x	x	x	x	x	x	46.2%	7.7%
Tyco		x	x	x	x	x	x	x	x	54.4%	6.6%
VivendiUniversal		x	x	x	x	x	x	x	x	13.3%	7.1%
Warnaco Group	x		x	x	x	x		x	x	23.3%	3.5%
Williams Corporation		x	x	x	x	x	x	x		31.0%	2.4%
Worldcom	x		x	x	x	x	x	x	x	71.8%	2.3%
Zurich Financial Serv.		x	x		x	x	x	x		25.1%	10.1%

### **Excessive Growth**

Almost each examined failure followed a phase of tremendous company growth. The 40 companies classified as burnouts showed an average compounded annual growth rate (CAGR) of nearly 30 percent over the five years prior to their failure.<sup>11</sup> In other words, these firms tripled their size in just five years. For example, the revenues of the energy broker Enron grew at an unbelievable 2000 percent between 1997 and 2001.<sup>12</sup> High growth has been related to a number of constraints and long-term problems in the extant literature.

First of all there are managerial constraints on firm growth.<sup>13</sup> Fast-growing firms are likely to incur managerial problems and reduced effectiveness in their core operations.<sup>14</sup> The problems arise from the lack of suitable management to coordinate the increasing complexity of an organization during its expansion. While a few firms do surmount the problems that high growth engenders, many fail.<sup>15</sup>

Second, there are market constraints on firm growth.<sup>16</sup> Companies quickly reach the limits of organic growth. In order to maintain their high

**Table 2**  
**Characteristics of the Burnout Syndrome**

Characteristics	Indicators
Excessive Growth	<ul style="list-style-type: none"> <li>• Sales growth significantly above the Sustainable Growth Rate (SGR)</li> <li>• Expansion fueled through large number of acquisitions</li> <li>• High financial leverage due to intensive investment in growth areas</li> </ul>
Uncontrolled Change	<ul style="list-style-type: none"> <li>• Endless reorganizations and loss of control due to overly aggressive diversification</li> <li>• Deterioration of core business due to management focus on problems in new areas</li> <li>• Loss of identity and orientation due to radical change of corporate business model</li> </ul>
Autocratic Leadership	<ul style="list-style-type: none"> <li>• Autocratic position of CEO due to missing opposition and weak board control</li> <li>• CEO hubris with over-ambitious and perilous visions and goals</li> <li>• Top-down culture marked by blind faith in leaders and lack of skeptical questioning</li> </ul>
Excessive Success Culture	<ul style="list-style-type: none"> <li>• Culture of strong competition between employees (i.e. up-or-out; bonus programs)</li> <li>• High degree of employee stress due to heavy workload and aggressive climate</li> <li>• Poor communication due to mistrust and lack of confidence between employees</li> </ul>

growth rates, most companies in our study turned increasingly towards acquisitions. At ABB there were 60 takeovers in two years, at WorldCom 75 in three years, at Interpublic Group 200 in four years, and almost 300 in five years at the French energy provider Suez. The conglomerate Tyco swallowed more than 200 companies per year at the height of its hyperactivity. However, there is a long history of literature that recognizes the risks associated with acquisitions.<sup>17</sup> Empirical studies have shown that the majority of all acquisitions fail and that in general acquiring firms experience negative returns.<sup>18</sup>

Finally, there are financial constraints on firm growth. The finance literature provides the "Sustainable Growth Rate" (SGR) concept that, based on a firm's financial position, calculates how much sales growth it can afford.<sup>19</sup> The average annual SGR for the 40 companies in our sample indicates that these companies could have grown at a maximum of 7.5 percent without affecting their finan-

cial position. However, in reality these firms grew at almost 30 percent per annum, four times higher than their financial condition would have allowed for.<sup>20</sup> In the finance literature such "excessive" growth, defined as growth above the SGR, is regarded as the main reason for insolvencies.<sup>21</sup> In order to finance growth above the SGR, the analyzed companies borrowed large amounts of outside capital. Studies have shown that such highly leveraged firms are substantially more sensitive to an economic downturn than their competitors.<sup>22</sup> In a recession the company loses earnings that are urgently needed for debt repayment. Even companies that can avert threatening insolvency face a mountain of debt that will tax their development for years. The three telecommunications companies British Telecom, Deutsche Telecom, and France Telecom, for example, faced a total debt burden of more than US\$150 billion.<sup>23</sup>

### *Uncontrolled Change*

Sooner or later high growth leads to the saturation of the original target markets. To ensure further growth, many of the examined companies diversified aggressively into new markets. The literature shows that an increasingly disparate portfolio of businesses leads to coordination problems and control losses.<sup>24</sup> Especially the integration of a wide variety of acquired companies caused an increase in complexity and unrest in the analyzed companies.<sup>25</sup> The absorption of managerial time and resources in the new business fields led to the erosion of the core business.<sup>26</sup> Some companies went even further and sold their core business to focus on the newly acquired fields. These companies suffered from a complete loss of organizational identity.<sup>27</sup>

A typical example is the technology group of companies ABB. After 60 acquisitions in various industries and a true restructuring frenzy, a dissipated, homeless group was all that remained. With the sale of the rail technology and the power station construction, the heart and soul of the organization was sold. The constant direction change and radical reconstruction led to a complete loss of company identity. Companies such as VivendiUniversal, Enron, and Marconi had similar experiences. The radical reconstruction from a conservative provider (Vivendi) or defense contractor (Marconi) — often across various intermediate identities — to Telecom or media companies is regarded as the chief cause of the failure.

Prior research has shown that organizational changes lead to an immediate increased risk of organizational failure due to the disruption and

destruction of existing practices and routines.<sup>28</sup> A certain organizational identity is required; companies cannot endure without developing a solid core that provides some guidance during changing times.<sup>29</sup> Fundamental changes, such as radical transformation, adoption of a brand new business model, entering a different industry or merging with another firm, always lead to a certain destruction of identity.<sup>30</sup> A loss of identity occurs if a new identity that the organization's members neither understand nor accept replaces the existing identity.<sup>31</sup> In Enron's case, in the end "no one could any longer explain what the basis of our business was," according to a top manager.<sup>32</sup> At Marconi an employee stated: "With all those acquisitions we have completely forgotten who we actually are."<sup>33</sup>

### **Autocratic Leadership**

Any organization that relies on the ability of a single person at the top is living dangerously. A top executive who has too much power has been found to be a major source of organizational decline.<sup>34</sup> Consistent with agency theory arguments, enhanced power may provide CEOs with sufficient discretion to pursue objectives that are inconsistent with company objectives.<sup>35</sup> Empirical research shows that firms where powerful boards effectively controlled managers' actions are associated with superior performance.<sup>36</sup>

A powerful CEO holding multiple titles (chairman, CEO, president), receiving particularly high compensation, and often controlling large shareholdings dominated the examined companies.<sup>37</sup> Troublesome managers or opponents in the leadership team were rapidly removed. Ineffective boards with directors mainly chosen through the influence of the CEO failed to provide the necessary checks and balances. The accounting irregularities that surfaced in a large number of burnout companies during a crisis illustrate the apparent lack of control.

