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SIGNS OF PENDING CORPORATE DEMISE

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Purpose

This research paper aimed to better understand signs of corporate failure in organizations. The paper presented the warning signs of organizational decline, so leaders could identify and eliminate them before the organization enters a death spiral.

Key words: *Corporate, Decline, Demise, Failure, Signs*

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INTRODUCTION

The term corporate failure entails discontinuation of company's operations leading to inability to reap sufficient profit or revenue to pay the business expenses. It happens due to poor management, incompetence, and bad marketing strategies. Understanding business failure has been one of the central topics of business studies for decades, driven by the concern of numerous stakeholders in corporations and the dramatic consequences of corporate failures. The initial work of Fitzpatrick (1932) following the stock market crash of 1929 has developed into a considerable canon—known by various names—on the *prediction* of business failure. Increasing corporation and systematic market failure has alarmed governments and the public, and has focused research activity on statistical models aiming to accurately determine a corporation's risk of insolvency and failure. One of the most significant threats for many businesses today, despite their size and the nature of their operations, is insolvency. Extant evidence shows that in the past two decades business failures have occurred at higher rates than at any time since the early 1930s. The factors that lead businesses to failure vary. The economic cost of business failures is significant; evidence shows that the market value of the distressed firms declines substantially prior to their ultimate collapse (Warner, 1977; Charalambous et al., 2000). Hence, the suppliers of capital, investors and creditors, as well as management and employees, are severely affected by business failures. Several terms have been used in the literatures: organization mortality, organizational death, organizational exit, bankruptcy, decline, retrenchment, downsizing, demise and failure.

Nowhere is it written that a company, regardless of how large it is or how successful it might seem to be, will survive. There have been too many highly visible and painful reminders of this fact over the last several years. While many of these companies fall apart seemingly overnight, the reality is that the decline is a process that usually takes several years and results from a number of actions, decisions, and behaviors that contribute to the demise. The research on corporate failure suggests there is a sequence to the process of corporate failure (Figure 1). The initial stages of failure are followed first by organizational and internal problems and later by financial signals that are common to the varying origins of failure of Ooghe and De Prijcker's process types. This area of research suggests that the failure process begins when the corporation's resources and their deployment are inadequate to create or sustain a valuable strategic position. During a corporation's cycle it responds to internal pressures (exploiting internal strengths and avoiding internal weaknesses) and external pressures (responding to opportunities and neutralizing threats).

