Why corporations fail: An exploration & theory on the recurring themes in corporate failure

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Declaration

I hereby certify that this dissertation, which I now submit in part fulfillment of the requirements for an award of the degree Master of Science in International Accounting & Finance at Dublin Business School, is entirely my work and has not been taken from the work of others, save and to the extent that such work has been cited and acknowledged within the text of our work. Furthermore, I certify that no part of this work will, in the future be used in a submission in my name, for any other degree or diploma in any university or other tertiary institutions without the prior approval of the Dublin Business School.

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List of Abbreviations

ACCA: Association of Chartered Certified Accountants
AIG: American International Group
Anglo: Anglo-Irish Bank
BBC: British Broadcasting Corporation
BE: Bank of England
BPM: Bankruptcy Prediction Model
CB: Central Bank
CD’S: Credit Default Swaps
CDO: Collateralized Debt Obligations
CEO: Chief Executive Officer
CF: Corporate Failure
CFD: Contract for difference
CFO: Chief Financial Officer
CG: Corporate Governance
CS: Corporate Survival
DOF: Department of Finance
DJIA: Dow Jones Industrial Index
EBITA: Earnings before interest, tax and amortization
EY: Ernst & Young
Fannie Mae: Federal National Mortgage Association
FASB: Financial Accounting Standards Board
FCIC: Financial Crisis Inquiry Commission
SFA: Statement of Financial Accounting Standards

SME: Small & Medium Sized Enterprises

SPE: Special Purpose Entities

SSC: South-Sea Company

SUV: Sport Utility Vehicle

TARP: Troubled Asset Relief Program

VOC: Vereenigde Oost-indische Compagnie (Dutch East India Company)
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Abstract

This research closes a gap in literature, by exploring the causes of corporate-failure (CF) in order to make an induction as to the recurring themes in CF.

The questions to be answered by the research includes:

1. What are the causes of corporate failure?
2. Do the causes of failures vary by time or industry?
3. Who is to blame?
4. Are failures of any economic benefit? (The debate on bailouts)

The research topic and questions are important because of the ripple effect of failures on economies and the society, in addition to the fact the rate of failures increased following the financial crisis.

The literature-review adopts a top-down approach, through a broad and in-depth look at literature, thereby examining what caused the downfall of The Medici-Bank, The South-Sea Company, The Mississippi-Company, Enron, Arthur-Andersen and Lehman-Brothers. Furthermore the bankruptcy of General-Motors is examined, in addition to themes that could have led to failure at Goldman-Sachs and Ernst & Young.

A post-positivist and interpretative philosophy is applied in the conducting primary research as they permitted flexibility & favoured the qualitative nature of the investigation. Therefore purposive-sampling was used in data collection in an interview with experts in the field of bankruptcies and liquidations.

The findings & discussion indicate that a lack of liquidity, bad-management, rapid-expansion, externalities, fraud and the economic cycle are all causes & recurrent themes in failures. Moreover, it indicates that the causes of failures do vary to a degree by time and by industry and that ultimately directors are to be blamed for CF, with the government having some blame where there is a change in policy. Furthermore, there are some benefits to CF. Nevertheless, governments should only bail-out economic critical companies.

In conclusion, ultimately human nature is to blame for the causes of CF.

Keywords: Corporate Failure, Failure, Corporations, Companies, Bankruptcy
Chapter 1: Introduction
1. Introduction

The issue of corporate failure (CF) became prominent yet again, following the financial crisis of 2007-2008, caused primarily by risky-investments made in the belief of a continuous appreciation in home-values, due to decades of low-interest rates & the era of light-touch regulation\(^1\) (Deregulation & free-markets). Furthermore, the collapse of Lehman-Brothers; a large investment bank was adjudged to be the catalyst for the financial-crisis, thus further igniting the researcher’s resolve to explore the issue. The collapse of Lehman’s has been described as the largest bankruptcy in the world, it was a bankruptcy ten times bigger than that of Enron and it rattled the global and domestic markets in the midst of an economic recession (M. A. Johnson & A. Mamun 2012)\(^2\). Consequently it is included in the literature-review when looking at the causes of failure in an attempt to answer the research question.

1.1 The Research Question

The research question is focused on why corporations fail, particularly the recurring themes from failures. This question is important as the total-assets of companies filing for bankruptcy in the U.S was at $1.159billion in 2008 (Kalwarski T, 2009)\(^3\). In addition big-businesses in Ireland that went burst in 2010 were five times greater than was seen at the peak of the Celtic-Tiger\(^4\) (O’Carroll L, 2011)\(^5\), with a huge-amount of failures concentrated in the construction-sector. Furthermore, in Lithuania alone the slowdown of the economy amplified the rate of bankruptcies to about 34% in the first half of 2008 (Silvanaviciûtè, S 2008)\(^6\).

\(^4\) Metaphor for the Irish economic growth.
Therefore, given the financial crisis of 2008, the globalization of the world economies and the ripple effect of corporate failures on economies & the society, the need to investigate the recurring themes is vital. (Azkunaga J, San-Jose L, Urionabarrenetxea S, 2013). Consequently, the research will ask the following questions through primary data collection and thus induct on the recurring them in CF.

1. What are the causes of corporate failure?
2. Do the causes of failures vary by time or industry?
3. Who is to blame?
4. Are failures of any economic benefit? (The debate on bail-outs)

1.2 Aim & rationale for this research

The aim of this research is explore the causes & recurring themes in failure through the collection of primary & secondary data. Furthermore, themes such as greed, corruption, corporate governance failures and the role of the economic-cycles in CF will be investigated by

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this research. Moreover, the rationale for this research stems from the need to curb future corporate-failures.

1.3 New & Relevant Research

As at 1988 an integrated theory of corporate-failures was non-existent. Hambrick & D’Aveni noted that the focus was on small business failures and public sector failures, with the existing literature being mainly qualitative (Daughen and Binzen, 1971; Richards, 1973; Starbuck, Greve, and Hedberg, 1978 cited in Hambrick). The quantitative aspects focused only on financial-ratios (Altman 1968)\(^9\), with the only work carried to contrast the above being that of Miller and Friesen's (1977) to point out the characteristics of large unsuccessful and the more successful firms. The shortcoming of Miller et al 1977 was that their project did not consist of firms who experienced complete failures\(^{10}\). (Hambrick, D, & D'Aveni, R 1988)

As a result, this research closes the gap in literature by exploring the causes of CF in order to make an induction about the recurring themes in CF through a combination of circumstances where there was complete failure and some circumstances were failure could have resulted. Consequently, the relevance of this approach, will be to update the existing literature and put the different aspects together under one piece of work. Something of this ilk has not yet being done by previous researchers based on the literature-review. Consequently, the findings & results of this research would be of practical benefit to academics and students seeking to further investigate the subject matter of CF.

1.4 Approach to the research

The research adopts a top-down approach to the literature-review, thus allowing for the understanding and identification of the relevant themes in corporate-failures. Furthermore, it assists in developing a framework for questioning via semi-structured interviews. The research is approached using both primary and secondary research methods. The interviews provide a

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primary qualitative insight into the issue through the perspectives of experts in the legal, bankruptcy & insolvency industries. Secondary research-methods enable data collection through a look at the previous cases of failures, newspaper articles, case-studies, reports, peer-reviewed journals etc. The justification for the research approach adopted will be discussed in greater depth in the research methodology [See Chapter 3]. The final objective will be to identify the contributions of this research to literature and recommendations for future research (Williams K, Pg. 68 2013)\textsuperscript{11}.

1.5 Learning Style & Suitability of the Researcher

The learning style of the researcher follows a methodical & logical approach, going through a step by step process. It is theoretical, involving reading and gathering information from various sources in order to get a broad view of a subject matter. This learning style is appropriate as this research requires sufficient knowledge of the various themes, models & theories pertaining to CF, generalizations about complex issues, including making necessary inductions.

The researcher is a Master’s in Accounting & Finance student who has completed all taught components of his degree with distinction. He holds an undergraduate degree [BA. (Hons) in Accounting & Finance] from Dublin City University with a significant specialism in accounting and will be entering the world of corporate audits and the financial services on completion of this research. The researcher has studied Corporate-Governance (CG), Quantitative-Methods and attended qualitative and quantitative analysis workshops during his studies, including the use of NVivo\textsuperscript{TM}; a qualitative analysis software and SPSS; a statistical software for quantitative data analysis. This avoids the researcher the flexibility to undertake the research quantitatively or qualitatively.

Furthermore, the researcher has conducted literature reviews and attended full year lectures on research methodology, including the use of the fine foundation’s criteria to critique articles and journals. This backs up the researcher’s capacity to understand the various themes and the ability to carry out a reliable analysis and critique of data for research purposes. The researcher’s academic experience and knowledge of working on individual & group projects, word-papers

and essays on related themes such as the impact of the financial crisis on banks, the Goldman-Sachs Abacus transaction, regulatory capital requirements, a proposal fantasy-budget sent to the Irish Institute of Taxation and a financial & investment analysis of UK & Irish listed corporations have all laid a foundation to handle the cognitive and challenging aspects of this research.

The need to gather qualitative data through semi-structured & open-ended interviews will benefit from the researcher’s open and engaging approach to formal & semi-formal situations. Furthermore, the experience obtained from previous interviews conducted with the managers of multi-national companies, in addition to the researcher’s ability to listen attentively and ask insightful questions would aid in the collection of good and reliable data.

1.6 Outline of the Dissertation

Title page
Declaration
Table of Contents
List of Tables & Figures
List of Abbreviations

Acknowledgements:
This section thanks & acknowledges those have helped the researcher in completing this research.

Abstract:
This serves as a brief synopsis of the research. It includes the research questions, the findings and conclusion.

This dissertation is divided into seven chapters, which includes sub-headings. The contents of each chapter are discussed below;

Chapter 1: Introduction

This chapter acts as a background to the topic, it goes through the rationale for the research, explaining why the research is new & relevant and the approach to be followed when carrying
out the research. Furthermore, it contains the learning style and suitability of the researcher as relates to this research and an outline of the dissertation.

**Chapter 2: Literature Review**

This chapter explores the literature on failures and cases where failure would have resulted. It includes an exploration of the origins of failures, the causes & the themes in CF, the economic cycle and the debate on bailouts. Therefore it raises awareness of the themes in the area, thus justifying the research question and sets the study in a wider context.

**Chapter 3: Research Methodology & Methods**

This chapter explains the research methodology using the ‘research onion’. It justifies by critical evaluation, the selection of an appropriate research philosophy & approach etc. It discusses the options for data collection and describes the ethical issues that should be mitigated during the research, the population sample and how data collection, coding & analysis will be accomplished.

**Chapter 4: Data Analysis & Research Findings**

Data collected using the research methods outlined in chapter 3 will be critically analysed here and the findings will be presented.

**Chapter 5: Discussion & Conclusion**

This chapter discusses and interprets the findings of the research. It discusses opportunities & recommendations for future research and draws awareness to the scope & limitations of the research. Consequently the conclusion summarizes the findings and concludes on the entire project.