Almost without exception blessed with a charismatic and self-confident personality, the leaders used their autocratic position to pursue aggressive and visionary goals. The press, shareholders, and analysts praised initial successes with increasing rapture. These leaders were the "superhero" Bernie Ebbers at WorldCom, the "genius" Jean-Marie Messier at Vivendi and the "godfather" Percy Barnevik at ABB. Surrounded by followers, they indulged in increasingly excessive conduct.<sup>38</sup> Tyco's CEO Kozlowski was called the "Roman emperor," Ahold's CEO Cees van der Hoeven, "the Dutch Napoleon." Prior research has identified success, media praise, self-importance, and weak

board vigilance as key sources of CEO hubris.<sup>39</sup> In this research, CEO hubris has been related to large acquisition premiums and weak performance. CEO hubris, manifested as exaggerated pride or self-confidence, played a substantial role in the failure of the examined burnout companies.

### **Excessive Success Culture**

The downside of a highly competitive company culture became apparent during the crises at the examined companies. Competitive reward systems had been designed to motivate employees with high salaries, bonus payments, and opportunities for swift promotion. To this day legends are woven about those who were privileged at Enron. The success culture was perfected by a rigid selection (up or out), long working hours, and a belief in strong rivalry. Employees at companies such as Enron, Finova Group, Tyco, TimeWarner or Worldcom characterized their company's culture as "shark-like," "egoistic," or "gun-slinging."

Studies have shown that increased rivalry and competition between employees can be detrimental to trust.<sup>40</sup> A lack of employee trust has a negative effect on openness in communication, in particular regarding information sent to the superior.<sup>41</sup> Two-thirds of Abbey National's staff, for example, indicated in a recent survey that their managers aren't open and trustworthy. This illustrates why no one questioned the excessive leadership behavior, or reacted to the first signs of a crisis in the examined companies. Recent revelations of accounting irregularities in various burnout companies show that despite a large number of accessories, no one challenged these practices.

A lack of trust also affects job satisfaction and the organizational climate.<sup>42</sup> An unhealthy work climate and other job stressors, such as an excessive work load, have been mentioned as key contributors to job stress, which ultimately leads to degraded job performance.<sup>43</sup> Flagging employee morale and high management turnover, which deprived the examined companies of key talent, are among the immediate consequences.

### **A Common Pattern**

In summary, the four described factors can be classified as symptoms of the same illness that we have called the Burnout Syndrome. In the long run the system is so burdened by an excessively ambitious CEO, and by excessive growth and inexorable change, that it simply burns out. In an extreme case the system, weakened by high debts, growing complexity, and constant uncertainty,

simply implodes.

There are so many examples of the Burnout Syndrome in the aftermath of the boom period of the late 90s that one could almost speak of an epidemic. In a period of market decline, highly leveraged firms suffer most from plunging margins that make debt repayment increasingly difficult. Does this mean that the Burnout Syndrome is a unique phenomenon at the end of a historical upswing period? Unfortunately one glance at history teaches us otherwise. In each decade there have been numerous examples of the Burnout Syndrome, among which are the U.S. steel producer LTV (1970), the German electrical company AEG (1974), the U.S. computer pioneer Atari (1984), and the German Metallgesellschaft (1993).<sup>44</sup> However, our supplementary long-term studies provide some indication that the number of burnouts rapidly rises in the aftermath of a stock market crash. Exemplary in this regard is the collapse of a high-flying utility empire, Middle West Utilities, as a result of the crash in 1929 that economic historians describe as identical to the fall of Enron.<sup>45</sup> While the root causes are internal, the danger of a burnout appears to increase significantly in times of market decline.

#### *DaimlerChrysler: Two Burnouts and an Open End*

The DaimlerChrysler case example is typical of the Burnout Syndrome described above. Retracing the company history over the past two decades reveals two burnout periods. In 1985 the automotive company Daimler-Benz had been praised as the most outstanding model organization in Germany. A decade later the company stood on the brink of financial disaster. Its record loss in 1995 was approximately US\$3.1 billion, and the organization's value had fallen more than US\$35 billion since 1985. This was the organization's first flirt with the Burnout Syndrome. What had happened?

From 1985 onwards, everything that was available on the market was simply acquired in an unprecedented expansion rush. Edzard Reuter, the new man at the top, restlessly pursued his vision of an "integrated technology organization." The "miraculous synergy effect" that so enthralled Reuter at the start, nevertheless remained a pipe dream.<sup>46</sup> The organization increasingly collapsed into the chaos of permanent reorganization. Employees told the press: "Previously we still knew what we are: a builder of automobiles. Now we no longer know."<sup>47</sup> Constant problems in the new sectors increasingly required capital and time — at the cost of the core business. At the end of his period in office, Reuter was called the "greatest capital de-

stroyer in German history."<sup>48</sup> Jürgen Schrempp succeeded Reuter as CEO. Within three years, as if stuck in the reverse gear, he successfully deconstructed his predecessor's "integrated technology organization."

In 1998 Daimler-Benz was again the old model organization with a record profit of US\$5.7 billion. It would, however, only be three years before the organization once again had to acknowledge a billion-dollar loss in 2001. The debt burden had tripled since 1998. More than 50 percent of the market value, or US\$65 billion, had been destroyed over the previous five years. In the same period, the value of its competitor BMW grew at approximately 60 percent. The explanation for the renewed crisis once again arose from the Burnout Syndrome.

Without any pressure from outside, the ambitious CEO Schrempp led the organization into the next round of expansion from 1998 onward. This time around the vision was of the "World Inc." with the expensive acquisitions of Chrysler, Mitsubishi, Hyundai and diverse U.S. commercial vehicle manufacturers. The initial opposition (e.g., by the previous Chrysler boss Thomas Stallkamp to a planned Nissan takeover) was soon silenced. From then on Schrempp ruled the organization with a team of loyal, devoted managers. However, the organization soon resembled a massive building site. The complex integration is only painstakingly progressing. Million-dollar losses in the new sectors require numerous reconstruction programs and reorganizations. Much capital, time and many of the best managers have been rotated in the new units. The first effects on Mercedes' core business have started appearing. Reduced investment budgets have led to quality and delayed production innovation problems. An employee questionnaire shows a rapidly declining morale, strongly reduced career possibilities and a fading identification with the company.

#### **The Premature Aging Syndrome**

Through a simple inversion of the present findings, one would suppose that an organization could avoid the Burnout Syndrome if it extensively abstained from growth, change, powerful organizational leadership, and success-oriented employees. Surprisingly, this is exactly what most of the remaining examined companies did. Nonetheless, they too encountered failure. This second group of companies unequivocally owes its failure to a lack of the mentioned success factors. Their lot is in direct contrast to the hyper-dynamics of the previously examined companies. Conversely, a slow-

down, or even the premature aging of the previously highly successful companies, can be identified in this group.

Companies qualified for the Premature Aging Syndrome if they showed at least three of the four characteristics described in Table 3. An overview of all the companies classified can be found in Table 4. We continue with a closer look at the four main reasons for that second group of companies' failure.

### **Stagnating Growth**

In the management literature, healthy growth is regarded as a basic prerequisite for organizational success.<sup>49</sup> Growing firms are increasing their size and market shares which are often associated with favorable economies of scale and scope.<sup>50</sup> In addition, high growth firms attract extraordinary management talent and financial resources.<sup>51</sup>

Most of the examined organizations, among them Kmart, Kodak, and Xerox, have, however, been reporting stagnating earnings for years. Tentative efforts to achieve new growth have failed. A relevant example is the telecommunications organization Sprint that, despite operating in a high growth market, has scarcely shown any increase in sales since 1996. Countless half-hearted excursions into the Internet and service growth markets failed, and a planned merger did not take place. Overall, the 12 companies that qualified for the premature aging syndrome grew at slightly over 4 percent annually over the five years prior to their failure. However, their average annual sustainable growth rate for the same period was at 13 percent.<sup>52</sup> In other words, without endangering their financial health, the analyzed companies could have grown three times as much as they did.