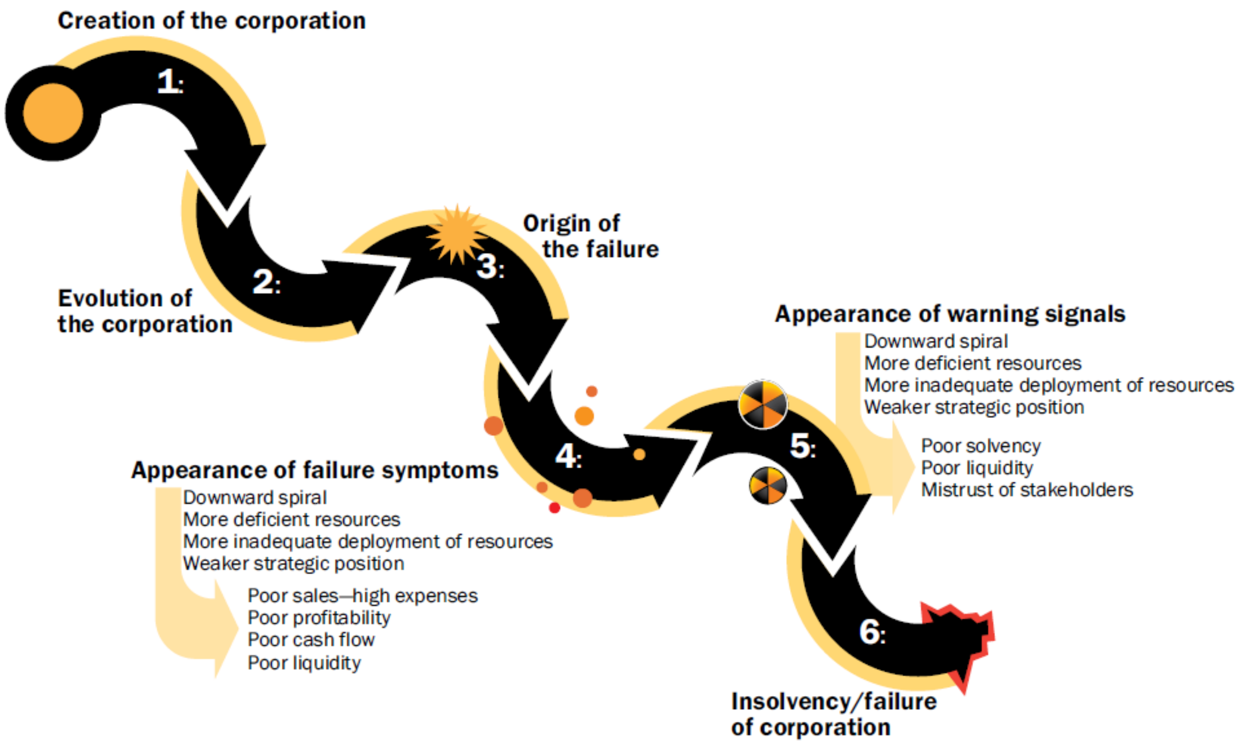

Figure 1: Signs of Coming Organizational Demise
Source: Ooghe H & De Prijcker S. (2007)

Moreover business failure is generally the result of a series of inadequacies, not a single deficiency. There are usually warning signs of coming organizational failure. Failure is usually the result of mostly visible flaws, and avoidable errors in the processes leading to eventual collapse or disaster. Usually there is a climate providing scope for these errors to spread, and this climate discourages people from drawing attention to the mistakes. If the resources of the firm and their deployment are inadequate to respond to internal and external pressures, the firm cannot create or sustain a valuable strategic position. If no corrective actions are taken to (re)align the resources of the firm and their deployment with the environment requirements, the failing firm enters into an organizational downward spiral (Crutzen & Van Caillie 2007). Corporate organizational failure can arise for many reasons. It may be a single catastrophic event. It may follow a lengthy process of decline. Whichever one may believe, corporate failure is a process, which starts with management defects, leading to poor decisions, leading to financial deterioration, and finally corporate collapse.

FINDINGS

This paper outlined eight (8) common signs of eminent corporate failure that were documented as follows;

1. Management and Leadership Signs

Management provides leadership and liaison in organizations. If the manager's roles, duties and functions are not properly executed, corporate failure is unavoidable.

One-person rule: CEOs whose drive help a firm to grow at early stages, sometimes find it hard to change to a more professional, team managed enterprise. Their initial strength becomes an obstacle to sound management of a larger firm. A short sighted CEO will gently crush a titanic.

An unbalanced top team: people like to work with people of similar outlook. However, diverse abilities help the organization to deliver on its promises to intended beneficiaries like shareholders. Racial, tribal, religious, gender etc similarities can be a hindrance to organizational performance (Wheelen & Hunger, 2012).

A lack of management depth: management experience, as well as intellect is important. Most experienced CEOs tend to perform better than most new CEOs. CEOs who have previously gone through crisis tent to perform better when faced by crisis in their next assignments.

Managerial in-competencies: the failure to mobilize adequate resources and poor resource management is a key sign of corporate failure. A corporation may experience a lack of resources, inappropriate management of resources or both. If the resources of the firm and their deployment are inadequate to respond to internal and external pressures, the firm cannot create or sustain a valuable strategic position. This happens when management incompetency is rampant eg a loss of legitimacy (Benson, 1975), management lacks enthusiasm, customer focus and is not coachable (Hill, C. W., Jones, G. R., & Schilling, M. A, 2014).