**Chapter 6: Learner Engagement & Reflection**

This is the final chapter and it contains the cognitive map showing the path flow from studies to a reflection on the skills enhanced and knowledge gained on completion of the research process.

**Bibliography:** This references the original works and literature used to back-up each chapter of this dissertation.

**Appendices:** This contains supporting documents: a sample coding reference, interview transcripts & interview questions.
Chapter 2: Literature Review
2. Literature Review

A literature review provides “the background on which a research is built” (Saunders M, Lewis P. & Thornhill A. Pg. 61, 2009). It is “an assessment of the body of knowledge that addresses a research question” (Harvard, 2012). According to Jaidka et al, literature reviews are can be written in two styles, ‘they can either be descriptive or integrative’. The latter contains more ‘research result information & critique and makes reference to information from the results & conclusion sections of source papers’. Whereas, the former contains mainly research methods information and references information predominantly from the abstract and introductory sections (Jaidka, K, Khoo, C, & Na, J 2013).

This literature review follows both the integrative and descriptive style. It begins by exploring the advent of failures and then the causes of failures. It then examines the avalanche of reasons why a plethora of firms have either failed or were brought to the brink of failure, with various reports and findings pooled together in order to set the issue in a broader context. Furthermore, it examines the divergent arguments for & against the bailing-out of entities. All these is achieved through a combination of peer-reviewed academic journals, databases and documentaries.

This literature review will not be ‘deductive’ in nature, because the deductive approach does not permit for a flexible structure and qualititative approach to the research. Moreover, it mainly favours scientific principles, the operationalization of concepts and the collection of quantitative data. Therefore, the inductive method will be adopted to allow the researcher some flexibility as the research progresses, in order to move from specific observations to general theories (Saunders et al 2009). Furthermore, it maintains some facets of chronology, so that the origins of failure precede the cases of failure in the modern times.

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Research Approach

**Figure 2 – Research Approach**

*Source: [www.socialresearchmethods.net/kb/dedind.php](http://www.socialresearchmethods.net/kb/dedind.php)*

The researcher, by exploring the literature will follow Toulmin’s scheme cited in Quinton & Smallbone (2006) in making & analysing an argument. So that claims are justified by support of evidence and there can be a “rebuttal or reservation” in circumstances where the warrant does not justify the claim. (Quinton S. and Smallbone T. 2006)\(^\text{16}\).

### 2.1 Origin of failures

One definition of corporate failure (CF) is that it is ‘a court filing by a company under Chapter 7 or 11 of the U.S Bankruptcy Code or other national codes’ (Dragan S, 2012)\(^\text{17}\). However, a company can cease to exist either through a liquidation or by receivership and as such, for this research CF is conceptualized simply as when a company goes out of business.

Investopedia (2014) defines a corporation as a legal entity that is discrete from its owners and therefore a sole-trader is justified as not being a corporation. Furthermore, corporations enjoy similar rights & responsibilities that individuals possess, for example; rights to enter into contracts, obtain finance, enter litigation, appoint employees, acquire assets and pay taxes.

\begin{itemize}
\item\(^\text{17}\) Simić, D, Kovačević, I, & Simić, S 2012, 'Insolvency prediction for assessing corporate financial health', *Logic Journal Of The IGPL*, 20, 3, pp. 536-549, Business Source Complete, EBSCOhost, viewed 2 June 2014.
\end{itemize}
“Limited Liability” is most significant perk of being a corporation, meaning that the owners/shareholders cannot be held individually liable for the firm’s debts\(^{18}\).

Corporate failure is assumed not to be fortuitous. According to Cass Business School, it is usually a “reflection of deep-seated corporate shortcomings”\(^{19}\) (Hopkin P, 2012). Moreover, it isn’t a new phenomenon, given the precedence of previous failures (Suter K, 2003). Indeed, CF can be traced back to the classical boom & bursts of The South-Sea Company and The Mississippi-Company. Moreover, the liquidation of the Medici Bank in 1494 would be the first reference point for CF as regards this research. Nevertheless, the researcher is aware that the bible made references to the availability of coins, minting presses and tax collectors, in addition to the fact that, in a research by Daniela, P, & Radu-Dan, M (2011), that modern banks had appeared sometime after 1100\(^{20}\), the earliest being the banks in Venice, Italy in 1171.

2.1.1 The Medici Bank [1397–1494]

Giovanni de’ Medici\(^{21}\) founded the Medici Bank in Italy during the Renaissance\(^{22}\) in the late 14\(^{th}\) century (Noonan JT, 1964) & (Whittemore J). He was a member of the influential Medici family “The House of Medici” who had migrated from the Tuscan hillside into Florence during the 12\(^{th}\) century. Giovanni through shrewd business transactions took the Medici Bank, which had evolved from previous partnerships to ‘the top of the ladder’. Its growth was aided by the rise in trade & industry, and with the momentum branches were established across Italy. Consequently after the turn of the 14th century, the Medici bank became “the official bank of the Papacy”, earning themselves the title “God's Bankers”. Furthermore, they had a practice of tying a general manager's remuneration to the shares he had purchased as an investment

---


\(^{22}\) The ‘renaissance’ being “the rebirth in the appreciation of classical times”.

(Whittemore J). This practice is one of the reasons for excessive risk-taking as suggested by the financial-crisis.

The bank was structured in such a way that it controlled a plethora of partnerships through the ownership of shares or the goodwill of the Medici name. Its banking operations usually involved the purchase and sale of foreign-exchange, government loans and the acceptance of deposits with interest payable. The bank was involved in industrial & commercial operations and the bank’s branches had distinct businesses. For example, the branch in Rome benefited from “huge papal deposits”24, the business of the London branch was in wool trading activities and the Lyon branch was involved in the international fair business (Noonan Jr., JT 1964).

The possible causes for the failure of the Medici Bank have been noted to include: a general depression at the end of the fifteenth century, which could be possibly traced to the war between Venice and the Turks. Furthermore, there was a serious over-extension of credit to irresponsible monarchs due to inadequately supervised branch managers. This was helped by the fact that Lorenzo de’ Medici, a third generation of the Medici’s had a greater interest in politics than in the running of the business. He left senior management decisions to Francesco Sassetti; a general manager (the highest available role for a non-Medici), who’s duty was to control the local managers, audit their accounts and lay down the rules to be followed (De Roover Pg. 75, 1943)25. However, Sassetti gave further discretion to the managers (De Roover Pg. 80) and was seen to have greater culpability in the failure of the branch in Bruges. He consistently overruled Angelo Tani; a top bank official, who had opposed the reckless lending schemes in the London branch by Tommaso Portinari. Sassetti even removed the last checks against Portinari’s excessive-lending to secular rulers and consequently this was the direct cause of the failure of the Bruges branch, which had failed so spectacularly that its long-term viability was damaged.

De Roover detected in the accounting methods of the “libro segreto” a growing distraction by Sassetti, who was increasingly interested in “secular humanist activities” such as having book collections and constructing chapels.

Other factors that have been suggested to have led to failure, are the conspiracy of the Pazzi (who operated the second largest bank in Florence) and the continuing war of the Pazzi and Pope Sixtus IV against the Medici’s. Finally, the expulsion of the Medici’s from Florence and the sequestration of their property by the Commune in 1494, the decline in the availability of English wool (De Roover.1966) in 1478 and the depressed market for alum26 (a mineral traded by the Medici’s) have all been suggested as the causes of failure.

Nonetheless, The Medici bankers had contributed to advancements in banking such as the ‘double-entry system’ and other banking advancements such as: bills of exchange or promissory notes; a precursor to the modern cheque and cash systems (Whittemore, J).

The themes here include war, bad-management and economic factors. These are evidenced by the reckless-lending practices, managerial irresponsibility and inadequate risk-assessment when granting loans. Market or economic factors is evidenced by the fall in the supply of wool and decline in the demand for alum. A depression in the market such as a slump in demand for a product or service is likely to be recurrent in many bubble burst and economic downturns. Therefore economic factors are reasoned to be a factor for failure. Furthermore, reckless-lending based on this case is reasoned to be a customary cause of failure in the financial industry & in lending institutions. However, war when compared to the other causes of failure here could be argued not to be a recurrent theme, the assumption here being that globalization and diversification, in addition to the lack of World-Wars, makes it questionable to argue that corporations could fail as a result of war. Nevertheless the case for war as a cause of failure should not be discredited.

2.1.2 The South-Sea Company - (The South-Sea Bubble)

In 1720, the burst of this bubble was described as ‘the great crisis of the financial revolution’27 (Walsh, P. 2012). At that time, Mercantilism28 an economic theory that believed in the benefits of profitable trading through government regulation for the purpose of augmenting state power (Encyclopædia Britannica, 2014) had been adapted to Europe foregoing from the rise in

overseas trading activities, specifically India and the ‘new world’. Consequently, in the 18th century shipping & trading companies were developed and banks were established (Atakisi A, Demirel, E, & Sönmezler, G 2010), with the Bank of England acting as “a great engine of state” (Smith A, 1776: cited in Atakisi 2010).

Furthermore, a group of London stock-dealers organized and formally established what is now known as the London Stock-Exchange (LSE), subsequently accepting joint-stock companies such as The East-India Company, The Royal African Company, The Hudson’s Bay Company, The Bank of England (BE) and The South-Sea Company to operate in the LSE.

The South-Sea company [SSC] founded in 1711 had royal privileges confirmed under the Acts of Parliament as a result of the opened trade in South-America against Spanish merchants (Hunts, 1840: 97-98 cited in Atakisi). It quickly became one of the major joint-stock companies in the UK as there was a need for the joint-stock companies to provide liquidity due to the war situations in Europe and increasing fiscal/budget deficits, The SSC bought a contract to supply slaves to America for 30 years. The cost of buying the contract was equivalent to the British national war debt of £10million. They issued shares to cover the cost, as at the time share ownership was becoming fashionable. The demand drove up prices and more shares were issued to keep up. The heightened competition for investors led to joint-stock companies such as the SSC requesting that companies issuing shares be granted a Royal-Charter and this was granted by way of the “Bubble-Act”; a first attempt at the general legislation of companies (Watzlaff, RH 1971). This act prohibited companies without a Royal-Charter from issuing shares, thereby increasing investor confidence and further driving up share prices.

Speculation here emanated from the locking of share prices & shareholder value to wars between countries and indirect lending i.e. debt swaps. Moreover, The SSC was backed by the government with ‘eight thousand pounds sterling allowed for the expenses of management, in addition to vested commercial & extraordinary powers. Consequently, in 1719, the capital of the company was further increased to nearly £12 million and a subscription for £520,000 of their stock was opened and at 114 per cent (Hunts, 1840; 99 cited in Atakisi). However by September

29 North & South America.
1720, the directors realised that the value of the company bore no relationship with the share price and they began disposing their shares. This became public knowledge resulting in widespread panic & share selling, ultimately investors lost their money (Suter K, 2003). The share price had soared from £130 in February 1720 to $1,050 by June 1720 and by September it was at £220, with the SSC holding £11.7m of the £50million British national debt.

“Shares were down to 124, dragging others, including government-stock with them. This speculative adventure had ended with tragedy” (Dale, 2004:178 cited in Atakisi).