The stagnating growth led to losses in market share and had a negative impact on the companies' relative cost position.

### **Tentative Change**

An organization's ability to innovate and change is essential for its survival in a changing market environment.<sup>53</sup> The failure of the examined group of organizations can be traced to a rigid clinging to a formula for success that was becoming increasingly obsolete. Powerful forces within the organizations prevented each attempted change.<sup>54</sup> The lack of change and innovation led to increasingly outdated product offerings and cost structures significantly above the competitive level.

A good example is Eastman Kodak. To protect its core film business, the trend to digital photography was ignored. Films still constitute 80 percent of the revenues, although the market is losing importance. The competition therefore profited from the growth market in digital photography. At Xerox, the American giant in the copier business, something similar occurred. Although the crucial products of the digital age had been developed in their own research laboratories, they focused exclusively on the core copier business. The copier market is nevertheless decreasing constantly, and Xerox has lost market share to cheaper producers.

### **Weak Organizational Leadership**

Carrying out change requires strong leadership that can assert itself against resistance within the organization.<sup>55</sup> This leadership was lacking in the examined organizations. In many cases, a long-standing CEO who, sustained by previous success, kept increasingly rigidly to his habits, led the or-

**Table 3**  
**Characteristics of the Premature Aging Syndrome**

Characteristics	Indicators
Stagnating Growth	<ul style="list-style-type: none"> <li>● Sales growth constantly below the Sustainable Growth Rate (SGR)</li> <li>● Sales growth constantly below market growth, leading to market share losses</li> </ul>
Tentative Change	<ul style="list-style-type: none"> <li>● History of failed growth initiatives (such as acquisitions or new ventures)</li> <li>● Strong resistance to change / Clinging to proven success patterns</li> <li>● Outdated product offering due to missing innovations</li> </ul>
Weak Leadership	<ul style="list-style-type: none"> <li>● High costs compared to the competition due to lack of restructuring initiatives</li> <li>● Weak position of CEO relative to lower-level managers, unions and/or employees</li> <li>● Change-resistant leaders blocking any attempt at change</li> <li>● Heavy executive turnover hindering a consistent change process</li> </ul>
Lacking a Success Culture	<ul style="list-style-type: none"> <li>● Failure to downsize on time due to culture of guaranteed lifetime employment</li> <li>● Bureaucratic organization and old-fashioned mindset hinder innovation</li> <li>● Culture of underperformance (i.e., fixed pay; promotions according to tenure)</li> </ul>

**Table 4**  
**Companies with the Premature Aging Syndrome**

	Type of Crisis		Selection Criteria			Traits of Premature Aging				Sales Growth	
	Bankr.	Crash	Losses	Debt	Success	Growth	Change	Leader	Culture	CAGR	SGR
Eastman Kodak		x		x	x	x	x	x	x	-3.3%	7.5%
Fiat		x	x	x	x	x	x	x	x	5.8%	5.3%
Ford		x	x	x	x	x	x	x	x	3.7%	26.4%
Goodyear		x	x	x	x	x	x		x	-0.6%	8.3%
Kmart	x			x	x	x	x	x		0.9%	3.3%
Marks & Spencer		x		x	x	x	x		x	3.3%	11.1%
Motorola		x	x		x	x	x		x	3.4%	4.3%
Reuters		x	x		x	x	x		x	5.4%	33.7%
Sprint		x	x	x	x	x	x		x	5.9%	9.3%
Sun Microsystems		x	x		x	x	x		x	20.7%	21.2%
UAL / United Airlines	x		x	x	x	x	x		x	4.3%	20.7%
Xerox		x		x	x	x	x		x	2.0%	5.5%

ganizations.<sup>56</sup> At Motorola, the company CEO Christopher Galvin, who had been with the firm for 36 years and was the grandson of the founder, blocked necessary reforms for years. When the era of the great man finally comes to a close, there is usually no suitable successor, all rivals having long been removed. A weak leadership follows, which is often very swiftly replaced. In the Kmart case, five CEOs were appointed within seven years to follow the company CEO Joseph Antonioni, with each appointment being accompanied by changes throughout the management team as a whole.

### *Lacking a Success Culture*

The examined organizations have congenial organizational cultures that demonstrate loyalty and trust in common. Labor relations often survive many decades, or even a complete working life. Standard fixed payment and tenure-based promotion systems provide further employee security.

Recent empirical studies have shown that such consensual or bureaucratic cultures are linked to a low degree of innovativeness and poor performance.<sup>57</sup> Guaranteed jobs and fixed wages, for example, encourage employees to "free-ride" on the efforts of their co-workers, because doing so has little effect on their reward as long as others work hard.<sup>58</sup> Another drawback of this culture is that the required cuts in personnel are avoided for far too long.<sup>59</sup> Reuters, for example, still has more than 100 percent more employees at its disposal than competitors of a comparable size. If dismissal becomes essential, this often leads to the destruction of the trust-based culture. Employees have

stated that at Eastman Kodak "there is no longer the least bit of loyalty or motivation left" after the disappearance of 30,000 positions over the last six years.<sup>60</sup>

### *A Common Pattern*

In summary, one can diagnose an increased aging process, what we have called the Premature Aging Syndrome, in the second group of organizations.<sup>61</sup> Through errors of growth and change, the organizations are aging too soon. Changes are increasingly ignored until the organizations are completely distorted.

The term "premature" does not indicate that young firms are particularly prone to catching this syndrome. Quite the contrary, the companies that qualified for premature aging often look back on a long and successful history. Prior studies have shown that companies with a long history of success are particularly in danger of getting stuck in past success patterns.<sup>62</sup> While the term "aging" reflects the age of these companies, "premature" indicates the fact that they failed before their time. The failure occurred at a time when the respective target markets were still growing and competitors in the same markets were prospering – as opposed to the end of the industry life cycles.

Our supplementary long-term research indicates that examples of the premature aging of successful organizations are numerous and can be found throughout all times: General Motors, for example, slept through the trend to Sport Utility Vehicles (SUVs), Lucent Technologies through the glass fiber technology, and IBM through the PC age. Even historians, such as Arnold Toynbee, who research

the rise and fall of large civilizations, ascribe their failure to the same factors.<sup>63</sup>

While the general "aging" process is largely independent of the market trend, the final phase of the crisis has often been triggered by external developments such as technological or competitive changes. Eastman Kodak's problems, for example, surfaced when the market made a sharp turn towards digital photography. As we will see in the following section, the failure at the British retailer Marks & Spencer occurred when markets changed and competitors moved aggressively against the company. While the root causes of failure are internal and often latent for years, the crisis becomes apparent when fundamental external changes reveal the inability of these firms to cope with such changes.

### ***Marks & Spencer: Enduring Success Causes Lethargy***

The British retailer Marks & Spencer was acknowledged as one of the world's most successful and profitable retailers of the last 50 years. The market leader in England for more than 100 years, its shares consistently outperformed the market during the last 30 years. With a pretax profit of more than US\$ 2 billion, the year 1998 was the most successful one in the company's history. Scarcely three years later, Marks & Spencer had destroyed more company value than any other FTSE 100 organization within this period. In 2000 the once successful organization was suddenly in the middle of a survival struggle. The causes? A textbook example of the Premature Aging Syndrome.

