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Why Companies Fail

Introduction
CEOs offer every excuse but the right one:
Their own errors. Here are ten mistakes to avoid.

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How many more must fall? Each month seems to bring the sound of another giant crashing to earth. Enron. WorldCom. Global Crossing. Kmart. Polaroid. Arthur Andersen. Xerox. Qwest. They fall singly. They fall in groups. They fall with the heavy thud of employees laid off, families hurt, shareholders furious. How many? Too many; 257 public companies with $258 billion in assets declared bankruptcy last year, shattering the previous year's record of 176 companies and $95 billion. This year is on pace, with 67 companies going bust during the first quarter. And not just any companies. Big, important, FORTUNE 500 companies that aren't supposed to collapse. If things keep going like this, we may have trouble filling next year's list.

Why do companies fail? Their CEOs offer every excuse in the book: a bad economy, market turbulence, a weak yen, hundred-year floods, perfect storms, competitive subterfuge--forces, that is, very much outside their control. In a few cases, such as the airlines' post-Sept. 11 problems, the excuses even ring true. But a close study of corporate failure suggests that, acts of God aside, most companies founder for one simple reason: managerial error.

We'll get to the errors in a moment. But first let's acknowledge that, yes, failures usually involve factors unique to a company's own industry or culture. As Tolstoy said of families, all happy companies are alike; every unhappy company is unhappy in its own way.

Companies even collapse in their own way. Some go out in blinding supernovas (Enron). Others linger like white dwarfs (AT&T). Still others fizzle out over decades (Polaroid). Failure is part of the natural cycle of business. Companies are born, companies die, capitalism moves forward. Creative destruction, they call it.

It was roughly this sentiment that Treasury Secretary Paul O'Neill was trying to convey when he said that Enron's failure was "part of the genius of capitalism." But aside from sounding insensitive, O'Neill got one thing wrong. Capitalism's true genius is to weed out companies that no longer serve a useful purpose. The dot-coms, for instance, were experiments in whether certain businesses were even viable. We found out: They weren't. Yet many recent debacles were of companies that could have lived long, productive lives with more enlightened management--in other words, good companies struck down for bad reasons. By these lights, Arthur Andersen's fall is no more part of the "genius of capitalism" than the terrorism on Sept. 11 was part of the "genius of evolution."

By "failure," we don't necessarily mean bankruptcy. A dramatic fall from grace qualifies too. In the most recent bear market, for instance, 26 of America's 100 largest companies lost at least two-thirds of their market value, including such blue chips as Hewlett-Packard, Charles Schwab, Cisco, AT&T, AOL Time Warner, and Gap. In the 1990 bear market, by contrast, none did, according to money management firm Aronson & Partners.

The sheer speed of these falls has been unnerving. Companies that were healthy just moments ago, it seems, are suddenly at death's door. But this impression may be misleading. Consider, for instance, a certain Houston institution we've heard so much about. There was no one moment when its managers sat down and conspired to commit wrongdoing. Rather, the disaster occurred because of what one analyst calls "an incremental descent into poor judgment." A "success-oriented" culture, mind-numbing complexity, and unrealistic performance goals all mixed until the violation of standards became the standard. Nothing looked amiss from the outside until, boom, it was all over.

It sounds a lot like Enron, but the description actually refers to NASA in 1986, the year of the space shuttle Challenger explosion. We pull this switch not to conflate the two episodes--one, after all, involved the death of seven astronauts--but to make a point about failures: Even the most dramatic tend to be years in the making. At NASA, engineers noticed damage to the crucial O-rings on previous shuttle flights yet repeatedly convinced themselves the damage was acceptable. Companies fail the way Ernest Hemingway wrote about going broke in The Sun Also Rises: gradually, and then suddenly. (For some solutions, see Three Quick Fixes.)

What undoes them is the familiar stuff of human folly: denial, hubris, ego, wishful thinking, poor communication, lax oversight, greed, deceit, and other Behind the Music plot conventions. It all adds up to a failure to execute. This is not an exhaustive list of corporate sins. But chances are your company is committing one of them right now.

Ten big mistakes

	Slave to Wall Street	See no evil	Overdosing on risk	Dsyfuncitonal board	Softened by success	Strategy du jour	Acquisition Lust	Fearing the boss	Dangerous culture	Death spiral
◆ Enron	●	●	●	●	●			●	●	●
Arthur Anderson		●	●						●	●
◆ Global Crossing	●	●	●	●						
Lucent	●		●	●	●					
◆ Warnaco	●	●		●				●		
◆ Kmart		●		●		●				
Providian	●		●		●					
◆ Sunbeam	●	●						●		
Tyco	●					●	●			
WorldCom			●		●		●			
Xerox	●	●		●						
AT&T						●	●			
◆ Polaroid		●			●					
Qwest	●		●							

◆ Filed for bankruptcy.

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