![Figure 2.1 - Stock Prices of selected companies (1720)](https://www.economics.utoronto.ca/munro5/25jtstck.pdf)

A parliamentary investigation in 1721 uncovered widespread corruption amongst the directors, company officials and their political friends, with at least three ministers accused of bribery and manipulation. The SSC itself survived until 1853 having sold most of its right to its Spanish counterparts.

John Carswell, who studied the Bubble in 1720, noted the company’s ‘indifference to their proven unprofitability in South-American trade’ (Satsuma S. 2012). Indeed, Allan Ramsay a

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The South-Sea Bubble has been attributed to each of these causes (Dale, 2005:236 cited in Atakisi). The causes of failure here have been suggested to be the British pride, stirred by success on the continent and believe that British companies could not fail\(^3\) (Beattie A). The perception of being ‘too big to fail’ will be a theme in modern corporate failures and would be examined in the collapse of Lehman-Brothers. Furthermore, investors were blind to many indications of poor management; The SSC could not break-even (*whole shipments of wool were misdirected and left decaying in foreign ports*). The indifference to unprofitability in trade noted by Carswell, suggests that management either lacked the knowledge to understand the issues facing the company or from the parliamentary report were involved in serious corrupt & fraudulent practices.

Consequently, there is justifiable reason to suggest that fraud & corruption would be recurring themes in CF. Furthermore, the investors were noted to be blind to the inefficiencies at the SSC. One notable case for blind optimism and the herd instinct was during the Tulip-Mania\(^3\) in Holland. The herd instinct is also evident in the real-estate bubble which preceded the financial crisis. Finally when there is a crisis or burst of a bubble like in the South-Sea Company, investors lose confidence and begin to panic sell assets & stocks. This loss of confidence and dumping of stocks as evidenced in the fall of Enron is a cause for failure.

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2.1.3 The Mississippi Company - (The Mississippi Scheme)

The collapse of John Law’s Mississippi scheme of 1719 has been described as one of the most “tumultuous manias”\(^{37}\) in business history (Reinstein, Ruth; Moss, Laurence, 1980). Therefore, it makes a classic case of failure and boom/burst cycles (Breuninger, S, & Berg, M 2001)\(^{38}\).

John Law an economist, convicted murderer \(^{39}\) & millionaire gambler had bought a controlling stake in the Mississippi Company\(^{40}\) (Marietta, M 1996)\(^{41}\). The company had been established in 1684 to assist French trade in the Mississippi, outbidding its rivals in 1718 for the exclusive rights to manufacture, import and trade in tobacco, including a monopoly over trade in French Louisiana. It is important to note that prior to the acquisition of a controlling stake in the Mississippi Company, Law had founded the “Banque Générale Privée” which later became the Bank Royale in 1718 because its notes were guaranteed by the king of France. Furthermore, the bank acquired and absorbed other joint-stock companies, becoming the “Compagnie Perpetuelle des Indes” in May, 1719 (Atakisi 2010).

The initial operations of the Mississippi Company were financed by a sell of shares, thus investors were attracted and eager to invest in the company. Moreover, investors/shareholders had hoped that the company would grow its profitability due to the great optimism stemming from a grant to expand into other territories, including the permission to run the government’s banking activities i.e. minting. Law planned to refinance the national debt at a lower interest rate and this necessitated the issuing of more shares. Then in 1720, he used his bank to peg the company’s stock at 9000 livres tournois\(^{42}\), provoking rapid inflation, with government debt being converted into equity (Velde, 2008: 151 cited in Atakisi).

Economic hyperinflation was ultimately followed by ‘a run on the bank’ stemming from Law’s attempt at a controlled slowdown. He had depreciated the currency and the company’s shares, with his decision triggering a selling frenzy that drove the share price down.

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\(^{44}\) Accessed 6th June 2014.


\(^{39}\) He killed a man in a sword duel.

\(^{40}\) renamed Compagnie d’Occident


\(^{42}\) the unit of currency at the time
Beattie (2009) argues that the Mississippi scheme was more of a currency blunder than a true speculative bubble\(^{43}\). Nevertheless similar to the SSC, the shareholders discovered that shares had been overvalued and panic selling ultimately led to the scheme’s collapse. The scheme was terminated at the end of 1720 and by 1721 the company’s shares were valued at 500 livres tournois\(^{44}\). Consequently, Law was dismissed from all of his positions, with the enormous debts of his company and bank consolidated and acquired by the state\(^{45}\). In recent times there has been arguments for and against the bailing-out of ailing corporations by the government and this will be discussed further down in this chapter.

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**Figure 2.2- Share prices in The Mississippi Company**

*Source: HenryThornton.com\(^{46}\) cited in by (Colombo J, 2012)\(^{47}\)*

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There have been debates on how to interpret Law’s scheme. Economic-historian Charles Kindleberger and economist Peter Garber, both believe that Law’s scheme was a legitimate enterprise that had more potential than is actually believed. However, Kindleberger did note that Law’s financial arrangements were misaligned. Besides, others noted that Law helped to make the intricate system of French taxation & finance simpler. Nevertheless, the story of John Law’s Mississippi Company is as absorbing as the modern financial-crisis, with the collapse of this scheme setting back the development of banking in France by about 100 years.

Suter (2003) notes that;

1. Businesses with smaller assets were taken to excesses
2. Herd instinct: people were buying shares because others were doing it.
3. Blind optimism: people were blinded by the promise of wealth ignoring the warning voices.

The SSC & the Mississippi scheme provided a benchmark against which later crisis were compared (Suter K. 2003). Other notable bubbles include (Atakisi, 2010) & (Beattie A):

- The stock price bubble of the ‘roaring twenties’ 1927-1929
- Asian financial crisis (1997)
- The bubble in mortgage, toxic bonds and derivative instruments in America (2008).
- Real-estate bubbles in Australia, USA, UK, Ireland, Spain Greece, France (2004 – 2008)

The suggested causes of failure in the Mississippi Company include speculation, very optimistic profits & growth potential, a frenzy ‘panic selling of shares’ in the market due to hyperinflation stemming from law’s policies.

Therefore, it is the researcher’s opinion that arguable, Law’s scheme was in good faith in order to help relief government debt and for trading as noted by economists such as Kindleberger and Garber. Moreover, aside from being overly optimistic of the resources available in Louisiana and pegging the stock price through his bank, the company did not exhibit fraudulent or corrupt behaviour such as accounting manipulation. Nevertheless, we could blame Law for continuously issuing shares for cash, thus exposing his lack of foresight concerning the long-term risks

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emanating from seriously overvalued shares. Excessive risk-taking and lack of adequate risk-management practices are plausible causes of failure here.

2.2 Causes of corporate failure

Corporate failure is a global phenomenon which cuts across economic and geographic lines. It is not a new phenomenon and with the many aspects, corporate governance has been identified as a major theme (Kumar N, 2013)\textsuperscript{49}. According to Thornburgh, the Enron and WorldCom disasters were caused by a complete breakdown in governance (Wells J, 2006).

Corporate governance is the way in which companies are directed and controlled, it influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimised. The OECD defines it as involving “a set of relationships between a company’s management, its board and all stakeholders”\textsuperscript{50} (OECD, 2004)\textsuperscript{51}. Corporate governance emanated from “the separation of ownership and control”\textsuperscript{52} (managers being contracted to run the company on behalf of the shareholders), which resulted in managerial discretion and opportunism, whereby some managers pursued their goals at the expense of the maximisation of shareholder wealth. Jensen and Meckling (1976) highlight this, in ‘the principal-agent paradigm’.

Consequently, shareholders who sought to monitor the activities of director’s incurred ‘residual losses, bonding and monitoring costs’. To overcome this problem shareholders sought to monitor companies by implementing effective corporate governance systems and aligning directors by performance related pay i.e. tying pay to stock-options. The issue of performance related pay & compensation is a theme and cause of failure in both Enron and Lehman’s.

According to the OECD, corporate governance should reduce opportunity cost by protecting shareholders and monitoring managerial activities. It should bring about goal congruence;

\begin{footnotesize}

\textsuperscript{50} OECD Principles of Corporate Governance \url{http://www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf} Accessed 11th June 2014.

\textsuperscript{51} The Organisation for Economic Co-operation and Development

\end{footnotesize}
thereby aligning managerial & shareholders goals. Good corporate governance should contribute to ‘sustainable corporate development’ by enhancing the performance of companies and increasing their access to capital. It should diminish their vulnerability to the financial crisis and lead to improved productivity, thus lessening any risk of financial failure.

We note here that if the principles of CG are properly implemented then its role in lessening the risk of financial failure and vulnerability to the financial crisis will be achieved. Indeed Suter (2003) predicted a renewed attention towards CG.

Furthermore, Yeoh (2010) notes a required attention to CG, looking at the severe lapses in transparency & disclosure norms and raising questions about the role of non-executive directors in financial institutions. Both Bear Sterns and Lehman Brothers were engaged in ‘opaque financial reporting’ and lacked transparency in their communications with shareholders\(^ 53\). A recurring theme in most cases is in the development & execution of strategy and the operation of proper government processes. (Brooks M, 2007)\(^ 54\). An open consortium & ethics group, recently studied 50 U.S corporation failures and most instances were linked to lapses in governance, “manifested by an over involvement of upper management and under involvement of the board” in addition to an “obsessive motivation for self-enrichment” (Wells J, 2006).

Four causes of corporate failure stood up at the top

- Lack of ethical tone at the top
- Poor alignment of variable compensation to the long-term interest of the company.
- Lack of an ethical culture that encourages employees to ask questions and raise concerns.
- Past errors reflected in financial statements.\(^ 55\)

Accounting scandals and frauds have been reported by the media in fragments, in all attributing the blame of CF to a small number of scapegoats. But the truth is that failures are more complicated than reported. False accounting and fraud are usually not far-off from greed.

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Greed, ‘a natural human factor comes to mind’, with examples including Bernie Ebbers, who was convicted of the WorldCom fraud, helping himself to $400 million of the company’s fund to buy a cattle ranch in Canada and Andrew Fastow of Enron, whose ‘fraudulent deals fetched himself and his wife $47 million’ (Wells J, 2006). Professor Lawrence Cunningham of Boston College notes that, investors are also affected by greed. This is reflected by the Dot-Com and real-estate bubbles where directors and investors had thrown caution to the wind. Joseph Hearington a corporate director points out that the Enron and WorldCom scandals had a similar theme, that of collusion\(^{56}\) (Wells J, 2006).

The need to meet short-term earnings expectations can influence executive behaviour, as investors acquire shares predominantly for short-term profit taking, which is now the story of the day. Moreover, the tying of executive-compensation to stock options is seen as a recipe for cooking the books [Earnings Manipulation] (Wells J, 2006) and with corporate boards contributing to the sharp rise in executive-compensation during the 2000’s, some critics maintained that the growth in compensation was a catalyst for excessive risk-taking and in turn the recession\(^{57}\).