Marks & Spencer, backed by a rigorous adherence to its motto of quality, value, and service, had for a long time succeeded in a profitable British retail market characterized by steadily rising prices and volumes. But from the mid-90s onwards fashion prices increasingly came under attack through the market entry of low-cost discounters. Marks & Spencer reacted with merciless cost cutting, driving the group to 1998 record profits, but also leading to falling product standards that led to the company's legendary reputation for quality and service being tarnished. Price-conscious shoppers switched to discounters, stylish customers to the rising specialist brand chain stores like Next, Gap, and TopShop. Shopping at dear old Marks & Spencer was no longer cool. Suddenly everyone joined the critical bandwagon and Marks & Spencer's market share dropped by 30 percent between 1997 and 2000. The intensifying competitive battle hit the company hard, but the seeds of decline had been sown years earlier by the company itself.

The root cause of the crisis was the rigid clinging to the old model of success, despite unmistakable changes in the competitive environment. Judi Bevan, author of the book *The Rise and Fall of Marks & Spencer* reasons that: "Sometimes in the second half of the 1990s, Marks & Spencer stopped moving."<sup>64</sup> Despite the growing competition, the company still declined to advertise or start price actions. Up to the time of the crisis there hadn't even been a marketing department. The trend to central high street stores was ignored. And despite changing customer needs and slumps in the core textile business, the old-fashioned off-the-peg garment departments weren't modified. Textile production remained largely in England, although the costs were substantially above those of rival producers. Until 1999 neither credit nor debit cards were accepted: in fact, in the more than 100-year history there had not been a single really revolutionary change.

Despite the stagnating earnings, no changes could be expected from a management that had been spoilt by success for far too long. Until 1998 there had not been a single director who had not started his career with the company. Chairman Sir Richard Greenbury ruled in a "colonial style" — orders had to be executed and under no circumstances questioned or even criticized. In 1999, after endless boardroom infighting and an attempted coup, another veteran inherited the chairman's position, but his efforts at restructuring only aggravated the crisis. The employees panicked and foiled each change, because Marks & Spencer had until then always cared for its employees in a lordly manner, with those who had been "adopted" by the company mostly spending their whole working life there. This myth of the paternalistic employer faded abruptly when Marks & Spencer began to dismiss tens of thousands of employees in 1999. A feeling of annihilation began to grow, and absence due to psychological illness increased by more than 25 percent.

### **Two Syndromes, One Logic of Failure**

The two described syndromes are two sides of the same coin. They are part of the logic of failure. We have seen that growth, change, a strong organizational leadership, and a culture of success are essential factors for organizations. Both syndromes have shown that either very low or very high values in respect of these essential factors could be negative for the company in the long run. The optimal value seems to lie between the extremes. Findings from management research confirm this belief.

### **Sustainable Growth**

In her management classic *The Theory of the Growth of the Firm*, Edith Penrose comes to the conclusion that growth is essential for organizations.<sup>65</sup> However, organizations that grow too rapidly push (as a result of scarce resources) against their administrative and cognitive boundaries and easily lose control.<sup>66</sup> A recent empirical study by Cyrus Ramezani and his colleagues at the California Polytechnic State University has confirmed this theory: continuous growth first has a positive effect on profitability and company value, but this effect turns unmistakably negative as soon as an optimum growth value has been exceeded.<sup>67</sup>

Firms should thus limit their growth to an optimum rate. To what extent growth can be sustained is firm specific. Three influencing factors are particularly important in determining the optimum rate of growth, notably financial, market, and managerial indicators.<sup>68</sup> The sustainable growth rate from the finance literature provides the first and foremost indication of how much growth should be envisioned. The rate of organic market growth in the targeted segments provides a second indication. Continued growth that is significantly above that of the market can only be achieved through acquisitions, diversification, or a mix of both. Studies reveal that both an increasing number of acquisitions<sup>69</sup> and a high degree of diversification are negatively related to performance.<sup>70</sup> Inorganic growth should thus be limited to a manageable level. How much growth a firm can manage is a third indicator of both inorganic and total growth. The internal ability to cope with growth depends on factors such as the organizational structure, the reward mechanisms, and the characteristics of the leadership team.<sup>71</sup>

### **Stable Change**

Insights from strategy research reveal that an organization's ability to innovate and change is indispensable in dynamic environments.<sup>72</sup> However, excessive change leads to the destruction of an organization's identity. People are only able to act when they have a specific degree of certainty. Organizational controls provide certainty, routines, and habits. If the change exceeds a certain dimension, organizations increasingly lose their ability to act.<sup>73</sup> Organizations therefore need a certain degree of both stability and change to survive.<sup>74</sup> While certain aspects of organizational identities need to change, others have to be maintained to provide the necessary security to accomplish change.<sup>75</sup> Companies thus need to balance stability and instability in their identities.<sup>76</sup>

### **Shared Power**

Studies from leadership research indicate that, although the optimal leadership style in organizations may be dependent on the situation, in the majority of situations mutual or shared power utilization leads to the greatest success. Only in a few selective crisis situations can an autocratic leadership style be an advantage.<sup>77</sup> Empirical studies have shown that a healthy balance between CEO and board powers is required to ensure effective company performance<sup>78</sup> and for effective checks and balances in corporate governance.<sup>79</sup>

### **Healthy Organizational Culture**

Insights from game theory indicate that egoistic competition between employees has less success in the long-term than trusting cooperation. However, in successful large organizations excessive trustfulness may lead to an increasing number of free riders being dragged along. The system then becomes unattractive for high performers. Game theory therefore advises the middle way of a "defensible" culture of trust. An achiever can count on being rewarded; those who do not achieve can count on being penalized (the tit-for-tat strategy).<sup>80</sup> Organizational culture has to strike an optimal balance between rivalry and cooperation.<sup>81</sup>

### **Keeping the Balance**

As we have seen, there seems to be an optimum value in line with the four factors. Minor fluctuations around this ideal value are nevertheless completely normal. At a certain point, i.e., during continuous overloading, the system becomes increasingly vulnerable. During constant deviation towards the top, the Burnout Syndrome could occur, while the Premature Aging Syndrome could occur when there is a continuous deviation towards the bottom.

Successful organizations therefore ensure that they keep the balance in the long term. Insights from our empirical study confirm this. The most successful competitors of the examined organizations, among them BMW, General Electric, Siemens, and Toyota, pursued an organizational policy which kept the organizations in balance in the long term.<sup>82</sup> The Siemens case study is exemplary of how such organizations work.

