AVOIDING THE CORPORATE DEATH SPIRAL:
RECOGNIZING & ELIMINATING THE WARNING SIGNS OF DECLINE[1]

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INTRODUCTION

There are no promises. 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. The newspapers continue to report about large, well known companies that at one time were extremely successful, falling apart seemingly overnight.

In reality, the decline of an organization is a process that takes many years and is difficult to connect to any one action, decision or event. By the time it becomes obvious the organization is in trouble, leaders often shift into crisis-mode and implement drastic actions to improve the situation that, although well-intentioned, actually result in speeding up the rate of decline.

It is the beliefs and operating philosophy of the leaders of an organization which guide the strategies, decisions, and actions that ultimately determines the level of success that will be achieved today and into the future. The philosophy governing many organizations today is unfortunately leading them into a death spiral that will be difficult to escape. The high number of layoffs, bankruptcy filings, lawsuits, and budget cutbacks, along with the continually shrinking tenures of CEOs all point to a bleak future. The reason that we are not in a full-fledged crisis and complete economic collapse is that so many companies are caught in the same spiral. If a company with serious problems has competitors with serious problems, it is not very likely that people will notice or be overly concerned with improvement.

WHAT'S THE PROBLEM?

It is not difficult to identify the companies that are caught in a death spiral. Declining profits, shrinking market share, mass layoffs and plant closings are the most obvious signs. The list of companies that are spiraling downward include some of the "perennial giants" that, at one time, appeared highly successful and unstoppable.

When a company begins to decline, executives and analysts often blame the troubles on the economy, market conditions, political situation, and a host of other external forces. Although these forces obviously have an effect on the success of a company, this does not explain why other organizations in the same industries and facing the same conditions seem to remain successful. Companies like Toyota, Southwest Airlines, Hillerich & Bradsby, and Nucor Steel are well-known for their approaches to business and being enormously successful in industries previously controlled by the perennial giants.

These companies are governed by a philosophy that focuses on people – not spreadsheets, machines or technology – to improve their ability to withstand external pressures. As an example of this focus, none of the aforementioned companies have a history of laying off workers during troubled times. By comparison, many competitors of these organizations resort to redundancies on a regular basis in response to shrinking sales revenues and profits. The focus on people is one of the reasons that these organizations grow during strong economic times and continue to remain profitable during a weak economy, while many of their competitors proceed to spiral downward into oblivion.

ENTERING A DEATH SPIRAL

Entering the corporate death spiral is a two-stage process. The first stage includes a weakening of the organization through a number of management practices. One example of this is a control cycle that breaks down the motivation of workers.

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[1] The information in paper is the subject of the book, Avoiding the Corporate Death Spiral: Recognizing & Eliminating the Signs of Decline by Gregg Stocker (Quality Press, Milwaukee, WI USA, 2006).

A person generally joins a company highly motivated and ready to contribute to the company's success. It often doesn't take long, however, for the person's motivation to begin to erode under the pressure of the policies, behaviors, and actions (or inactions) of management that result from a lack of trust in the ability and motives of workers.

The decreased motivation of the new worker (along with continued de-motivation of the existing workers) often becomes evident in the quality of work performed or in the lack of initiative to take on new projects or go beyond the expectations of management. Recognizing this, management strengthens its perception that workers are not intrinsically motivated, are lazy, and are incapable of working without direction. Managers and supervisors focus heavily on "worker performance" and can cite several examples supporting their belief that workers only respond to extrinsic motivators (positive and negative) like money, threats, and punishment, which in turn, strengthens the case for tighter controls.

What managers do not understand, however, is that they are directly responsible for creating this situation. Their philosophy regarding the need to closely manage and monitor workers had become a self-fulfilling prophecy. The people in the company now need tighter controls and clearer direction because of the barriers that management built that interfere with intrinsic motivation and the ability to take pride in work.

WEAKENING THE IMMUNE SYSTEM

The control cycle repeats itself and gradually weakens the organization's ability to withstand external pressures. If the market for the company's products and services is strong, the weakened immune system may not be immediately evident to the organization's management team. It is conceivable (and has been proven many times throughout history) that a immune-deficient company can remain profitable for a given period of time thereby creating a false sense of security for managers and stockholders.

The problem occurs when one or more external events begin to hurt the company's sales revenues. These events could include a weakening economy, a new competitor or competitive technology, a change in political situation, or a host of other situations. Once one of more external events occurs, sales revenues begin to slide, disease sets in and managers begin to shift into crisis-mode thereby beginning the death spiral (Figure 1).

Figure 3 presents the death spiral that results from a weakened immune system and crisis-mode management. When a drop in sales leads to declining profits, managers begin to take actions to reduce expenses to restore the company to profitability. A usual first step in this process includes reducing or eliminating the expenses that don't lead to immediate and measurable results. Included in this first stage of cost cutting are often expenditures for training and development of people, and many longer-term product and/or service development projects.

If the immediate cost-cutting actions do not result in increasing profitability, the next step often includes pressuring suppliers for reductions in price or lengthening of payment terms for purchased products and services. When this occurs, the quality of incoming materials and services tends to fall and leadtimes from suppliers increases. As a result, the reduction in the cost of incoming materials and services shows up as a cost increase in other areas of the company and the net effect is either no change in profitability or, most likely, a further decline in profits.

Eventually, the situation for the company worsens until employee layoffs are implemented (although in many organizations, layoffs tend to be the first step to address weakening profitability). Layoffs are always followed by a drop in morale among remaining employees which shows up in productivity and dealings with customers. This, along with the fact that the remaining employees are often not able to effectively keep up with customer demands, leads to decreased customer satisfaction and a further decline in sales revenues.