Likewise, a lack of risk oversight by boards contributed to bank collapses in Iceland, Ireland etc. (Conyon, M, Judge, W, & Useem, M 2011). Berrone (2008)\(^{58}\) and Van Den Berghe (2009)\(^{59}\) viewed faulty incentive systems for the executives of financial institutions as one of the main reasons for the financial crisis. (Naveen K, 2013) noted that several academics and researchers have identified remuneration system deficiencies as the key lesson from the crisis. (Buiter 2009, cited in Naveen K 2013) agreed that the remuneration structure of banking professionals allowed them to take extreme risk with focus on short-term profit. (Sahlman 2009, cited in Naveen K)\(^{60}\)


concluded that “many organizations suffered from a lethal combination of powerful and sometimes misguided incentives, inadequate control & risk management systems and finally misleading accounting”.

Complacency on the part of investors, regulatory agencies, managers and credit-agencies as highlighted following the financial-crisis is one of the factors that could lead to failure. Complacency leads to people joining the herd as noted in previous bubbles. (Hays, J, & Ariail, D 2013). In the case of Enron Chandra (2003) notes that senior-management had developed enormous arrogance due to its early successes. The tone was set at the top and it permeated to the lower levels and eventually became the culture of the corporation.

Like in the decline of the Medici-Bank, Enron and many other corporate-failures, no one in management accepted primary responsibility for oversight; the controls were not executed properly and there were structural defects which became apparent over time (Powers, 2002, p. 10 cited in Chandra, 2003). Moreover, with no one stepping up to bring issues to the attention of the board, we can see how boards sometimes lack awareness and are deemed to be incapable of taking corrective action.

Furthermore, according to an ACCA (Association of Chartered Certified Accountants)61 technical paper for failure prediction and prevention, a qualitative scoring model developed by Argenti (1976)62 indicated that failure followed a predictable path of defects, mistakes-made and symptoms of failure. Some defects include autocratic CEO’s, passive boards, poor response to change and lack of management depth. The mistakes-made include over-gearing or high leverage, over-trading and undertaking vast projects beyond a firm’s capacity. In addition, some of the symptoms of failure derived from 65 UK insolvencies included, not focusing on a particular market due to poor research, liquidity problems, and poor-management and diversifying into new unknown markets etc.

Furthermore, they alluded to a study by a U.S bank which indicated that the top causes of failure include; poor business & financial planning, poor management and poor marketing.

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61 ACCA; Business Failure Prediction and Prevention

Nevertheless, the paper notes that the ultimate reason for failure was poor leadership. Moreover, leadership is a very significant factor for success in a competitive & turbulent economy.

An article in the Harvard Business Review (HBR), based on over 21 years of the semantic clustering of the term failure from the HBR’s archives found a correlation between failure and the shifts in business philosophy over time.

![Figure 2.3. – Failures & shifts in business thinking](http://blogs.hbr.org/2011/03/the-hbr-approach-to-failure/)

Source: (Shaughnessy H, 2011)

Firstly, in nineties during the shift to a service based economy, the HBR associated failure with the deterioration in the business cycle, team performance and worsening conditions. However, by the noughties, failure fatigue had set it and the issues relating to failure became more complex. Furthermore, failures within 2004-2007 were noted to be characterised by CEO succession, a lack of risk anticipation, cyclical downturn, & structural change. But around 2007-2010, the focus was on risk, in the sense of the risks inherent in globalization and product & service development. Therefore, the HBR’s research, acknowledges that business cycles & cyclical downturns, lack of risk anticipation and worsening conditions are causes of failure as explored in this chapter.

Similar to the views above, the Turnaround Management Society (TMS), in their research survey consisting of 405 turnaround managers & restructuring experts, found that management have been blamed for most causes of an internal crisis.

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Figure 2.4 – What level of management caused an internal crisis?

Source: TMS Survey 2014

Figure 2.5 – Common causes of crisis experienced

Source: TMS Survey 2014
Furthermore most of the cases of crisis experienced were tied to management, with management decisions and inability together with a lack of liquidity being an issue. Below they graphed the crisis factors over the span of 38 years and found that Poor management remained a significant cause of failure over-time.

Figure 2.6 – Causes of failure graphed over time

Source: TMS Survey 2014

2.2.1 Goldman Sachs

Conflicts of interest and fraud are usually result in CF & CG failures and Strier F. (2005) notes that conflicts of interest are often structural & obvious. This leads to potentially wrongful or undesirable corporate behaviour and might call into question the ethical standard of individuals and corporations. Goldman Sachs was tainted by significant conflicts of interest resulting from

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the sale of a complex financial product “ABACUS 2007-AC1”\textsuperscript{65} to investors & counterparties without proper disclosures as to the intricacies of the deal. The ABACUS\textsuperscript{66} was a ‘collateralized debt obligation’ (CDO), which Goldman had offered in 2007 to various investors\textsuperscript{67} (Mogielnicki, & Jeffers, 2010) such as:

1. Paulson & Co.
2. ACA Management LLC
3. IKB Deutsche Industriebank\textsuperscript{68}
4. ABN AMRO now part of Royal Bank of Scotland [RBS]

In 2010, The Securities and Exchange Commission (SEC) which holds the primary responsibility for enforcing federal securities law and regulating the securities industry in America, charged Goldman-Sachs with the structuring & marketing of CDO’S that hinged on the performance of RMBS (Residential Mortgage Backed Securities). The SEC alleged that Goldman & Fabrice Tourre a top executive at Goldman, had violated anti-fraud provisions by structuring & marketing these complex products, in particular failing to disclose essential information to investors. Some of the breaches included a failure to disclose the role Paulson & Co Inc. a major hedge fund played in the portfolio selection process\textsuperscript{69}, in addition to the fact that Paulson and Sachs had taken a short position against the CDO\textsuperscript{70}; short here meaning, they believed that the value of the portfolio would go down. This was a clear conflict of interest as Paulson was allowed to choose the sub-prime mortgages to be thrown into the Abacus. Paulson had inside information and was able to bet against the RMBS to the detriment of Goldman’s


\textsuperscript{68} IKB Deutsche Industriebank https://www.ikb.de/ . Accessed 12\textsuperscript{th} March 2014.


clients\textsuperscript{71}. This behaviour was criminal and fraudulent, it showed a lack of duty of care for investors and led to significant losses for other counterparties.

Fabrice Tourre misled ACA by making them believe that Paulson was taking the short position and that his interests were aligned with theirs. In contrast Paulson’s position was clearly the opposite. Goldman had violated and gone against the rules of the SEC, its own code of conduct & business principles “integrity and honesty at the heart of our business”, they violated the integrity standard against conflicts of interest;

\textit{“Mitigate actual conflicts of interest, regularly communicate with business associates to avoid apparent conflicts of interest and advise all parties of any potential conflicts”}.

However, no one including the investors and regulators questioned the credit ratings attached to the various tranches in the Abacus’s capital structure. This raised very important questions as to the role of credit agencies in abetting the financial crisis and the lack of board oversight as evident by their inability to question/monitor the activities of Fabrice Tourre and his own position in the deal.

Although the transaction did not lead to the collapse of Goldman, the huge fine of $500million dealt down by the SEC sent out a message, with the regulators stating that “half-truths and deceptions” would not be tolerated (The Guardian, 2010)\textsuperscript{72}. Robert Khuzami, director of the SEC’s division of enforcement, said: firms would not avoid a heavy price if they violated the fundamental principles of “honest treatment and fair dealing”. The result of this lawsuit and fine was that the reputation of Goldman Sachs had been tarnished but maybe not to the extent of Arthur Andersen who had to go down with Enron after a tarnished reputation (SEC, 2010).

The regulators had played a pre-emptive role in what could have resulted in bigger issues and possibly the collapse of Goldman or one of the other counterparties. This case thus highlights some of the possible causes of corporate failures which include conflicts of interests, lack of board oversight and lack of knowledge. Lack of board oversight or top management

\textsuperscript{71}US S Form -8k \url{http://www.goldmansachs.com/investor-relations/financials/archived/8k/pdf-attachments/4-16-8k-doc.pdf}. Last Accessed 30\textsuperscript{th} January 2014.

irresponsibility has already been noted in the decline of the Medici Bank. This together with conflicts of interest are further highlighted in the Collapse of Enron and Arthur Andersen.

2.2.2 Enron

The collapse of Enron Corp, an energy superstar corporation based in Houston, Texas\(^73\) had been the largest corporate bankruptcy in the world before the collapse of Lehman Brothers (Probert, LJ 2013). Its failure was noted to be attributable to accounting irregularities and this was suggested to have had an impact on other firms in the industry\(^74\) (Akhigbe, A, Madura, J, & Martin, A 2005). The firm came about as a result of deregulation and the merger between Houston Natural Gas and InterNorth. There was a need for diversification and growth via numerous acquisitions at home and abroad. This included acquiring Nigerian oil barges, building what was supposed to be the largest power plant in Dabhol, India and a failed venture into the broadband industry\(^75\).

‘With our networks, we can significantly expand our existing businesses while extending our services to new markets with enormous potential for growth’” (Enron Annual Report 2000, cited in Chandra, G. 2003).

The shoots for strong concern emerged following one of the conference calls about quarterly earnings to then CEO (Chief executive officer) Jeff Skilling as regards the firm’s financial statements in April 2001. According to reports and by evidence to an audio recording\(^76\), an analyst complained to Enron’s CEO; “You’re the only financial institution that can’t come up with a balance sheet or cash flow statement after earnings.”, In which Skilling appreciated the question but quite audibly called him an “asshole”. This caused ‘great consternation in Wall Street’ because a CEO of a fortune 500 company had lost it in this way. On the company’s logo it says ‘Ask Why’ but it played off in the media as ‘Ask Why? Asshole’, a reference to a clear case of managerial irresponsibility and vulgarity.


\(^{75}\) The Smartest Guys in the Room: http://www.youtube.com/watch?v=gxzLX_C9Z74 . Accessed 13\textsuperscript{th} June 2014.

\(^{76}\) A clip from the documentary: The smartest guys in the room http://www.youtube.com/watch?v=dQ10kRJY1VY . Accessed 13\textsuperscript{th} June 2014.
Consequently, months later, Skilling resigned in line with other top-executives who had left the company. The media continued with inquiries into its financial statements at which the firm confirmed some complex accounting transactions. This was followed two days later by Enron’s announcement that CFO (Chief Financial Officer), Andrew Fastow had been replaced. All this was in addition to the issues of accounting irregularities, CEO irresponsibility and previous cases of abuse of government connections, price fixing in the Californian energy sector (termed; Ricochet), off-balance sheet accounting through various investment vehicles\(^{77}\) used to hide colossal losses, insider trading\(^{78}\) by top management\(^{79}\) and collusion with Arthur Andersen (Enron’s auditing firm). Enron with its macho culture ran wild with various malpractices under the watch of Andersen, abusing accounting loopholes that sought to achieve accounting rather than operating results (Schwarz, S). The company had an arrogant and aggressive culture\(^{80}\) which enabled it to hide a deteriorating financial position (Henderson, M, Gregory Oakes, M, & Smith, M 2009). Enron’s lack of transparency became so problematic that investors required analysts in order to invest.

