

Organizational Failure: Causes and Consequences

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Abstract

Organizations of all kinds encounter various problems and crises that lead them to fail and consequently to demise in one way or another. Undoubtedly, the phenomenon of organizational failure is ubiquitous in the realm of organizations. Most of failed organizations have vanished forever during the history, whereas a few of them have survived nevertheless. The author of the present paper presented a diagnostic model of failure elsewhere (Samuel, 2010:7). Based on literature review, this model specifies the underlying conditions upon which organizations are most likely to fail. In this sense, those conditions can be defined as antecedent variables affecting the life chances of organizations.

Classified in broad categories, organizational failure may occur as an outcome of external strikes (e.g. random shocks) or internal deficiencies (e.g. bad management). In many cases failure is an outcome of harmful combination of external and internal factors.

This paper unfolds the main components of those broad kinds of causes of failure; and it also delineates the probable kinds of consequences to the failing organizations.

Although failing organizations are most likely to die, not all of them do so. They may become stagnant, enter a long process of decline, encounter crisis, or suffer from pathological maladies such as politics, corruption, and crime. Yet, some failed organizations do survive for long periods of time as permanently failing organizations due to the support of certain public or private stakeholders.

Introduction

The term *organizational failure* used in this paper refers to a state of an organization's inability to adapt itself –both in terms of effectiveness and efficiency – to the conditions of its environment. “The notion of failure as “mal-adaptation” primarily means the inability of an organization to fit itself to the immediate environment or to the particular niche in which it exists and operates” (Samuel, 2010:130). Following Anheier and Moulton (1999), organizational failure does not necessarily mean a finite phenomenon.

“Symptoms of organizational failure include shrinking financial resources (Cameron, 1983), negative profitability (D’Aveni, 1989; Hambrick and D’Aveni, 1988), a loss of legitimacy (Benson, 1975), shrinking markets (Burt, et al., 2002; Jackson et al., 2005), and severe market erosion (Mellahi, et al., 2002; Starbuck, et al., 1978)” (Levinthal, 1997:934).

The essence of failure

Organizations are likely to fail because of damaging effects of their external or their internal conditions; frequently due to a harmful combination of both. Stated differently,

organizations actually fail whenever they do not respond properly to a set of challenges which need to be met. In such situations those organizations are likely to get caught in a state of disadvantage vis á vis threatening pressures that require them to change in certain ways. Since organizations are usually reluctant to change due to inertial forces, they are likely to encounter severe difficulties in their efforts to re-adapt once and again to their changing environments. Thus, it takes a severe crisis to conduct fundamental changes in order to survive. It is no wonder then that many organizations are not capable of conducting such changes. Consequently, they fall down in a spiral form of decline, sometimes leading to their end (Greenhalgh, 1983; Guy, 1989; Sutton, 2005; Weitzel & Jonsson, 1989; Hambrick & D'Aveni, 1989).

The phenomenon of failure is rather ubiquitous in the realm of organizations – in the private as well as in the public sectors. Thus, organizations of any kind, of any size, and in any context are susceptible to fail sooner or later. Therefore, the notion of failure is no less important than that of success. Yet, it seems that students of organizational studies show much greater interest in the study of organizational success than in the study of organizational failure. The main reason for ignoring this issue lies in the deep-rooted value of success in contemporary Western culture (e.g. Argenti, 1976; Whetten, 1980). Broadly stated, the 'sickness' and 'death' of organizations tends to be attributed to incompetent leadership and poor management. It is not surprising that nobody likes to be associated with failure. A popular proverb says: Success has many fathers, but failure is always an orphan” (Samuel, 2010:11).

Causes of Failure

Environmental Causes

Organizations of all kinds are embedded in their *task environments*, with which they continually exchange resources, products, and services. Some part of a task environment constitutes the specific niche in which a certain type of organizations specializes (e.g., fast food, life insurance, public transportation, higher education). “An *organizational niche*, then, contains a certain combination of various resources (e.g. raw materials, human resources) that carry those organizations and enable them to survive” (Samuel, 2010: 8). Organizations fail down, and probably demise, whenever their particular niche can no longer support them as in the past. The printed newspaper industry represents one example of organizational failure caused by ongoing depletion trend of its niche. No wonder then that more and more printed newspapers as well as magazines get closed all over the world nowadays.

The process of *niche erosion* refers to a set of environmental effects upon the life chances of organizations. Among such factors the following ones play a major role in the likelihood of failure among organizations.

(1) **Alternative Products:** The availability of products that serve the market as functionally equivalent to the previously exclusive or dominant ones; substituting the older ones in that particular niche. The plastic products of various kinds represent examples of alternative products to those of glass made ones.