Equipment and machine preventive maintenance is also reduced (or eliminated) because of budget cutbacks, reduced resources, and a lack of interest by workers caused by reduced morale. As a result, machine and equipment breakdowns increase and the level of quality is reduced. Lower quality levels enable the decline in sales and profits to continue, and the cycle starts all over again.

This death spiral continues until the culture is so sick that changing and improving the environment becomes a monumental task appearing to be insurmountable. If the spiral continues for several years, the problems can become so deeply-rooted that real improvement cannot occur without a fundamental change in the philosophy of the organization's leadership and a carefully planned strategy that shifts the organization from tight controls to an open, improvement-focused culture.

A *fundamental* change in philosophy refers to a shift in deeply held beliefs about people, business, and society. The shift can occur in response to a single event or series of events that causes a person to evaluate and reflect on his or her role in the world. For some people, the shift never takes place. Others may desire to make a change, but lack an understanding of what it takes to make a change. The leader must feel strongly enough about the need to change to continually evaluate his or her own personal actions and behaviors. If it is a crisis that leads to a desire to change, the desire must be strong enough to continue on after the immediate crisis has passed. Without this level of change the organization's systems and overall approach will not change and sustained improvement will not take place.

Figure 1(b)
The Corporate Death Spiral

This is one of the biggest reasons for the failure of improvement initiatives like *6 sigma* or *lean manufacturing* to achieve large-scale sustained improvement. These initiatives require a supportive culture that continually breaks down the barriers to improvement. Managers of those companies in the midst of a death spiral do not understand the importance of these elements and tend to focus only on the technical aspects of improvement initiatives. As a result, attempts to improve fail because the culture is too weak to support the process.

Improving the cultural health of an organization is similar to improving the physical health of an individual. A person in declining health attempting an exercise program while continuing to smoke, eat the wrong foods, and maintain a stressful lifestyle will not significantly change his or her health. On the other hand, the person who understands the links between diet, exercise and stress, and fundamentally changes his or her lifestyle to improve overall health has a much better chance of success.

THE WARNING SIGNS

The obvious signs of declining organizational health include drops in sales, profits and market share. Unfortunately, these signs don't usually appear until the death spiral has already begun and disease has set in thereby making improvement much more difficult. The key to success is to avoid the death spiral by understanding and resolving the issues before the obvious signs appear.

Fortunately, there are several warning signs that identify an impending corporate death spiral. The warning signs bring to light the practices that weaken the organization's immune system and lead a company into decline before significant damage becomes obvious. The longer these signs are allowed to continue, the more deeply-rooted the problems become and the more difficult it will be to pull out of the spiral.

The warning signs of declining organizational health are as follows:

1. Lost Focus: The people in the organization do not know why the company is in business and what they are attempting to accomplish usually resulting in a focus that is solely on personal definitions of success (which are often financially focused and severely conflict with each other).

   This is identified by a number of behaviors including more focus on profitability than customers, heavy focus on products instead of the value the products provide, and regular changes in direction by management;

2. Number Obsession: The leaders are heavily focused on financial indicators, and pay very little attention to the non-measurable aspects of the business (e.g., morale, culture, leadership development, etc.) that greatly affect the financial performance.

   Management meetings that start with, or focus heavily on financial measures instead of quality or customers is a fairly clear message that number obsession is prevalent;

3. Supplier Squeezing: Management considers the role of purchasing to be one of pressuring suppliers to reduce the price of incoming products and services, instead of developing long-term relationships with suppliers to continually improve quality, cost, and delivery.

   Continual attempts to extend payment terms with suppliers, as well as forcing suppliers to reduce the price of purchased products are signs that supplier squeezing occurs. High supplier turnover and poor quality incoming material are other symptoms of supplier squeezing;

4. Undervalued Employees: The leaders do not place a high value on employees. Layoffs are common, fear is prevalent, and there is very little leadership development within the organization. Attempts are made to measure employee performance without taking into account non-measurable contributions;

5. Dirt, Clutter & Damage: The workplace is dirty and unorganized, and buildings, property and equipment are not well maintained. Letting equipment and other assets deteriorate leads to poor quality products and services, as well as increased costs;

6. Operational Fragmentation: The level of teamwork is low and the company operates as a fragmented group of departments and people instead of as a single system working together to accomplish a common objective.

Leading a company out of a death spiral is a difficult task. The ability to reflect and openly discuss how actions and current systems may have led to the decline is absolutely necessary. Also required is an understanding that many commonly accepted business practices are contributing to the decline. This most likely requires moving out of a comfort zone and changing the systems and practices that are preventing the people in the company from achieving their full potential (as an example, throwing out traditional performance review systems and replacing them with something that helps people develop, grow, and contribute to the organization's success).

CONCLUSION

It is the responsibility of management to create organizations where people can have fun and take pride in the work they do. History has shown that satisfied employees lead to satisfied customers which, in turn leads to strong financial performance (and satisfied shareholders). To create an environment where people enjoy their jobs and are able to continually improve processes, however, requires a method to identify and remove the barriers to long-term success.

By continually working to understand the existence and extent of the warning signs within an organization, its leaders will be better able to focus on those systems and practices that interfere with sustainable improvement and success. Improvement initiatives like lean manufacturing and 6σ will not result in significant improvement unless they are implemented in an environment of trust where people can take pride in their work and are always looking for better ways of doing things.

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