\(^{77}\) Steven L Schwarz: Enron and the use and abuse of special purpose entities in corporate structures\nhttp://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2308&context=faculty_scholarship Accessed 13\(^{th}\) June 2014


### Table 1: Events that Indicate Concern with Enron Accounting Statements.

<table>
<thead>
<tr>
<th>Event</th>
<th>Date</th>
<th>Description</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Feb. 1, 2001</td>
<td>General comments about potential problems from volatility, misplaced bets, rogue traders, etc. for the energy industry, including Enron.</td>
<td><em>Financial Times</em></td>
</tr>
<tr>
<td>2</td>
<td>Apr. 18, 2001</td>
<td>Enron CEO, Jeffrey Skilling, used vulgarity towards analyst Richard Grubman. Grubman asked to see Enron’s balance sheet, Skilling responded that it would not be available until later, in disbelief Grubman stated that Enron was “the only financial institution that can’t come up with a balance sheet or cash flow statement,” and Skilling responded with vulgar language.</td>
<td><em>Houston Chronicle</em></td>
</tr>
<tr>
<td>3</td>
<td>Aug. 14, 2001</td>
<td>Enron CEO, Jeffrey Skilling, resigned, becoming the sixth senior executive to leave in a year. Lay said in a conference call with stock analysts, “I never felt better about the company” yet deflected analysts’ pleas for more disclosure. Some analysts expressed concern that other surprises may be lurking.</td>
<td><em>LA Times</em></td>
</tr>
<tr>
<td>4</td>
<td>Sep. 10, 2001</td>
<td>Report described Enron’s poor stock price performance as stemming from “heavy insider trading, indecipherable accounting practices and a stream of executive departures.” In general, the credibility of Enron’s accounting statements was questioned.</td>
<td><em>New York Times</em></td>
</tr>
<tr>
<td>5</td>
<td>Oct. 17, 2001</td>
<td>Enron reported a third-quarter loss of $618M due to $1B in one-time charges. Enron Chairman, Kenneth Lay, confirmed that part of the one-time charges to earnings was due to complex transactions with limited partnerships created and run by Enron’s CFO, Andrew Fastow.</td>
<td><em>New York Times</em></td>
</tr>
<tr>
<td>6</td>
<td>Oct. 22, 2001</td>
<td>Enron confirmed that the SEC opened an informal inquiry into Enron’s complex transactions with limited partnerships tied to an Enron senior executive.</td>
<td><em>PR Newswire</em></td>
</tr>
<tr>
<td>7</td>
<td>Oct. 24, 2001</td>
<td>Enron CFO Andrew Fastow was replaced in an attempt to restore investor confidence. A class-action lawsuit was filed against Enron and its executives for misleading accounting statements.</td>
<td><em>Press Release by Enron &amp; Business Wire</em></td>
</tr>
<tr>
<td>8</td>
<td>Nov. 8, 2001</td>
<td>Enron admitted accounting errors, inflating income by $586M and understating debt by $2.6B since 1997. This was Enron’s first assessment of the degree to which their accounting statements were misleading.</td>
<td><em>Press Release by Enron</em></td>
</tr>
<tr>
<td>9</td>
<td>Nov. 28, 2001</td>
<td>Enron notified by Dynegy of merger termination. Enron’s credit was downgraded to below investment grade.</td>
<td><em>Business Wire</em></td>
</tr>
<tr>
<td>10</td>
<td>Dec. 2, 2001</td>
<td>Enron filed for bankruptcy.</td>
<td><em>PR Newswire</em></td>
</tr>
</tbody>
</table>

*Notes:* These 10 major event dates reveal some degree of concern over the validity of Enron’s accounting statements that ultimately led to the filing of bankruptcy; we obtain the event dates and descriptions from *Lexis-Nexis* daily news articles.

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**Figure 2.8 - Events that indicate concern for Enron’s accounting statements**

*Source: (Akigbe, A, Madura, J, & Martin, A 2005)*
Figure 2.9 - Enron’s stock price.

Source: (Akhigbe, A, Madura, J, & Martin, A 2005). Black diamonds indicate key events that affected stock price.

Senior staff at Enron were not aware of Fastow’s strategy, whereby cash-flows were manipulated to and from a complex network of companies, known as special-purpose entities (SPE’s). Some of these entities had exotic names such as Raptors, LJM, JEDI, Chewco, Whitewing etc. (Hays, J, & Ariail, D 2013) & (Chandra, G. 2003). He designed the transactions to both hide losses and to create the appearance of revenue. Fastow himself served as director of some of the companies involved. Again highlighting conflicts of interest, greed, corruption, unethical behaviour, lack of management involvement/knowledge, manipulation, deceit. His approach to scheming the company together with a methodology termed ‘mark-to-market accounting’ (Chandra, G. 2003) backed by Arthur Andersen ensured that the company appeared profitable thereby hiding colossal losses.

False accounting increased confidence and optimism in the market at the time (Probert, LJ 2013). Bethany McClean, a reporter wrote an article titled “Is Enron Overpriced?” In it, she observed that even experienced analysts struggled to understand exactly how the company made money. In 2003, McLean and Peter Elkind published an account of the Enron scandal, The Smartest Guys in the Room, further highlighting their worries and concerns about Enron. There

was a lack of related party disclosure\textsuperscript{82} and a lack of adherence to internal controls (Wilson, A, & Key, K 2013). Some of the accounting irregularities recognised by Wilson et al (2013) included

- Revenue was recognized before it was earned.
- Gains were improperly recognized by Enron for increases in the value of Enron’s own stock.
- Non-consolidation of Special Purpose Entities.
- Special Purpose Entities lacked economic substance.
- Contra-equity was reported incorrectly by Enron as an asset.

Bad decision making by management was highlighted by the disastrous power plant venture in Dabhol, India and a failed venture into the broadband industry. They tried their hands at different businesses, moving away from their core business of energy, to selling unused bandwidth in the broadband industry (Henderson, M, Gregory Oakes, M, & Smith, M 2009). The story of Enron has since become ‘the archetypal tale of corporate greed gone badly wrong’ with numerous reports, documentaries and books published detailing the company’s decline and fall. Enron failed for bankruptcy in 2001 and its collapse led to Andersen’s fall\textsuperscript{83} (Chandra, G 2003).

2.2.3 Arthur Andersen

Arthur Andersen LLP once stood for trust and accountability\textsuperscript{84}. Before its demise, it was one of the world’s largest accounting corporations and it stuck to its values. Once, the firm had sent out an eager young auditor to certify the inventory of a million bricks baking under the hot Ohio sun, each time the bricks were counted the auditor came up 100,000 bricks short. He made the factory owner aware of the issue, who then called-up his boss asking why he had sent out a rookie. The bricks were then counted again and this time the factory owner came to the realisation that his ‘factory manager was secretly selling tons of brick through the back door’.

This story was testament to the diligence and vigilance that made Andersen a ‘gold standard’ in the accounting profession for decades (Chicago Tribune, 2002).

However in the 1990’s, greed corrupted Andersen as it embarked on a path that cherished large fees ahead of diligence and vigilance in accounting. There were conflicts of interest between its auditing & consulting objectives. These conflicts of interest were confirmed following a comprehensive review that, contrary to prior assertions, the firm tried to mix ‘its auditing mission with a mercenary consulting culture, resulting in a botched job’. Nonetheless, many of its staff continued to uphold a high standard, whereas others conceded to the culture of generating fees. This compromise would justify that argument that bad corporate culture and ethics could lead to CF. According to Dean Christensen, who ran the Ohio office, the aim was to do the job as quickly as possible to make the most money.

“They pushed the edge of the envelope--pushed it too far,” He continues "I just think it got out of control. What it ended up being is greed. Total greed." (Chicago Tribune, 2002).

Arthur Andersen himself as far back as the great depression had spoken against having conflicts of interest. “To preserve the integrity of the reports, the accountant must insist upon the absolute independence of judgment and action”.

A former Andersen, CEO Harvey Kapnick had unsuccessfully sought to address concerns about conflicts of interest by splitting the audit and consulting practices. However with more lucrative consulting deals being sold, the seeds of the firm’s downfall were planted. The germination of these seeds is evident from the fallout that unfolded due to prior decisions in the wake of headlines about shredded documents, restated earnings, financial & earnings-manipulation at Enron, WorldCom etc., who were all Andersen’s clients besieged by accounting scandals (Chicago Tribune, 2002).

Furthermore, Duane Kullberg a new managing partner had split the leadership & role of the firm’s internal standards watchdog into three parts “accounting, auditing procedures and professional standards”. This accumulated in less ‘face-to-face contact, closed door meetings and table-pounding arguments’ which had built the firm’s reputation. Moreover with each department required to meet high revenue marks, the group’s pronouncements fell on deaf ears (Chicago Tribune, 2002). There was increased bureaucracy/hierarchy evident at the time of the
Enron scandal through the seven layers of management that existed between management and the top partners.

In the 1990’s globalisation, client objectives, complex finance and Wall Street's focus on quarterly earnings had pressured auditors to go along with new accounting techniques aimed at boosting stock prices by ensuring predictable growth in profits. This was further worsened by corporations like Enron who had tied top executives’ pay with stock-options (the right to buy company stock at a set price in the future). The difficulty was that, those options needed to be off the balance-sheet in order to shroud the true cost to investors and to bloat earnings.

Meanwhile, Enron had been found to be “a cesspool of financial fraud” and as it ran wild, Andersen's Professional Standards Group (PSG) proved too weak to intervene. ‘Money had trumped honest services’ and Enron's executives were able to collude with Andersen to distort the true business performance and forecasts. Moreover, when the truth came to light, Andersen engaged in a cover-up, with its employees ‘shredding box after box of Enron-related documents, day after day, for a period of weeks’ (Chicago Tribune, 2012).

Andersen had helped in the structuring and accounting of some of the transactions between Enron and the SPE’s, thus negating their audit responsibilities & compromising ethics. The collapse of Andersen in 2002, therefore highlighted issues already identified in previous cases of failure such as conflicts of interest, collusion, greed, corruption, ineffective CG and an excessive focus on the short-term noted by Wall Street’s appetite for quarterly predictable earnings and the tying of top-executive compensation to stock-options. In this case we note a tarnished reputation as one the causes of failure.

2.2.4 Lehman Brothers

The collapse of Lehman’s Brothers, a 158 year old investment bank, was the biggest corporate bankruptcy & failure in history. Furthermore, following its collapse, the Dow Jones Industrial Index (DJIA) dropped 500 points, with the government’s decision not to bail out Lehman’s being the tipping point to the financial crisis.

Lehman’s had survived many economic downturns, it withstood the American civil war, two World-Wars, and the Great-Depression, but this time it was different (Johnson, M, & Mamun, A 2012 and Hurley, P, & Hurley, R 2013). In 1966, Richard Fuld worked as an intern at Lehman’s and by 1993 he had risen through the ranks and was appointed the CEO. He was a ‘larger than life figure’ and was nicknamed ‘the gorilla’ by Wall Street for his ‘unorthodox style of leadership’, besides he led Lehman’s through the hard times.