### **Siemens AG: A Balanced Organization**

The German electrical engineering company Siemens is the direct opposite of its competitors ABB

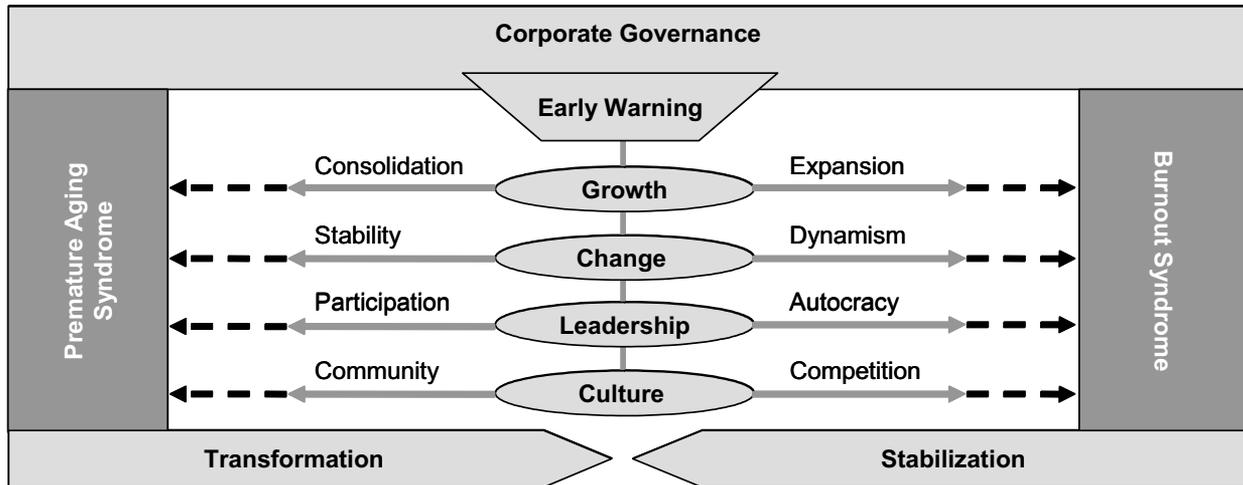


FIGURE 1  
The Balanced Organization

and Alstom, both of which feature prominently on our list of organizations in crisis. Despite the worsening market environment, the company profit in 2003 was approximately US\$ 3.1 billion. The Siemens shares outperformed the benchmark index MSCI Europe by more than 80 percent (ABB: -50; Alstom: -70 percent) over the last five years. In addition, the organization is almost debt-free. This performance is the result of the well-balanced firm policy.

The average sales growth over the last ten years has been approximately 6.2 percent and corresponds relatively precisely to twice the same Sustainable Growth Rate.<sup>83</sup> The growth was, moreover, mainly organically achieved. Targeted smaller acquisitions (e.g., Alstom's industrial turbine business) were financed by the proceeds from the sale of less attractive sectors (e.g., the semiconductor division Infineon). A long-term cost-reduction and reconstruction program complemented the healthy growth.

Siemens pursued an active portfolio management with regular purchases and the sale of weak sectors. However, even after 156 years of company history, the clear focus on electrical engineering remains unchanged and gives the organization an unmistakable identity. Siemens pursued gradual change and resisted all radical demands. In contrast to ABB, Siemens did not act upon analysts' demand to sell off the "boring" energy business, and currently enjoys this unit's growing returns.<sup>84</sup>

In its CEO, Heinrich von Pierer, Siemens has a recognized and visionary company leader. Simultaneously his power within the organization is clearly limited. The strong supervisory board traditionally designs Siemens' organizational strat-

egy and also has a part to play in the daily business. Moreover, to a greater degree than his predecessors, von Pierer has delegated responsibility to the division heads and the regional units.

Siemens' culture, previously regarded as bureaucratic and resistant to change, has been changed radically during the last ten years. Changes in the organizational structure, in the salary system, and in the leadership behavior have led to a far more profit-oriented organizational culture. Simultaneously the profit-oriented culture has also not been exaggerated. Siemens still pursues a cooperative relationship with the employee representatives and is, for example, a leader in the field of work-life-balance concepts (e.g., teleworking, parenting time).

### How Organizations Prevent Failure

As the Siemens example shows, long-term successful organizations keep their balance. A good company leader therefore often changes direction. Consolidation follows a growth phase, and stabilization follows change. The leader corrects the course instead of over-steering. How can an organization promptly determine that the time for course correction has come? And which measures must be taken once the organization is no longer in balance?

### Effective Early Warning Systems

In some countries, including Germany, larger companies have lately been legally compelled to introduce a monitoring system to prevent organizational crises. The great majority of the

organizations that we examined did indeed have such a monitoring system. The failure of this system can be largely explained by its practical implementation. Risk management mostly occurs within the framework of corporate controlling while, simultaneously, analysis increasingly confines itself to financial indexes. Some organizations, among them Siemens, considered adding a few operative measures (e.g., in the context of a Balanced Scorecard).

Our investigation, however, shows that it is only during the final phase of a crisis that there are recognizable effects on the organization's quantitative characteristics. Then it is usually too late to prevent the crisis from occurring.<sup>85</sup> An effective early warning system should therefore not be limited to quantitative characteristics alone, but must already register recognizable weak signals much earlier.<sup>86</sup> These first signals of a crisis are of a qualitative nature and resemble the previously described strategic factors such as, for example, excessive growth. Existing early warning systems should therefore be expanded to include a strategic component.

Moreover, our investigation has verified that whether and how effectively an organization reacts to the signs of a crisis very strongly depends on the board of directors. In almost all cases the CEO persisted with the previous recipe for success.<sup>87</sup> Instead of correcting the course when success was not achieved, the now counterproductive behavior pattern was reinforced even further. An independent and competent board of directors, as for example at Siemens, is therefore essential for countermeasures to be introduced promptly.<sup>88</sup>

### Countermeasures to Failure

If the latent signs of a crisis have been recognized through a strategic early warning system, it is essential to apply suitable countermeasures to (ideally) prevent the crisis from occurring. Countermeasures mean a change of direction, a course correction so that the organization can find its balance once again.

Once the first signs of a Burnout Syndrome appear, the organization has to immediately draft a stabilization program. Some of the burnout companies analyzed in this study applied such a stabilization program and managed to overcome the crisis. While these organizations failed to prevent the crisis from occurring, much can be learned from their successful stabilization programs. The countermeasures to either prevent or overcome a crisis are basically similar. With reference to our previ-

ously outlined DaimlerChrysler case, the key elements of a successful stabilization program are:

- *Stabilization of growth.* Since the start of the crisis in 2001, DaimlerChrysler has focused wholly on the consolidation of its new sectors. Surplus capacity at Chrysler is being reduced. In a strategic move, non-core assets and surplus production sites are being sold off. The troubled Mitsubishi investment has been put up for sale.
- *Stabilization of the organization.* DaimlerChrysler's primary focus is now on the integration of the organization. Planned synergies are increasingly being realized by a reduction in the costs of materials and through the joint utilization of platforms. Further investments in the range of models are only approved if savings are realized.
- *Stabilization of the leadership.* The top management has been jointly responsible for the turnaround. However, in this regard DaimlerChrysler has not gone as far as, for example, the American conglomerate Tyco. There the corporate governance was completely reformed to prevent future crises in time.<sup>89</sup> At DaimlerChrysler the organization is, as previously, strongly directed towards one single man at the top.

The stabilization program at DaimlerChrysler shows the first signs of being a success: The group operating profit is up 77 percent for the first half of 2004 and the operating profit of its troubled Chrysler unit turned significantly positive during that time period.

However, if there are strong signs of the Premature Aging Syndrome, this requires the implementation of a transformation program. The Marks & Spencer example illustrates which elements are significant here:

- *Opening up of the system.* According to analysts, only the massive replacement of personnel and management at Marks & Spencer saved the organization. Breaking open familiar routines by means of fresh stimuli from outside is the primary aim. The injection of fresh blood should simultaneously take place on all levels, on the board of directors as well as on the management level and among the employees.
- *Investment in growth and change.* The new team at the top revolutionized Marks & Spencer in its entirety. In addition to the traditionally strong textile sector, new investments were made in the growth sectors of food products, furnishings, and financial services. The textile production was largely relocated to cost-effective countries. The bureaucratic structure of the organization was

completely changed. The first marketing campaigns were run, and new and more attractive brands and product lines have been successfully introduced.