Poor or lack of leadership: Businesses act a lot like families, and employees imitate leaders just like children copy their parents. If leaders are lazy, incompetent, or mean, this trickles down to the employees. Leaders should provide the direction and the mood, pace and the direction of the whole organization. A weak task leadership - no strong leadership in the team, a lack of strong individuals with particular skills and knowledge/expertise taking responsibility in different situations to see things through. Lack of good leadership in change management exposes the organization to increased turbulence that may work against the organizations success.

False or lack of commitments From Team Members: An Organizations is a system made up of many parts. Each part must play its role for success to be realized. When organizational cohesiveness is low, commitment from the members tend to be low. This leads to increased incompatibility and lack of commitment from team members that negatively affects firm performance. It is team members who build organizations and it is lack of team work that leads to corporate failure.

2. Economic Signs

Firms depend so much on financial health and their economic health is paramount in their life time.

Bankruptcy- Although bankruptcy filings provide a public record of a firm's demise they reflect only a small portion of business failures**.** Thus, the large body of accounting and financial management literature seeking to develop financial and accounting models to predict organizational bankruptcy. This may be due to shrinking financial resources and negative profitability.

A weak finance function: No organization can sustain itself for long if no one is monitoring the cash flow. Focusing on short-term profits may be a strategic error. Cash, asset, and risk management are critical to long-term viability. A strong Chief Finance Officer (CFO) must go beyond being a historian, and contribute to the top team strategic thinking as well as prepare clear directions for finance mobilization and reporting.

Inadequate financing: Businesses need cash flow to float them through the sales cycles and the natural ebb and flow of business. Running the bank accounts dry is responsible for a good portion of business failure. Cash is king, and many may quickly find that borrowing money from lenders can be difficult. The finance needs of the firm must be met especially on investment needs.

Delayed Financial Commitments: Plain and simple, a successful company should be able to pay its bills on time. This should be priority for a business and if for some reason it cannot pay the bills it used to be able to, this is a serious issue that needs immediate attention and reflection. If a firm is regularly receiving payment requests from creditors in the form of threatening letters, phone calls, and emails then it could be symptomatic of a serious cash-flow problem. Ignoring this type of contact from a creditor can lead to more serious action being taken, which could be the beginning of the end for a business if it can't afford to pay. A prudent firm must pay up (Broyles, J., 2020).

Delayed Cash Receipts: Every business has cash receipts especially from cash sales, credit sales, rent receives, and commission receives. Delayed cash receipts can easily cripple firm operations leading to corporate failure. Late payments from customers are one of the primary reasons businesses are unable to pay their own creditors on time. If a firm offers unnecessary long payment terms or do not have an established collection procedure in place, it could experience a cash shortfall that may impact its business's ability to operate effectively.

Economic Distress: Economic downturn is one of the major signs of corporate failures, across many businesses. The decline in the economy may lead to the reduction in the activities, which adversely affects the performance of many firms in the economy. Economic distress may be caused by a variety of reasons.

Working Capital Problems: When the company is going through financial distress, it may face liquidity shortages. Due to the insufficiency of funds the organization fails to carry out the day to day operations of the organization properly and weak liquidity becomes evident.

High debt levels: If a firm has reached over borrowing limits, majority of its cash reserves are used to settle debt. Although leverage may increase production capacity, debt crisis is a key sign of a firm on the spiral. Over borrowing makes the firm unable to meet loan repayments and thus may lead to corporate failure.

3. Corporate Governance Signs

Corporate governance encompasses the arrangements by which the power of those in control of the strategy and direction of an entity is both delegated and limited to enhance prospects for the entity's long-term success, taking into account risk and the environment in which it is operating (Uhrig, 2003).

Poorly structured board: an active board can warn of failing corporate governance as corporate governance is key to a performing firm. Where some or all board members are comprised (either by management or other factors), they remain rubber stumpers in key decisions that affect the firm. A story is told of a board member who was secured a foreign trip on the eve of a board session. The following day a decision was made to nullify a previous board decision that had approved to pay suppliers. The money was factored to pay for employees retreat. After two weeks all the suppliers downed their tools. The company lost millions due to delayed supplies and court cases from clients. It is vital that boards have a clear idea

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of what they are responsible for. Poorly structured board can lead to lack of independence thus compromising decision making.