The firm operated as a traditional investment bank handling merger & acquisitions, clients’ money and making sensible investments, but soon it began using borrowed money to play the markets. In 1994, a share was $4 but it had grown 20 folds to $82 in 2007 due to Fuld’s insatiable appetite for profits. Consequently, the bank expanded into lucrative derivative products such as credit default swaps (CD’s) as the markets became deregulated. ‘Risk was now the name of the game’ and its staff were rewarded with massive pay and bonuses as the company’s profits continued to skyrocket. Dick himself took between $310-$500million in pay & bonuses.

In 2007, the company had made over $4 billion in profits geared by an American administration that championed home ownership. Furthermore, house prices were rising as a result of a slash of interest-rates following a slight economic slump after the Dot-com bubble and the attack of the World-Trade centre. The bubble in the housing market was fuelled by a boom in loans with tempting introductory rates being offered to risky borrowers (sub-primers). These loans were then securitized (bundled loans) and subsequently traded between banks, with Lehman’s being the largest underwriter of these loans as at 2007 in America.

Securitization had brought with it a false sense of confidence that risk have been eradicated in the market (‘a fool’s paradise’). Therefore, spurred by this confidence Lehman’s borrowed aggressively with a leverage ratio of 40 to 1 ($40 dollar borrowed for every $1 owned) compared to the industry average of 20 to 1. Furthermore, using borrowed money, it invested heavily; about $60 billion in real-estate and commercial property worldwide and by late 2007, Lehman had amassed $111billion in commercial and residential real-estate holdings and securities.

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87 25 People to Blame for the Financial Crisis: The good intentions, bad managers and greed behind the meltdown [http://content.time.com/time/specials/packages/article/0,28804,1877351_1877350_1877326,00.html](http://content.time.com/time/specials/packages/article/0,28804,1877351_1877350_1877326,00.html)
Accessed 19th June 2014
However, when rates were increased, the sub-prime borrowers could not keep-up and defaulted on their payments. Subsequently, the sub-prime bubble burst and its massive exposure to the property markets became a lead-weight to its books. Moreover, Lehman’s had announced its first ever quarterly loss of $2.8billion and a loss of $3.9 billion the following quarter (Johnson et al), triggering the dumping of stocks by investors as confidence in the bank began to evaporate. Lehman’s took massive write-downs in the market values of its commercial property and the company would fail unless it was bailed out by the government or acquired by other corporations.

Nevertheless, Fuld was arrogant “he bet a farm on the river card”, holding out for a better deal instead of solving Lehman’s liquidity problem. He was very optimistic, according to reports, that with one more trading day that the position of the company would improve. He believed they would emerge from the cycle stronger.

In the weeks preceding Lehman’s collapse, the Federal Reserve had called a meeting of the so-called ‘masters of the universe’ (top executives of the major banks in America) in order to address the issues facing Lehman’s and the fact that the government was unwilling to bail out Lehman’s with taxpayer money. Hank Paulson, the Secretary of the Treasury told the executives of other banks, that they had to come up with a solution to contain the problem. Barclays and Bank of America (BOA) were potential suitors, but BOA had merged with Merrill Lynch; also a big retail bank, thus leaving only Barclays as potential suitors. During the due diligence carried out by BOA and Barclays, huge holes were found in Lehman’s books. Assets which had a value of about $40 billion were only worth about $20billion. Furthermore, the British government wasn’t willing to guarantee Lehman’s debts as did the American government. This left Lehman’s with no option but to file for bankruptcy.

At its peak Lehman’s shares were worth $85 but in bankruptcy, it was worth $0.03 cents\(^\text{88}\).

\(^{88}\) BBC: The Love of Money – Episode 1 -The Bank that Bust the World
In the wake of Lehman’s collapse, there were reports that it used collateralized short-term borrowings or sale & repurchase agreements (Repo 105) as approved by its auditor Ernst & Young (EY) to hide its high leverage and to make its balance-sheet appear healthy to investors (Verschoor C. 2011), (Jeffers E. 2011) and (Caplan, D. H., Dutta, S. K., & Marcinko, D. J. 2012). Repurchase agreements were usually used by banks to manage their short-term cash needs by exchanging highly liquid securities for cash. The problem here was that Lehman’s accounted for these Repo 105 transactions as an asset sale. It structured these transactions in such a way that it sold securities to European counterparties based on legal opinion obtained and then used the cash generated to reduce ‘troubled liabilities’ at the end of the quarter/at year end, thus improving its leverage ratios and balance sheet figures (Jeffers E. 2011).

Figure 2.11 – Lehman’s Repo 105 Usage

Source: Aggressive Application of Accounting Standards\textsuperscript{90} (Caplan, D, Dutta, S, & Marcinko, D 2012) and Lehman’s Shell Game\textsuperscript{91} (Dutta, S, Caplan, D, & Lawson, R 2010).

Lehman’s bankruptcy examiner Anton Valukas blames EY and Lehman’s executives for its “misleading financial statements” and “actionable balance-sheet manipulation” (Verschoor C. 2011). There was an argument made in a complaint about EY, that it allowed Lehman’s to engage in transactions without a business purpose to achieve specific financial statement results, similar to what was pointed out in the fall of Enron. In the chart below we see how significant the use of Repo 150 impacted on selected financial ratios. For example the current ratio\textsuperscript{92} is significantly less under correct accounting norms, indicating Lehman’s had less than 1 current asset to its current liabilities and would have struggled to settle short-term obligations as they fall due.


\textsuperscript{92} Current Ratio; \url{http://www.investopedia.com/terms/c/currentratio.asp}. Accessed 27\textsuperscript{th} July 2014.
Lehman’s unethical behaviour and conflicts of interest was characterized by a reluctance to notify shareholders and clients of the questionable Repo 105 transactions. Furthermore, Lehman’s also utilized a loophole under accounting rule SFAS 140; Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities to account for these transactions as sales rather than as borrowings. Richard Fuld took responsibility, but admitted no deliberate wrongdoing because he had acted on information available to him at that time. Nevertheless, Lehman’s had violated the Sarbanes-Oxley Act 2002 requirements for fairly stated financial statements (Jeffers E. 2011) and from reports, it seemed that Lehman’s senior financial executives had knowledge that the Repo 105 transactions were used to carry out inappropriate transactions and accounting manipulation to hide the extent of liabilities without proper disclosures. Moreover, they had certified the accuracy of Lehman’s accounts, with Jeffers (2011) finding that they may be ‘subject to criminal & financial liability’.

After revelations at Lehman’s, the FASB (Financial Accounting Standards Board) sort to close the loophole available in SFA’s 140 by introducing SFA’s 166; Accounting for Transfers of Financial Assets to reduce the ambiguity and cloudiness in accounting for factored receivables with the new standard contingent on meeting 3 specific conditions, one being that the transferee maintains actual control over the transferred assets .i.e. it is not likely to end up being returned to the transferor (Jeffers E. 2011).

**Figure 2.12 – Lehman’s financial-ratios using Repo-105**

*Source: Jeffers, A. E. (2011)*

<table>
<thead>
<tr>
<th></th>
<th>Using Repo 105</th>
<th>Using Correct Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Ratio</td>
<td>2.5</td>
<td>.71</td>
</tr>
<tr>
<td>Debt to Equity Ratio</td>
<td>36.59%</td>
<td>49.08%</td>
</tr>
<tr>
<td>Liabilities to total assets</td>
<td>30.0%</td>
<td>40.0%</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>2.44%</td>
<td>1.84%</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>2.0%</td>
<td>1.5%</td>
</tr>
</tbody>
</table>
Figure 2.13 - Steps in Lehman’s Repo 105 Transactions

Source: Jeffers, A. E. (2011)

The arguments for and against the bailing out of Lehman’s would be looked at in the section questioning the benefits of corporate failures. The causes of failure here have been noted to be greed and hubris, so much money was made and people thought they were invincible. The board had taken a leisurely approach to risk-management, with a dubious CG pointed out by a handpicked board. Moreover, Fuld served as the chair of a two man executive committee, chairman of the board & CEO. In addition to this, Lehman’s finance and risk-committee was headed by an 80-year-old Henry Kaufman, only meeting on two occasions during 2007. A ten man board was full of individuals well into their 70’ and 80’s, thus pointing out that there was a need for new blood. Excessive risk taking by playing the markets, high leverage, not sticking to its traditional investment banking business, regulatory laxity & loopholes, auditor negligence, accounting manipulations all tied the noose that lead to Lehman’s hanging.

Figure 2.14 – Lehman’s consolidated statement of Cashflow

Source: Lehman’s cash-flows (Hurley, P, & Hurley, R 2013.)
2.2.5 Ernst & Young

Ernst & Young (EY) is a ‘Big 4’ public professional services firm headquartered in London. It was founded by Arthur Young and Alwin C. Ernst in 1989, after 140 years of mergers and once served as the auditor of the now defunct Lehman-Brothers, receiving about $150million in audit fees from Lehman’s between 2001 & 2008. Consequently and similar to the role of Arthur-Andersen in the demise of Enron, a civil suit was filed in New-York in 2010 by the state Attorney General of New-York against EY, alleging that, they had engaged in accounting fraud by helping Lehman’s to hide billions of liabilities off the balance-sheet (Verschoor C. 2011) & (Caplan, D. H., Dutta, S. K., & Marcinko, D. J. 2012). Moreover, some have argued that EY should have been held responsible for ‘failing to blow the whistle’ on ‘Lehman’s shady accounting practices’ and thus should return fees earned and settle damages. Jeffers (2011) found that EY did not audit Lehman’s repo transactions even though it was perceived not to be a normal accounting practice. Moreover, Lehman’s had applied the repo transaction based on legal advice from the UK as it was unable to get any from U.S law firms. It used a UK subsidiary to carry-out these repo transactions and “EY apparently did not object to the stretch of circumstances” (Verschoor C. 2011), allowing Lehman’s to engage in transactions which only had a purpose of achieving specific financial statement results.

Nevertheless, EY argued that the transactions in question were recorded in accordance with Generally Accepted Accounting Principles (GAAP), and the clean audit opinion was therefore justified. Furthermore, they argued that the rules at the time of the repo transactions did not require them to disclose the transaction and moreover the financial statements clearly portrayed Lehman’s to ‘be a highly leveraged and operating in a very volatile and risky industry’.

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Although an audit investigator of the case did not take action against EY following an 18 month investigation (Treanor J, 2012), reports in 2013 indicate that EY reached a $99 million agreement to settle former Lehman investors, admitting no liabilities (Harris A, 2013), but nevertheless, settling to put the matter behind them (Brown N, 2013). It was noted that the agreement would need the court's approval.

Auditor irresponsibility & conflicts of interest is evidenced by EY’s inability to balance their duty to Lehman’s, whilst respecting its responsibilities to other stakeholders. Moreover, EY never signed off a qualified audit report detailing any discrepancies in Lehman’s books. Furthermore, divergent regulatory requirements between UK and U.S standards made it possible for Lehman’s to exploit the loophole in the US standard. For example, UK standards required financial statements to represent a true and fair view, whereas the U.S standard required only compliance with GAAP requirements. Nonetheless, EY did not fail like Arthur Andersen, who had lost its reputation in the wake of the lawsuit and the allegations of auditor negligence. It had survived.