(2) **Technological Innovations:** The rapid introduction of new products based on novel technologies creates growing demand for the new ones and consequently cause a shrinking demand for the old products. Computer laptops, cell phones, e-books, tablets, hybrid cars, and digital cameras are just a few examples of such innovative technologies, gradually taking over the “outmoded” ones (e.g. landline telephones, printed books, film cameras).

(3) **Change of Tastes and Habits:** People are accustomed to consume commodities of certain kinds that suit their habits and/or their individual tastes. Once their tastes or habits change, for whatever reason, they sooner or later they no longer consume the respective products. Change of fashion, of values, of eating habits, of smoking or drinking patterns – all of them and others likewise affect the usage of relevant products respectively. Tobaccos represent a good example of change of the widespread habit of smoking in the near past.

(4) **Fear of Health Hazards:** The more people get to know about possible side effects of various products – the greater their fear of such hazards and, consequently, their avoidance those products or services. For example, the fear of older women from consuming hormone pills regularly; the reluctance of to eat genetic "engineered" fresh produce; the fear of damages caused by electromagnetic radiation from antennas are just a few concerns leading to diminish their regular usage of such and similar products.

(5) **Niche Saturation.** Whenever the demand for some product(s) increases, more and more suppliers compete one another in that particular niche up to a point of saturation, which inevitably leads to niche erosion, where most competitors tend to fail and perish (Hannan & Freeman, 1989).

The idea of niche erosion, then, refers to various processes of decline in the external task environment of certain organizations, which impinge upon the chances of failure among those organizations. It seems in order to mention here that niche erosion is a phenomenon that is not exclusive to for-profit enterprises in the business sector. Not-for-profit organizations in the public sector (e.g. schools, hospitals, museums, and labor unions) are not immune in this sense and might fail for the same reasons (Hannan, Carroll, & Polos, 2003).

Another source of external factors affecting the wellbeing of organizations is referred here as the *general environment* (Daft, 2004). This term refers to a remote set of forces that affect organizations rather indirectly but by no means less forceful than the task environments. As a matter of fact such effects upon organizations are frequently devastating in nature. The general environment, then, consists of both natural forces (e.g. climate) as well as man-made institutes of power (e.g. governmental agencies). Elements of the general environment strike organizations in a form of random shocks. Let's briefly consider some of them here.

(1) **Financial or Economic Crisis.** The abruptness of a crisis most likely to inflict severe impact upon certain kinds of organizations such as banking houses, investment corporates, insurance firms or stock market brokerages. The financial crisis of 2008 in the United States with its spillover to other countries is a recent example of such a "random shock". In Spain thousands food supplying and serving enterprises (e.g. restaurants, caterers, coffee shops, bakeries, etc.) were compelled to close their businesses. Others discharged much of their labor force as well closed some of their product lines.

(2) **Change of Political Power.** A political revolution, uprising of civilians, coup d'état, massive demonstrations and the like lead to a change in the power of certain state or country. As a result, more than just a few organizations do fail, rapidly decline or simply disintegrate due to their incompatibility with the new regime. For many business enterprises the shock is too strong to withstand intact. This is the present situation in some Arab countries such as Libya, Egypt, and Syria where numerous businesses were simply destroyed.

(3) **Devastating Terror or War.** Terrorist acts strike often as random shocks, bringing about disastrous losses to both private firms and public institutes in specific industries such as tourism, transportation, and entertainment that can barely recover. The United States, Russia, United Kingdom, India, and Israel represent a few countries in which have been suffered from such terrorists' acts over and over. Needless to say, full scale wars, like the recent ones in Iraq

and Afghanistan, prove to have destructive effects upon a wide range of organizations operating in those countries as well as in others involved (e.g. multinationals).

(4) **Nature's Disasters.** Hurricanes, tsunamis, tornados, earth quacks, floods and fires, and irruption of volcanoes are major disasters that bring about devastating effects on various kinds of organizations. The huge earth quack in Eastern Turkey in 1999, the Indian Ocean tsunami in South Asia in 2004, the Hurricane Katrina in New Orleans in 2005, and the storm Sandy that hit hard New York and New Jersey in 2012 are some well known events of nature's disasters around the world that caused devastating damages. Pending on the kind of the disaster and its location, it most likely leads to organizational failures in certain industries (e.g. shipyards).

Organizational Deficiencies

At least four types of organizational deficiencies serve as sources of internal stress, which eventually cause them to fail. (a) *Structural misfit.* This kind of deficiency is represented by outmoded structure or by inappropriate structural configuration that does not fit the nature of the task environment with which the organization works. A simple functional structure designed to cope with the complexities of a global market is an example of such misfit. (b) *Human resource mismatch.* This kind of deficiency is typical to organizations that for whatever reasons employ a considerable rate of their manpower that lacks the knowhow or necessary skill to do the required job properly. Nepotism is a well-known example of this kind of deficiency. (c) *Stagnating culture.* In times of rapid and multiple changes, like the present time, an organization that adheres to old values and outdated social norms tends to stagnate. In fact, conservative culture indicates mal-adaptation to current values and norms of society. Thus, an ongoing resistance to change and surrender to inertial forces are typical symptoms of stagnation. Such organizations are most likely to fail and eventually to perish. (d) *Incompetent management.* Bad management is considered by scholars and practitioners to be a major cause of failure in the realm of organizations.