Lack of Discipline: Corporate discipline is a commitment by a company's senior management to adhere to behavior that is universally recognized and accepted to be correct and proper. This encompasses a company's awareness of, and commitment to, the underlying principles of good governance, particularly at senior management level. Business ethics is at the center stage of business discipline.

Lack of Transparency and Accountability: Transparency is the ease with which an outsider is able to make meaningful analysis of a company's actions, its economic fundamentals and the non-financial aspects pertinent to that business. This is a measure of how good management is at making necessary information available in a candid, accurate and timely manner – not only the audit data but also general reports and press releases. It reflects whether or not investors obtain a true picture of what is happening inside the company. Firms with atoms of transparency tent to perform poorly. Individuals or groups in a company, who make decisions and take actions on specific issues, need to be accountable for their decisions and actions. Mechanisms must exist and be effective to allow for accountability. Transparency provide investors with the means to query and assess the actions of the board and its committees. Lack of accountability leads to frauds and mismanagement (Vian, 2020).

4. Strategy and Structure Signs

Organizational strategy is key in giving the strategic direction of a firm while the organizational structure holds the organization together in form of reporting relationships, power, authority and communication.

Ambitious Growth: Over ambitious growth prospects may lead to risks, which in turn leads to low sales poor cash flows and corporate failure.

Lack of or Poor Planning: Poor planning or lack of planning means the a firm has no path of engagement. This is disastrous as the firm banks on change and destiny instead of a well calculated path. Astitute firms need to plan about where they want to be, based on where they are then come up with a way path. For example poor strategy or poor strategy implementation may leave the organization at a worse state. In most cases, success can be achieved through complete implementation and operationalization of plans. Lack of planning denies firm any expected benefits of planning.

Poor Diversification and Over Diversification: Businesses often diversify their products and services to grow, but moving too far away from the core business, or overdiversification can increase costs, open up to new unnecessary competition, and cause a firm to lose competitive advantage. An overly diverse portfolio can be a sign of a struggling business.

Failed Turnaround: The objective of a turnaround is to take back the firm to revitalization, stability and prosperity. However, not every turn around strategy is successful. The results may be continued failure, terminal failure or a complete turnaround. A failed turn around is a key sign that the organization may be on its final spiral.

Strategy-Structure Fit: Several studies have indicated that some combinations of strategy and structure are associated with higher performance than are others. There is always an optimal point of strategy structure trade off. However, if that trade off is not realized, strategy structure fit fails and this can lead to corporate demise if not properly diagnosed in time and the corrective action taken. Poor strategy structure fit is a precursor of a corporate failure.

5. Marketing Based Signs

Organizations must sale to remain afloat as revenues are the live blood of firm operations

Loss of market share is a sign that everything is not alright. Mass exodus of customers leads to revenue hemorrhage that leads to failure. This may be caused by severe market share erosion,

Lack of or Poor Communication: Firms must be able to clearly communicate to the target market economically. The communication must define well the value proposition. What is the value a firm is providing to its customer? A good communication must be economic and effective as it must connect with the customers.

Overdependence on a single customer: If a firms biggest customer walked out the door and never returned, would that organization be ok? If that answer is no, then this is a sign of eminent corporate underperformance. When a key customer switches off, revenues may be badly affected and if not addressed in time, it may lead to corporate failure.

Poor Product, Service and Target Market: A target market must be courted with the right product and or service. Customers have needs to meet and they solve their needs by purchasing the right products that meet those needs. If products cant solve customer needs, customers switch off to competitive products. On the flip side, appealing to the wrong customers is a complete waste.

6. Human Resource Based Signs

Human resources contribute immensely in making sure all the factors of production are properly mixed to achieve optimal production.