2.2.6 General Motors (GM)

General Motors Corporation, was established in 1908 and is headquartered in Detroit, Michigan. It is a multi-national company that manufactures cars under brands such as Chevrolet, GMC, Buick Vauxhall, Opel and Cadillac. Furthermore, it distributes vehicle spare parts and sells financial services.

97 Jill Treanor: Lehman audit investigator takes no action against Ernst & Young
98 Andrew Harris: Ernst & Young Settles Lehman Investor Suit for $99 Million
99 Nick Brown: Ernst & Young to pay $99 million to end Lehman investor lawsuit
100 About GM: Our Company
GM once controlled ‘60% of the American market’. Indeed it once sold half the cars bought in America\textsuperscript{101} and vied with Toyota for the title of the world biggest auto company. However, in 2009 this all changed as the company filed for bankruptcy. The reasons for GM’s bankruptcy was that, from 2005 it had stopped making a profit due to a decline in sales (Berman K & Knight J, 2009)\textsuperscript{102}. Furthermore, the decline in car sales and loss of profits was worsened by the global economic recession as the credit markets froze. The recession has been maintained to be ‘the nail in GM’s coffin’ \textsuperscript{103}(Hill C, 2010). GM had lost over $90biillion in the first quarter of 2009 (Berman K & Knight J, 2009).

Indeed, some have argued that GM should have filed for bankruptcy reorganisation earlier in 2005 in order to cope with the slowdown of sales and the high level of fixed-costs such as its labour costs and that, if GM had filed for bankruptcy in 2005, it would have been in a much better position to compete, as it would have been a “leaner and meaner company capable of battling the economic downturn”.

![Figure 2.15 - GM’s shrinking market share](image)

*Source: CNN Money 2009.*


The issues that lead to GM’s bankruptcy have been suggested to be as follows: After the ‘2001 terrorist attacks’, GM offered incentives such as 0% finance to car buyers, in addition it offered rebates & enticing deals in order to remain competitive in the market-place. But the problem was that their ‘marketing strategy was skewed’ towards advertising these deals than promoting their car brands. Furthermore, GM had been an innovator and leader in electric-car technology, but its decision to kill its EV1 electric program allowed Toyota to gain an upper-hand with their hybrid Prius (Carty, S. 2009).

In 2005, billionaire investor Kirk Kerkorian bought a 10% stake in GM and recommended the company to appoint his aide Jerome York to be a board member. He even tried to persuade GM into a partnership with Nissan/Renault. Although the Nissan/Renault joint-venture failed, he had showed some foresight. Subsequently, in 2006 he noted that “Time is of essence” and that GM had to be more realistic about its revenue/market share expectations and that the firms excess products and brands should be withdrawn, with the unprofitable business units been disposed. Furthermore, he called for a "clean sheet of paper approach to the business," in order for the entire operations of the company to be seen with fresh eyes. He however resigned from the board and noted GM’s inability to compete (Carty, S. 2009).

Its biggest problem was that in 2006, 51% of its profitable financial division: General Motors Acceptance Corporation (GMAC) which had raked in more revenues quarterly than its automotive operations, was sold to Cerberus, a private equity fund for $14 billion of cash and staggered payments. GM had sold its cash cow and thus had lost flexibility in its ability to control and extend loans to dealers during the credit crisis (Carty, S. 2009). Before it was sold the joke at the time was that “GM was a bank that happened to make cars”.

Another issue was that having acquired 20% of the Italian automaker Fiat for an exchange of $2.5billion GM shares, a deal which in addition to its Opel/Vauxhall brands would have given GM dominance over the European market, they bought-out. There was a clause in the deal, which could allow Fiat to force GM into buying the remaining shares and taking control, but instead GM paid $2billion to come-out of the deal and consequently Fiat used that money to restructure “turning itself around” and is now Chrysler’s newest owner. Finally, GM was noted to have overreacted to the truck boom and this is evidenced by their Hummer brand of SUV’s. The failure here was that by the time they got into the market, there was starting to be a change in taste away from trucks due to the hike in fuel prices & environmental concerns such as “global
warming” and therefore, GM was faced with no option but to wound up the Hummer brand (Carty, S. 2009).

By filing for bankruptcy, they were protected by the courts in order to be able to carry out a formal restructuring of the business. They have been backed by over $49billion\textsuperscript{104} in aid by the American government in the years preceding and proceeding from their bankruptcy filing. All this meant that one of the world’s largest automaker did not meet the fate of Lehman’s or Enron, it had survived. GM was able to reduce its costs by ‘disposing off leases, contracts, employee benefits and, in some cases, court judgments or class action lawsuits’ (Tumulty B, 2009)\textsuperscript{105}. History has evidenced that businesses with a profitable core business can survive bankruptcy. The government now owns 60% of the firm’s stock in a smaller, more profitable company\textsuperscript{106} (Welch D, 2009).

From the above, it is clear that most of the issues and problems that brought General Motors to the brink of total failure would seem fortuitous. However the researcher would argue that the inadequacy of the board/management to be proactive & innovative and to pursue change in light of unfavourable market conditions to be one of the issues that brought GM to the brink of complete failure. Furthermore we note that market forces & economic conditions, management inaptitude, credit freeze, lack of foresight as evident in opting out of Fiat are all justifiable recurring themes and have been noted in the companies above.


2.3 The OECD’s Corporate Governance Findings

According to the OECD’s findings\(^{107}\), the financial crisis highlighted CG’s importance to financial institutions and non-bank institutions such as insurance, pension funds, and micro-finance institutions. Recent evidence shows that inadequate board oversight, weak internal controls, and insufficient supervisory emphasis on CG were detrimental to safety and soundness.

Findings

1. Remuneration policies/incentive schemes

Remuneration/incentive schemes have been noted to be negotiated at an arm’s length, with managers having too much influence over the level and conditions for performance-based remuneration. Furthermore, the boards have been identified to be unable to exercise objective/independent judgement, hence resulting in weak links between performance and remuneration. Moreover, the use of a company’s stock price as a single measure does not permit benchmarking or enable comparisons against an industry/market average. The OECD noted the asymmetric nature of incentives due to their limited downside risk has encouraged excessive risk taking. They are usually short-term focused with an inappropriate balance between the fixed and variable components.

2. Risk management practices/standards

Inadequate risk management was noted to be widespread and in many cases, risk was neither managed on an enterprise basis nor adjusted to corporate strategy. Furthermore, boards were in a number of cases were ignorant of the risk facing the company. Liquidity risk which resulting from borrowing short and lending long (maturity transformation) required a great deal of prudential oversight.

3. Boards

In cases such as those at Lehman’s, the functions of the Chief Executive Officer and Chair of the Board of Directors were not separated. Policies for the identification of the best skill composition and professional qualities for an effective board were non-existent.

4. Shareholder Activism

\(^{107}\) Corporate Governance and the Financial Crisis: Key Findings and Main Messages:  
The alignment of the interests of some shareholders and those of management led to a great deal of short-term behaviour. Furthermore, shareholders were noted to be reactive rather than proactive, seldom challenging boards in sufficient numbers to make a difference. Moreover, the voting behaviour of certain shareholders suggested, that they can have significant conflicts of interest.

The findings of the OECD go to further highlight some of the issues discussed in literature.

2.4 Reports on the financial crisis

The financial crisis inquiry report (FCIR)

In the US, the Financial Crisis Inquiry Commission (FCIC) through this report stated the causes and issues that led to the financial crisis. It is noted that the issues that led to the crisis were years in the making. Nevertheless, the burst of the housing bubble in America around 2007 caused by a plethora of issues ranging from low-interest rates, cheap and available credit, deregulation & free markets (“scant regulation”) and the sub-prime mortgage debacle is one.

Risky mortgages running into trillions of dollars were packaged and sold much like the maligned Goldman-Sachs ‘ABACUS’. These mortgages were so widespread that the risks became embedded and systemic. Furthermore, risks were magnified by derivatives (a security/asset which drives its value from an underlying asset) such CDO’S. The collapse of Lehman’s and the impending collapse of AIG (American International Group) in 2008 caused panic and pandemonium, with the panic in the markets attributed to a lack of transparency on the balance sheet of major financial institutions, in addition to interrelated exposures arising from complex and risky transactions.

These institutions considered to be “too big to fail” caused the credit markets to seize up and stocks to plummet, much like the South-Sea bubble. Consequently the economy plunged into a deep recession (FCIR, 2011).

In their findings, the commission concluded that that the crisis was avoidable and was caused by human action and inaction. They stated the dramatic failures in CG & risk-management, excessive borrowing, risky investments, lack of transparency, a systemic breakdown in accountability & ethics, the collapse in mortgage lending standards, mortgage securitization,
lack of regulation with regard to over the counter derivatives (OTC’s), credit rating agencies and failures resulting from inadequate regulation and supervision were to blame. Furthermore, debt in the U.S financial sector had soared to $36 trillion in 2007 and there existed an inability of public stewards to fully understand, question and manage risk. Predatory & risky subprime lending practices accompanied the unsustainable rising prices in the property sector.

The lack of independence in oversight manifested in $2.7 billion in lobbying expenses and $1 billion in political contributions. Furthermore, the over reliance on mathematical models, chased common sense and reasonable judgement out the door. Compensation was based on the short-term performance as confirmed by the OECD’S CG report in an era where the quick deal was rewarded.

Examples of CG issues include, AIG senior- management’s ignorance of the terms and risks of a $79 billion exposure to mortgage-related securities, Fannie Mae’s increased exposure to risky loans and securities in the quest for bigger market share, profits & bonuses and Merrill Lynch realizing that it held $55 billion of supposedly “super-safe” mortgage-related securities that resulted in billions of dollars in losses. In 2007, Bear Stearns, Goldman-Sachs, Lehman-Brothers, Merrill Lynch, and Morgan-Stanley were operating with extraordinarily thin capital but were taking on huge risks. Lenders made loans that they knew borrowers could not afford and that could cause massive losses to investors in mortgage securities (Moral hazards).

They concluded that attributing the crisis to mortal flaws like greed and hubris would be simplistic, maintaining that, the failure to account for human weakness was relevant to this crisis. They stated that the crisis was a result of human mistakes, misjudgements and misdeeds.

**The Nyberg Report**

This was an Irish report on the causes of the banking crisis in Ireland. The problems noted here were not in isolation as Irish banks usually adopted policies from abroad, mainly the UK. In the case of Ireland there was a reckless abandon in assessing wholesale funding and lending to the property sector\(^{108}\). The report noted that regulators, auditors and credit rating agencies generally remained calm and optimistic until the eleventh hour, hence it suggests that they generally did not understand the risks facing the banks.