- *Cultural change.* A further goal will be to promote an innovative and achievement-oriented culture in the new growth areas. In a second phase, these entities can then form the nucleus of an in-depth transformation of the organization as a whole.

The transformation program for the organization that was aging far too soon, had an effect: Contrary to the negative market trend, earnings and organizational profit have increased noticeably in the past business year.

### Implications for Managers

This study has shown that in the majority of cases, the failure of successful firms largely follows the same logic. At the same time, the number of affected organizations in our investigation reveals that this is a real threat faced by all organizations, both today and in the future.

The good news is that organizations do not face this danger defenselessly. If the danger is recognized in time, and if the organization corrects the course effectively, the crisis itself can be avoided. Our findings and conclusions lead to four key lessons learned and the related actions for company leaders:

*Growth is important – unless it becomes excessive.*

- Calculate the optimum target growth rate of your company.
- Focus on bottom-line improvements to increase your optimum growth rate.
- Prioritize organic growth and identify your financial and managerial limits for acquisition growth.

*Change is positive – if you preserve your company's identity*

- Innovate in the core business first before addressing radical new fields.
- Whenever changing, define the elements of your identity to be kept and reinforce them.
- During the change process, provide employees with a vision of the future identity.

*Visionary leaders are beneficial – as long as they share their power.*

- Deploy all available resources to pursue your company's vision and objectives.

- Create checks and balances by reinforcing the board with independent directors.
- Balance power with a decentralized structure and a bottom-up culture that encourages constructive questioning.

*Internal competition spurs performance – if incorporated into a culture of trust.*

- Reward employees for performance and delivery.
- Promote trust through openness in communication.
- Establish a code of conduct that promotes integrity and cooperation and enforce strict compliance.

### Endnotes

<sup>1</sup> Cameron, K.S., Whetten, D.A., & Kim, M.U. (Eds.). 1988. *Readings in organizational decline*. Cambridge: Ballinger Publishing Company.

<sup>2</sup> For a detailed introduction to population ecology and life-cycle concepts, see: Hannan, M.T., & Freeman, J. 1989. *Organizational ecology*. Cambridge: Harvard University Press. For an introduction to organizational decline and failure, see Harrigan, K.R. 1982. *Strategies for declining businesses*. Lexington: Heath.

<sup>3</sup> Hambrick, D.C., & D'Aveni, R.A. 1988. Large corporate failures as downward spirals. *Administrative Science Quarterly*, 33(1): 1–23.

<sup>4</sup> The classification is based on data from BankruptcyData.com and abiworl.org for the U.S. and Creditreform for Europe. We excluded privately held firms and "tactical" Chapter 11 filings due to asbestos claims.

<sup>5</sup> The following U.S. and European stock indices were used to compile the 50 "crashes": AEX (NL), CAC40 (F), DAX30 (GER), FTSE100 (UK), MIB30 (I), SMI (CH), and S&P500 (US).

<sup>6</sup> The research design relies strongly on methods developed by Eisenhardt, K. 1989. Building theories from case study research. *Academy of Management Review*, 14(4): 532–550; Yin, R.K. 1989. *Case study research: Design and methods*. Beverly Hills: Sage Publications.

<sup>7</sup> There are precedents in the use of general and business press publications for scholarly research, e.g. Chen, C.C., & Meindl, J.R. 1991. The construction of leadership images in the popular press. The case of Donald Burr and People Express. *Administrative Science Quarterly*, 36(4): 521–551; House, R.J., Spangler, W.D., & Woycke, J. 1991. Personality and charisma in the U.S. presidency: A psychological theory of leader effectiveness. *Administrative Science Quarterly*, 36(3): 364–396.

<sup>8</sup> Yin, op. cit.

<sup>9</sup> The classification occurred in three steps. First, we identified the main characteristics of failure and the related concrete indicators (as specified in Tables 2 and 3). Then we classified the companies according to these characteristics. A company was classified if at least two of the three indicators of a characteristic were present. Finally, we classified companies into a syndrome if they showed at least three of the four characteristics of the syndrome. In total, 40 companies qualified for the Burnout Syndrome and 12 companies for the Premature Aging Syndrome. The remaining five companies displayed only single characteristics of one or both syndromes and were not classified. Few of the classified companies also revealed single char-

acteristics of the opposite syndrome. Only two companies showed a truly "mixed" type: while these companies qualified for Premature Aging along all four characteristics, they displayed additional characteristics of the Burnout Syndrome. To counter the aging process, new management teams had aggressively moved into acquisitions and change that subsequently failed and further increased the crisis.

<sup>10</sup> The study of burnout is a major research area in industrial and organizational psychology. Burnout refers to the syndrome of physical and emotional exhaustion in response to chronic interpersonal stressors on the job. Burnout leads to declining productivity and effectiveness at work. In this study we apply the term burnout to companies. As with all metaphors, there are a few striking similarities (i.e., the exhaustion of the system through permanent stress, and the negative effect on performance), while other aspects might differ. For further reading, see Maslach, C. 2001. Job burnout. *Annual Review of Psychology*, 52: 397–422.

<sup>11</sup> The compounded annual growth rate (CAGR) was calculated for all companies over a five-year period. The selected period covers the five years prior to the failure (in most cases the first loss-making financial year). On average, the forty analyzed companies grew their sales at 29.5 percent per annum over this period. The detailed results can be found in Table 1.

<sup>12</sup> For a detailed account of the rise and fall of Enron, see: Swartz, M., & Watkins, S. 2003. *Power failure: The inside story of the collapse of Enron*. New York: Doubleday.

<sup>13</sup> Penrose, E. 1995. *The theory of the growth of the firm*. Oxford: Oxford University Press; for empirical evidence, see Gander, J.S. 1991. Managerial intensity, firm size and growth. *Managerial and Decision Economics*, 12: 261–266.

<sup>14</sup> Slater, M. 1980. The managerial limitations to a firm's rate of growth. *Economic Journal*, 90: 520–528

<sup>15</sup> Hambrick, D.A., & Crozier, L.M. 1985. Stumblers and stars in the management of rapid growth. *Journal of Business Venturing*, 1(1): 31–45; Gartner, W.B. 1997. When growth is the problem, not the solution. *Journal of Management Inquiry*, 6(1): 62–68.

<sup>16</sup> Penrose, op. cit.

<sup>17</sup> A comprehensive overview of the risks associated with acquisitions can be found in Sirower, M.L. 1997. *The synergy trap. How companies loose the acquisitions game*. New York: Free Press.

<sup>18</sup> For recent empirical evidence, please see Agrawal, A., Jaffe, J.F., & Mandelker, G.N. 1992. The post-merger performance of acquiring firms: A re-examination of an anomaly. *Journal of Finance*, 47(4): 1605–1621; Loughran, T., & Vijh, A.M. 1997. Do long-term shareholders benefit from acquisitions? *Journal of Finance*, 52(5): 1765–1790.