Employees Turnover: The process of recruitment and selection is very expensive and time consuming. When employees don't stay, it's a big loss to organizations. High employee turnover is a sign that all is not well. Employees are always looking for greener pastures and when the slightest chance is available, chances are that they will leave. Turnover may be precipitated by poor future prospects from the eyes of the employees. Employee turnover scares the current employees, the employer, future employees and customers.

Toxic Work Environment: A healthy work environment should look and feel natural. Toxic work drain employees morale, commitment and productivity leading to firm losses. A toxic environment leads to a don't care attitude which negatively affects the returns of the organization. This leads to poor performance that can regenerate to corporate failure.

Lack of Trust Between Team Members: Building trust seems to be the most elusive ideal for teams but creating it could be the greatest source of competitive advantage. Where team members don't trust one another, communication, commitment becomes elusive. This in turn leads to poor goal achievement.

Poor Human Resource Policy: A poor or lack of human resource policy may lead to poor recruitment selection leading to less qualified or trained staff being engaged at the expense of qualified prospects. This in turn leads to poor decision making especially putting the firm into bad commitments. Poor human resource policy leads to poor staff structure that becomes a burden to the organization.

7. Technological Signs

With the advancement in the technology, new modes of doing business have been introduced, which are better than the traditional ones. If an industry fails to employ the latest information and production technology, then the chance of failure of the firm may increase. Choosing poor technology or not embracing new technology at all may lead to similar results-losing competitiveness thus corporate failure.

8. Calamities Signs

Calamities may include natural disasters, global warming, droughts, volcanic eruption accidents, pandemics which send shivers on the spines of organizations and thus may both directly or indirectly affect performance of firms. The table below 1 below shows the study by Ooghe & De Prijcker, (2007) and what they found out.

Factors Influencing Corporate Failure

Table 1: Ooghe and De Prijcker (2007) Immediate Factors of Business Failure

	Type 1	Type 2	Type 3	Type 4
	Failure process of an unsuccessful start-up	Failure process of an ambitious growth company	Failure process of a dazzled growth company	Failure process of an apathetic established company
Management				
Competencies and skills	Insufficient competencies and skills in many areas	Wrong estimation turnover Lack of financial background		
Motivation		Enduring motivation	Very motivated	Insufficient motivation and commitment
Personal characteristics	Rashness Authoritarian leadership	Persuasiveness Risk lovers Over-optimism	Over-optimism Dazzled	Inertia
Corporate policy				
Strategy	No strategic advantage			No adjustments to environment
Capital expenditures	Inappropriate	Exaggerated	Exaggerated	Unadjusted
Commercial policy	Lack of customers Customer dissatisfaction	Overestimated sales		Loss of customers Customer dissatisfaction
Finance and administration	Insufficient financial planning	Lack of expertise	Extreme gearing	
Operational policy	Severe operational errors		Unadjusted management and operational structure	Operational inefficiencies
Human resources management	Insufficient training Minor influence			
Corporate governance	Moderate influence			

The table below shows the paper summary of the proposed signs of corporate failure Kavale, 2022.

Table 2: Signs of Corporate Demise

Sign	Indicators	Proposed Effect (scale of 1-5)
Managerial & Leadership Signs	One person rule Unbalanced top team Lack of Experience Incompetence Lacking leadership Poor communication	3 3 4 4 3 2
Economic Signs	Bankruptcy Weak finances Inadequate financing Delayed financial commitments Delayed revenues Economic distress High debt levels	4 4 4 3 4 3 2
Corporate Signs	Poorly structured board Lack of discipline Lack of transparency and accountability	3 3 2
Strategy and Structure Signs	Ambitious growth Lack of or poor planning Failed turn around Strategy structure fit Poor product or service	2 3 3 3 4
Marketing Signs	Loss of market share Unresponsive niche Poor communication Overdependence on single customer	3 3 2 3
Human Resource Signs	Employee turnover Toxic work environment Poor human resource policy	4 3 3
Technology Signs	Poor technology No technology	2 2
Natural Calamities Signs	Earth quakes Pandemics Floods Accidents Volcanic Eruptions	2 2 2 2 2

Source: Kavale (2022) – from the above analysis

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