“Bad management means unrealistic strategy, improper decisions, and poor responsiveness to the changing conditions of the organization's external environment. This so-called ‘bad management’ creates serious deficiencies in the organization, adversely affecting its performance and eventually dragging it down to the terminal condition of bankruptcy” (Samuel, 2010:31).

Pathological Processes

In addition to the above mentioned causes of failure, organizations are apt to be affected by one or more harmful phenomena that any of them is likely to pull them to a state of failure. Such phenomena may be deeply rooted in some organizations; hence they are identified here as *organizational pathologies.*

Inherent Corruption. This is the first pathology to be briefly addressed here. This term refers to a state of affairs by which executives, managers and/or lower-level employees are involved with some illegal acts that enable them to gain certain benefits that they are not eligible to get. Benefits such as extra income, employment, promotion, and classified information represent just a few kinds of corruption. Corruption is considered to be inherent whenever it becomes a permissible pattern of behavior among members of an organization. The intake of bribery as a condition for doing whatever business serves a good example of such a corruption. Favoritism shown to relatives by securing them vacant jobs (i.e. nepotism) is another example of inherent corruption. Sexual abuse of employees by their managers is merely an illegal and immoral act of coercion that represents another form of corruption in organizations.

Divisive Politics. Another kind of pathology takes place in many organizations. This term refers here to organizational politics characterized by ongoing power struggles between groups of rivals inside the organization. In this kind of politics a group of opponent members attempts once and again to nullify the power, authority and/or the privileges of the ruling coalition; usually for the purpose of replacing the other group as the dominant one (Mintzberg, 1983). Divisive politics gradually tears apart the internal cohesion of the organization; it gradually drags it down to failure and eventually leads to its disintegration.

Corporate Crime. A third type of pathology takes the form of unlawful acts performed by organizations (Clinard & Yeager, 2006). Corporate crime is essentially misconduct, secretly done by executives and their accomplices for the purpose of enhancing the status of the organization and increasing its profits. Corporate crime takes a variety of forms such as falsified display of the corporate assets and profits to the public; violation of rules and regulations; mistreatment of the environment; abuse of labor rights and exploitation of needy immigrants; manufacturing and marketing of unsafe merchandizes; and unfair trade practices intended to reduce free and honest competition (Samuel, 2010). Such crimes eventually bring about the organization to a state of failure, which may finally lead it to its dissolution. Therefore, corporate crime in the realm of organizations is like a "malignant malady" in the realm of organisms; namely, it is pathological misbehavior of people for attaining unjust benefits to the organization.

Organizational Stagnation. This notion refers to senior executives' strategy known as "laissez-faire"; that is, their consistent refusal to initiate changes in their organization. Such a conservative approach develops a pathological situation that goes on for a long time due to the effect of inertial forces like protection of past investments, leaning on prior successor observance of other fixations alike. In the era of rapid changes worldwide it prevents that organization to adapt itself to new ways of doing business or rendering services to the public. Organizations under long time stagnation eventually lag behind competitors and they are likely to lose their clientele as well. This process of stagnation together with its side effects surely leads to organizations to a state of failure, in some cases even to their death.

Consequences of Failure

Organizational failure is most likely to bring about some consequences to the failing organization. Some of such consequences are either unanticipated and/or undesirable ones. In this section a few of them are briefly addressed.

(1) **Life-threatening Disaster.** One form of such calamity is a process in which the failed organization encounters a deep crisis that it cannot handle. Consequently, it starts to fall apart in such a way that some divisions or other sub-units become independent mini-organizations, separated from their parent organization. Needless to say, such a centrifugal trend, mainly by the better parts, endangers the organization's chances to survive. The likelihood of this consequence is rather high in the world of business, but also among political parties, trade unions as well as voluntary associations.

(2) **Organizational Crash.** Failure may be a catastrophe to some organizations to such an extent that they simply cannot withstand it. In the eyes of those beholders (e.g. share holders, executives, owners) a failure is merely a signal of the end of the organization. Under such and similar circumstances the failing organization is most likely to be crashed right away. Indeed, many business corporations were crashed in just a short time when the financial crisis broke out in the New York Stock exchange in 2008.