<sup>19</sup> The sustainable growth rate (SGR) has been defined as the maximum annual percentage increase in sales that can be achieved based on target operating, debt, and dividend payout ratios. The SGR can be calculated by means of the following formula:  $SGR = (ROE \times b) / (1 - (ROE \times b))$ , where Return on Equity (ROE) = Net Income / Shareholder's Equity, and Retention Ratio (b) = ((Net Income - Dividends) / Net Income). See, for example, Ross, S.A. 1996. *Corporate finance*. Chicago: Irwin (pp. 92 ff); Van Horne, J.C. 1997. *Financial management and policy*. London: Prentice-Hall (pp. 743 ff).

<sup>20</sup> The detailed SGR and sales growth rates of the individual firms can be found in Table 1.

<sup>21</sup> Two interesting studies on the subject are Higgins, R.C. 1977. How much growth can a firm afford? *Finance Management*, 6(3):3–16; Altman, E.I. 1983. *Corporate financial distress: A complete guide to predicting, avoiding, and dealing with bankruptcy*. New York: Wiley.

<sup>22</sup> Opler, T., & Titman, S. 1994. Financial distress and corporate Performance. *Journal of Finance*, 49(3): 1015–1040.

<sup>23</sup> The three telecom companies British Telecom, Deutsche Telekom, and France Telecom (as well as AT&T) qualified for "excessive growth" despite rather modest growth rates (relatively close to their SGR). This is explained by the fact that their large investments in mobile licences, as well as in mobile and Internet companies did not translate into immediate sales growth. However, the burden of the huge debt loads from these aggressive investments on future growth was the main cause of failure.

<sup>24</sup> Rumelt, R.P. 1982. Diversification strategy and profitability. *Strategic Management Journal*, 3: 359–369.

<sup>25</sup> Integration difficulties are a main cause of failure for mergers and acquisitions. For a detailed account of integration risks, see Jemison, D.B., & Sitkin, S. 1986. Corporate acquisitions: A process perspective. *Academy of Management Review*, 11(1): 145–163.

<sup>26</sup> Ahuja, G., & Katila, R. 2001. Technological acquisitions and the innovation performance of acquiring firms. A longitudinal study. *Strategic Management Journal*, 22(3): 197–220; Zook, C. 2001. *Profit from the core: Growth strategy in an era of turbulence*. Boston: Harvard Business School Press.

<sup>27</sup> Organizational identity has been defined as the distinctive and enduring attributes that determine the character of an organization. These core values of the organization provide guidance for corporate actions. See for example Dutton, J.E., & Dukerich, J.M. 1991. Keeping an eye on the mirror. Image and identity in organizational adaptation. *Academy of Management Journal*, 34(3): 517–554.

<sup>28</sup> Hannan & Freeman op. cit.; Amburgey, T., Kelly, D., & Barnett, W. 1993. Resetting the clock: The dynamics of organizational change and failure. *Administrative Science Quarterly*, 38(1): 51–73; Delacroix, J., & Swaminathan, A. 1991. Cosmetic, speculative and adaptive organizational change in the wind industry. A longitudinal study. *Administrative Science Quarterly*, 36(4): 631–661.

<sup>29</sup> Collins, J.C., & Porras, J.L. 1994. *Built to last: Successful habits of visionary companies*. New York: Harper Collins; Fiol, C.M. 2001. Revisiting an identity-based view of sustainable competitive advantage. *Journal of Management*, 27(6): 691–699.

<sup>30</sup> Bouchikhi, H., & Kimberly, J.R. 2003. Escaping the identity trap. *Sloan Management Review*, 44(3): 20–26.

<sup>31</sup> Fiol, op. cit.; Bouchikhi & Kimberly, op. cit.; Gioia, D.A. 2000. Organizational identity, image, and adaptive instability. *Academy of Management Review*, 25(1): 63–81.

<sup>32</sup> Hamilton, S. 2003. The Enron Collapse. IMD Case Study, ECCH 1–0195.

<sup>33</sup> BBC News, 5 July 2001. Analysis: Where did Marconi go wrong?

<sup>34</sup> Argenti, J. 1976. *Corporate collapses: The causes and symptoms*. London: McGraw Hill; Whetten, D.A. 1987. Organizational growth and decline processes. *Annual Review of Sociology*, 13: 335–358.

<sup>35</sup> Daily, C.M., & Johnson, J.L. 1997. Sources of CEO power and firm financial performance. A longitudinal assessment. *Journal of Management*, 23(2): 97–117.

<sup>36</sup> Pearce, J.A., & Zahra, S.A. 1991. The relative power of CEOs and boards of directors: Associations with corporate performance. *Strategic Management Journal*, 12(2): 135–153.

<sup>37</sup> An excellent account of the different sources of CEO power and the related measures has been provided by Finkelstein, S. 1992. Power in top management teams: Dimensions, measurement, and validation. *Academy of Management Journal*, 35(3): 505–538.

<sup>38</sup> Prior studies have shown that leaders in decline situations become more susceptible to authoritarianism and narrow vision. See, for example Whetten, D.A. 1980. Sources, responses and effects of organizational decline. In Kimberly, J.R., & Miles,

R.H. (Eds.). 1980. *The organizational life cycle*: 342–374. San Francisco: Jossey-Bass.

<sup>39</sup> Hayward, M.L.A., & Hambrick, D.C. 1997. Explaining the premiums paid for large acquisitions: Evidence of CEO hubris. *Administrative Science Quarterly*, 42(1): 103–127.

<sup>40</sup> Ferrin, D.L., & Dirks, K.T. 2003. The use of rewards to increase and decrease trust: Mediating processes and differential effects. *Organizational Science*, 14(1): 18–31; Dunn, J.R., & Schweitzer, M.E. 2004. Too good to be trusted? Relative performance, envy, and trust. *Academy of Management Best Conference Paper Proceedings*, CM, B1-B6.

<sup>41</sup> Roberts, K., & O'Reilly, C. 1974. Failures in upward communication in organizations. Three possible culprits. *Academy of Management Journal*, 17(2): 205–215; Dirks, K.T., & Ferrin, D.L. 2001. The role of trust in organizational settings. *Organizational Science*, 12(4): 450–467.

<sup>42</sup> Dirks & Ferrin, op. cit.

<sup>43</sup> Driskell, J. E., & Salas, E. (Eds.). 1996. *Stress and human performance*. Mahwah: Lawrence Erlbaum Associates; Cluskey, G.R., & Vaux, A. 1997. Vocational misfits: Sources of organizational stress among accountants. *Journal of Applied Business Research*, 13(3): 43–55.

<sup>44</sup> Sutton, R.I., Eisenhardt, K.M., & Jucker, J.V. 2001. Managing organizational decline: Lessons from Atari. *Organizational Dynamics*, 14(4): 17–29; Sutton, B., & Neubauer, F. 1996. Metallgesellschaft AG. IMD Case Study, ECCH 212.96.

<sup>45</sup> U.S. market plagues follow a familiar pattern. *The Wall Street Journal Europe*, 12 February 2002

<sup>46</sup> Missmanagement bei AEG: Am Ende gescheitert. *Manager Magazin*, 28 August 2001

<sup>47</sup> Herbst, D. 2003. *Corporate identity*. Berlin: Cornelsen.

<sup>48</sup> Supermanns harte Landung. *Stern*, 11 February 2004.

<sup>49</sup> McGrath, J., Kroeger, F., Traem, M., & Rockenhaeuser, J. 2001. *The value growers: Achieving competitive advantage through long-term growth and profits*. Boston: McGraw-Hill.

<sup>50</sup> Porter, M.E. 1985. *Competitive advantage*. New York: The Free Press.

<sup>51</sup> Penrose, op. cit.

<sup>52</sup> See Table 4 for details.

<sup>53</sup> Ansoff, H.I. 1979. *Strategic management*. New York: Wiley & Sons; Hofer, C.W., & Schendel, D.E. 1978. *Strategy formulation. Analytical concepts*. St. Paul: West Publishing Inc; Teece, D.J., Pisano, G., & Shuen, A. 1997. Dynamic capabilities and strategic management. *Strategic Management Journal*, 18 (7): 509–533.

<sup>54</sup> A number of prior studies on corporate decline pointed to the fact that organizations tend to get trapped in their previous success patterns and lose their flexibility to change and adapt (the so-called "success breeds failure" phenomenon). Readers interested in this topic might consider Miller, D. 1992. *The Icarus paradox: How exceptional companies bring about their own downfall*. New York: Harper Collins.

<sup>55</sup> Thompson, J.D. 1967. *Organizations in action*. New York: McGraw-Hill; Mintzberg, H. 1984. Power and organization life cycles. *Academy of Management Review*, 9(2): 207–224.

<sup>56</sup> Harrigan, K.R. 1985. *Strategic flexibility*. Lexington: Heath.

<sup>57</sup> Deshpandé, R., Farley, J.U., & Webster, F.E. 1993. Corporate culture, customer orientation, and innovativeness in Japanese firms: A quadrature analysis. *Journal of Marketing*, 57(1): 23–27; Homburg, C., & Pflesser, C. 2000. A multiple layer model of market-oriented organizational culture: Measurement issues and performance outcomes. *Journal of Marketing Research*, 37(4): 449–462.

<sup>58</sup> Kenworthy, L. 1995. *In search of national economic success. Balancing competition and cooperation*. Thousand Oaks, CA: Sage.

<sup>59</sup> Excess personnel have been found a key characteristic of

the crisis-prone company. See Lorange, P., & Nelson, R.T. 1987. How to recognize and avoid organizational decline. *Sloan Management Review*, 28(3): 41–49.

<sup>60</sup> Kodak to lay off 10,000 employees in a 10% cutback. *The New York Times*, 12 November 1997.

<sup>61</sup> The Premature Aging Syndrome (PAS) is a genetic disease whose victims age five to ten times faster than normal. We selected the term as a metaphor for companies that are aging too soon. However, it has to be made clear that companies, while composed of human beings, differ from the latter: they are able to renew themselves (e.g., by replacing the management team). This allows companies to overcome PAS while there is unfortunately no effective cure for humans.

<sup>62</sup> Miller, op. cit.

<sup>63</sup> For further reading, see Gibbon, E. 2001. *The history of the decline and fall of the Roman Empire*. New York: Penguin USA; Toynbee, A. 1987. *A study of history*. Oxford: Oxford Press reprint Edition; Schiavone, A. 2000. *The end of the past: Ancient Rome and the modern West*. Cambridge: Harvard University Press.

<sup>64</sup> For more information, see: Bevan, J. 2001. *The rise and fall of Marks & Spencer*. London: Profile Books.

<sup>65</sup> Penrose, op. cit.

<sup>66</sup> Hambrick, & Crozier, op. cit.

<sup>67</sup> Ramezani, C.A., Soenen, L., & Jung, A. 2002. Growth, corporate profitability, and value creation. *Financial Analysts Journal*, 58(6): 56–67.

<sup>68</sup> Penrose op. cit.

<sup>69</sup> Kusewitt, J.B. 1985. An exploratory study of the strategic acquisition factors relating to performance. *Strategic Management Journal*, 6(2): 151–169; Hitt, M., Harrison, J. Ireland, R.D., & Best, A. 1998. Attributes of successful and unsuccessful acquisitions of U.S. firms. *British Journal of Management*, 9(2): 91–114.

<sup>70</sup> Rumelt, op. cit.

<sup>71</sup> Hambrick, & Crozier, op. cit.

<sup>72</sup> Teece et al., op. cit.

<sup>73</sup> Hannan, & Freeman, op. cit.; Nelson, R., & Winter, S. 1982. *An evolutionary theory of economic change*. Boston: Harvard University Press.

<sup>74</sup> Leana, B., and Barry, C. 2002. Stability and change as simultaneous experiences in organizational life. *Academy of Management Review*, 25(4): 753–759; Hambrick and D'Aveni (op. cit.) argue that failing firms respond to environmental changes either too actively or too passively: "Both inaction and hyperaction seem to typify firms in their years prior to failure."

<sup>75</sup> Gioia et al., op. cit.; Gagliardi, P. 1986. The creation and change of organizational cultures. A conceptual framework. *Organization Studies*, 7(2): 117–134

<sup>76</sup> The literature on organizational identity speaks of "adaptive instability" (see Gioia et al., op. cit.).

<sup>77</sup> Ogbonna, E., & Harris, L.C. 2000. Leadership style, organizational culture, and performance: Empirical evidence from UK companies. *International Journal of Human Resource Management*, 11(4): 766–789.

<sup>78</sup> Pearce & Zahra, op. cit.; Pearce, J.A., & Robinson, R.B. 1987. A measure of CEO social power in strategic decision making. *Strategic Management Journal*, 8(3): 297–304; Vance, S.C. 1983. *Corporate leadership: Boards, directors, and strategy*. New York: McGraw-Hill.

<sup>79</sup> Pearce & Zahra, op. cit.

<sup>80</sup> Axelrod, R. 1984. *The evolution of cooperation*. New York: Basic Books.

<sup>81</sup> Abell, P. 1996. A model of the informal structure (culture) of organizations. Help, trust, rivalry, and team spirit. *Rationality and Society*, 8: 433–452.

<sup>82</sup> The four mentioned companies, BMW, General Electric,

Siemens, and Toyota (as well as other successful firms) showed a sales growth rate over the last ten years that matched their sustainable growth rate almost exactly.

<sup>83</sup> Siemens AG: Telecom recovery to drive growth. *SG Equity Research*, 2 December 2003 (<http://www.sgcib.com>).

<sup>84</sup> Siemens proves prudence is a virtue. *Business Week*, 11 November 2002

<sup>85</sup> John Argenti stated: "The earliest and clearest signs are almost certainly not financial, they are managerial, and they can be seen long before – perhaps years before – the company's financial position begins to deteriorate". See Argenti, J. 1976. *Corporate collapses: The causes and symptoms*. London: McGraw Hill. Along the same lines: Finkelstein, S. 2003. *Why smart executives fail and what you can learn from their mistakes*. New York: Portfolio; Sull, D.N. 2003. *Revival of the fittest: Why good companies go bad and how great managers remake them*. Cambridge: Harvard Business School Press.

<sup>86</sup> Mitroff, I.I. 2000. *Managing crises before they happen*. New York: Amacom.

<sup>87</sup> Prior research has shown that executives under pressure tend to stick to outdated "mental models," thus further increasing the risk of failure. See, for instance, Starbuck, W.H., Greve,

A. & Hedberg, B.L.T. 1978. Responding to crisis. *Journal of Business Administration*, 9: 111–137.

<sup>88</sup> In a similar vein, Richard Schroth and Larry Elliott suggest designated "counterpointers" that ask the rudest questions possible. (2002. *How companies lie*. Yarmouth: Nicholas Brealey Publishing).

<sup>89</sup> Pillmore, E.M. 2003. How we're fixing up Tyco. *Harvard Business Review*, 81(12): 96–103.

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