(3) **Organizational Decline.** This is probably one of the most common consequences of organizations' failure. Some failing organizations neither collapse immediately nor fall apart in response to their failure. Instead, they get caught up in a process of decline that it may roll on for quite a long period of time. Declining organizations frequently struggle their way up to restore their regular way of doing "business as usual." However, climbing up is rather a difficult, painful and complex effort, which hinders quite a few organizations to complete such a reversal trend (Samuel, 2010). Those organizations keep going down, reach the point of no return and eventually debase.

(4) **Permanent Failure.** Some organizations suffer from a continuous failure, even though they remain alive and active. Admittedly, *permanently failing organizations* represents quite an exceptional phenomenon, mainly in the world of business. However, it is not so exceptional among organizations in the public sector. According to Meyer & Zucker (1989:45), "permanent failure sets in when there is little expectation that efficient and effective conduct will be restored or (to use a different language) that recuperation will take place, yet there is little disruption of existing organizational pattern" (Ibid). Some public hospitals, public colleges, state-owned defense industries, public transportation companies, cultural institutes and the like represent a various kinds of public endeavors that are economically inefficient and, in fact, are permanently failing ones. They keep alive due to the support of the government, the public, philanthropic funds and/or other sources that maintain them alive.

(5) **Disbandment and closure.** Failing organizations may reach their end as a result of deliberate decision of their owners' or governors to shut them down and terminate their activities for good. This is just "natural" consequence of failing organizations, which actually no longer serve their clientele or they continue to "bleed", namely, to accumulate financial losses. Organizations on the verge of desistance are subject to disbandment, including labor dismissal, closure of divisions and other units, forsake of their clients, discard of their inventories, and disclamation of their assets (Sutton, 1987). In the realm of business organizations, bankruptcy of failing enterprises serves as an example of a final process of *disbandment and closure* that is conducted under decree of the court of justice.

Turnaround: From Failure To Success

As already mentioned, failing organizations are doomed to die in most of the cases. Yet, in reality quite a few of them not only survive, but succeed to climb up once again towards better state than they had been in the past. Such changeover is made possible whenever a failing organization makes the correct steps that are essential to recover from its malaise. Let us briefly consider them here.

Buffering: Apparently the first necessary act is to apply a mechanism that can contain the grave situation and moderate its side effects. In the realm of organizations, one kind of such a buffering mechanism is the so-called the *Crisis Management Program (CMP)*. A well planned CMP, prepared in advance, is probably the best means of handling organizational problems like crisis, decline, or failure.

Turnover: Organizational failure of any kind is at least to some extent an outcome of bad management. Therefore, an organization that learned the lessons of its failure tends to lean on a different management with a new type of leadership. It is no wonder then that Board of Directors of failing organizations prefer to replace the top executives (e.g. the CEO, the VPs) by new ones.

Reorientation: The idea of turnaround of a declining organization requires the initiation of a new vision and the setting of a new strategy. This is the task of the top management

in general and of the CEO in particular. In order to renew failing organizations it is necessary to have a crystal clear direction for the organization where to go and how to get there.

Transformation: Pending on the depth of failure, in at least some failing organizations, it is necessary to redesign their structure and function (e.g. re-engineering). For instance, many of those organizations choose to do an extensive downsizing in a way of shrinkage of their manpower and closure of various units or product lines; other ones change their main business such as to conduct a shift from manufacturing to trade or vice versa.

Focus: It is quite common stance among managers and consultants that to get back to normal business it is necessary to focus on a specific product, on a particular market niche or on a certain type of technology. The idea is to improve the organization's performance by way of concentrating on its core competencies and to get rid of marginal activities such as by opting for outsourcing.

Conclusion

The phenomenon of organizational failure has been ubiquitous throughout the world of organizations, from its early stages in the history up to the present time. As a matter of fact, organizations, like all other systems, pass away eventually; most of them due to a fatal failure of one kind or another. Nonetheless, this phenomenon has not been scholarly studied as much as it should have been by students of organizations. This is because of the common admiration of the dominating ethos of success in the modern North American society.

No wonder, neither the few theorizing attempts nor the scanty empirical studies of this issue have not produced yet a comprehensive theory of failure that accounts for its causes and consequences.

The diagnostic model discussed in this paper suggests that failure is most likely to occur in organizations that are inflicted by some external forces or caused by some internal deficiencies, occasionally by a combination of both at the same time. The external sources of failure are of two main kinds: sudden "random shocks" and gradual "erosion of niches." On the other hand, failure is due to unfit structure, culture, behavior, or the manpower of an organization.

Organizational failure is rather a grave situation that may affect the life chances of a given organization. Indeed, the consequences of failure are likely to prove fatal, but not inevitable. Some failing organizations manage to handle their grave situation properly by means of clever strategies and/or by means of correct actions, as specified in this paper. In many cases those remedies are painful and costly for organizations suffering from highly stressful situations due to their failure. However, a successful process of turnaround involves a great deal of effort, risk, and resourcefulness. Thus, this is life or death type sort of gambling.

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