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Banks in Ireland, pressured by the need for increased earnings and increased competitiveness in the European market reacted by setting aggressive profit targets without making adequate and fundamental adjustments to their strategy. They believed that the Celtic Tiger (a metaphor for Ireland’s earlier economic boom) had come to stay. There were moral hazard such as incentives to conform to prevailing views, even in cases where proper analysis would have identified the growing risk. Furthermore, with Ireland’s construction sector growing, Irish Banks such as Anglo-Irish (Anglo) and the Irish Nationwide Building society (INBS) were involved in speculative site finance and increased financing of commercial property in order to achieve profit growth. Their risk mitigation, primarily only involved selecting trusted and previously successful customers, which in hindsight was a terrible and bad risk-management procedure. CG controls weakened over time due to poor management information systems that resulted in incomplete information to directors/boards. Moreover, divisionalization made group oversight very difficult.

The Non-executive directors lacked sufficient knowledge and expertise in assessing the relevant funding risks inherent in their business models and as noted in the FCIR, there was an over reliance on various models including regulatory capital requirements\(^\text{109}\) (Kwak J, 2009), which after an examination in the aftermath of the financial crisis were deemed to be inadequate (Benink H and Kaufman G, 2008)\(^\text{110}\). In Anglo, a lot of board members had significant shareholdings in the bank thus it’s an example of board optimism and lack of understanding of the risk facing their banks.

Remuneration was not a major cause of the crisis in Ireland as noted in the report but it was upheld to be a likely contributor to expansionary lending since the incentives did not sufficiently stress modifiers for risk.

Conflict of interest arose from treasury centres acting as profit centres & using short-term funding to increase treasury profitability at the expense of long-term profit stability. Risk

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\(^{109}\) James Kwak: *Regulatory Capital Arbitrage for Beginners*  

\(^{110}\) Harald Benink and George Kaufman: *Turmoil reveals the inadequacy of Basel II*  
management was ineffective and furthermore, in the media and amongst some political/academic circles, the thinking was that there would be a “soft landing”.

The report placed blame on the authorities, as government policies tended to support their expansion and risk went undetected or at least seriously misjudged by the authorities whose actions and warnings were modest and insufficient. The Financial Regulator (FR) continuously trusted bank leadership to make proper and prudent decisions, but even when problems were identified, corrective action wasn’t taken by the FR. The report argues that, although the FR did not have the powers to intervene, it could have acted with either the support of the Central Bank (CB) or the government. Consequently, the report cited the lack of scepticism and the appetite to prosecute challenges as the real problem.

The CB relied on the FR to appropriately handle banking stability issues, and in turn the FR chose to trust bank leadership. This would justify the argument that there was a lack of responsibility on the part of the authorities. Furthermore, the hierarchical culture and elements of self-censorship at the CB made it difficult to address the increasing instabilities in the financial market. Neither the FR nor the CB suspected any significant problems.

The Department of Finance (DOF) despite its mandate, did not see itself as concretely involved in financial stability issues. Furthermore, it did not have the requisite professional staff. However, it is well documented that the DOF consistently, though not forcefully enough, supported a less expansive fiscal policy, particularly regarding property market incentives. It also appears that worries about the developing financial situation were expressed internally from time to time by some DOF staff. However, nothing came of this as the CB and FR were seen to hold the responsibility for financial stability (Nyberg, 2011).
2.5 Corporate Failure & the Economic Cycle

Literature contains studies focused on explaining the relationship between business failures and fluctuations in aggregate measures of economic activities (Liu J, 2009) and (Kane, G, Richardson, F, & Graybeal, P 1996) suggested that stress processes resulting in corporate failure can be dichotomized into two groups:\footnote{Kane, G, Richardson, F, & Graybeal, P 1996, ‘Recession-Induced Stress and the Prediction of Corporate Failure’, Contemporary Accounting Research, 13, 2, pp. 631-650, Business Source Complete, EBSCOhost, viewed 17 June 2014.}

1. Macroeconomic stress processes induced by firms' exposure to events such as a recession and

Here, the research focuses only on the macroeconomic determinants of failures

Their results supported their hypothesis that the occurrence of corporate failure depended at least partly on whether the source of a firm’s stress is recession-induced. The first research into the issue, was that of Rose, Andrews, and Giroux (1982)\footnote{Rose, P, Andrews, W, & Giroux, G 1982, 'Predicting Business Failure: A Macroeconomic Perspective', Journal Of Accounting, Auditing & Finance, 6, 1, p. 20, Publisher Provided Full Text Searching File, EBSCOhost, viewed 17 June 2014.} citied in Kane et al, which studied the effect of economic developments on the probability of failure from an initial list of 28 business cycle indicators.

Recessions are noted to be often characterized by a general loss of confidence, accompanied by growing risk-aversion on the part of lenders and suppliers. Furthermore, it is usually preceded by above average periods of economic growth i.e. high level of sales & expenditure. Therefore, it follows that, during a recession, creditors and suppliers might be more inclined to force a run on stressed firms, ultimately leading to bankruptcy or involuntarily liquidation. A reduction in sales and an increase in costs could combine to produce recession-induced stress. Firms that failed during a recession were suggested to be perhaps severely constrained by these stressed conditions.

Kane et al (1996) asserted that the effect of recession-induced stress on the risk of CF will vary as a function of a firm’s fundamental & stress related characteristic. This is because firms who pursue expansionary strategies prior to a recession, are noted to be more susceptible to the risk
of recession induced CF. Whereas, others mitigate such risk by building up cash reserves, reducing capacity and carefully managing inventory.

Chrysler was able to make a profit in 1990 because we saw the trouble in the economy earlier and we began back in May, 1989 to take tough, painful actions to get trim for the downturn... we tackled our capacity to control our costs and we did so sooner rather than later. (Chrysler 1990)

Kane et al (1996) notes that the knowledge of the source of stress (a recession) together with the current fundamental characteristics of a firm (sales performance, inventory, profitability) might signal that stress when it occurs would have little impact on a firm’s risk of failure. Furthermore, firms with stress related characteristics are usually burdened with detectable risk of corporate failure (Hopwood et al. 1994), this together with recession-induced stress may further intensify the risk, resulting in reduced cash-flows and impinged debt. An additive occurrence of this could push a firm across the threshold of insolvency thereby resulting in CF.

In a recession a run on a firm by investors and suppliers could lead ultimately to bankruptcy or liquidation. Increased competition for resources would spell the end for already stressed firms and would result in failure if the lender and creditors are unwilling to extend credit. Intuitively the duration of the stress and the nature of the economic cycle would have an impact of the level of failures.

(Liu J, 2004)\textsuperscript{113} indicated that failure rates are associated with credit, profit, price and corporate birth and death rates, with interest rates appearing to being a very important factor. Non-financial factors were noted to include the age of the firm, no. of directors and management behaviour. The results here indicate that failure respond to changing interest rates and that there exists a dynamic relationship between the macro-economy and CF rates. The control of price levels (inflation) is key to reducing corporate failures. If this is the case then it can be argued that a deflation in prices/a recession would impact on failures rates. Therefore interest rates and a deflation are argued to be recurrent themes in corporate failures as evidenced in the financial crisis. Krugman (1999) cited in Liu 2009, notes that shocks form corporate failures could lead

to a depression, or as we saw in the case of Lehman’s it could lead to financial failure and an economic recession.

(Dah-Kwei, L, & Malcolm6Smith 2007) & (Ildikó, K, Zoltán-Krisztián, K, Orsolya, S, & Nicoleta, J 2011) noted that several economic variables are closely related with corporate failures and Ildiko 2011 focused on GDP as one of the factors external to firms.

Furthermore, corporate failures are increasingly reacting to changes in monetary policy post the 1980 period. (Liu J, 2009) in her study indicates that new business incorporations would lead to an increase in future business failures. Her view can only be justified if the increase in new business incorporations leads to greater competition between firms in an economy, thus weeding out weaker corporations or it could be justified by the argument in studies which states that firms are most likely to fail within three to five years of incorporation (Altman, 1983; Hudson, 1987; Dun and Bradstreet, 1994 cited in Liu 2009).

2.6 Are corporate failures of any economic benefit?

Continental Illinois Bank, the sixth largest bank in America at that time with assets of $45 billion was bailed out with an infusion of $2 billion & a guarantee made jointly by the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency because it was seen as ‘systematically too important to fail’. The Comptroller of the Currency Todd Conover, in his testimony before Congress, pointed out “we could very well have seen a national, if not an international financial crisis, the dimensions of which would be difficult to imagine” (Conover 1984). Therefore, Continental Illinois was deemed to be “too big to fail,” regardless of existing laws or precedent (Smith RC, 2011).

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In 2008, over 20 years since Continental Illinois, Bear Sterns (the 5th largest investment bank in America) was forced into a merger with JP Morgan Chase (a top investment banking outfit) assisted by the Fed’s $29 billion guarantee of troubled assets. It was bailed out by the Fed because it was thought to be too interconnected to large banks through swap and other markets to be permitted to fail (Geithner 2008). Furthermore, the two largest government-sponsored mortgage finance companies in America, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) were bailed out, with the government capturing an ownership stake of 79.9% in each.

AIG (American International Group) was rescued from bankruptcy with an $85 billion infusion because it was the largest insurance company in America. AIG was in this position predominantly because of a “mismanagement of its risks and collateral exposures” (Smith 2010). However, on the same week, AIG was rescued, Lehman’s was let to go burst (‘hanged out to dry’). The issues the Fed had tried to avoid in the bailout of Bear Stearns and the others was exactly what it reaped in the fallout from Lehman’s Collapse. Regardless of the loss in value and panic in the financial markets globally, the government tried to “draw a line in the sand”.

Nonetheless, with several rounds of government intervention through the Troubled Asset Relief Program (TARP) of $700 billion, the government bailed out Bear Stearns, AIG, Merrill Lynch, Bank of America, Citigroup, and Wachovia in the interest of systemic stability. However, Lehman’s, Washington Mutual and much smaller banks were not saved. The government’s stance as to which firms would be bailed-out and which wouldn’t be rescued was far from clear. Lehman, which met the “too big to fail” criterion, had been allowed to fail anyhow. (Bernanke 2010) the chairman of the Federal Reserve Bank, points out that the Fed wasn’t in a position to rescue Lehman’s because its position was very different from Stearns because Lehman’s had little collateral. Nevertheless, in Ireland as well as all over the globe, banks were

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bailed with 3 of Ireland’s banks recapitalized and bailed out to the tune of €70 billion\textsuperscript{120} (Irish Examiner, 2011).

Bailouts are noted to usually result from managers’ greed, irresponsibility & stupidity and with reason is much disliked due to their use of taxpayers’ money instead of allowing market forces to take force (Smith 2011). This leads to the whole debate on Economic ideology\textsuperscript{121}.

This debate was highlighted in the BBC documentary on the collapse on Lehman’s where former CEO of Merrill Lynch John Thain argued that, letting Lehman’s go burst was “a tremendous mistake”. He stated, “what would it have cost to the save Lehman’s?” $20 billion perhaps $30 billion was little compared to the damage and billons lost in value from the fallout of Lehman’s. In contrast to his argument, Anthony Fry a former employee at Lehman’s pointed out that historians will debate about this for years. But there was a need for the government to “draw a line in the sand” (BBC, 2008)

John Maynard Keynes\textsuperscript{122} and Friedrich Hayek all great economists of their time, have all different economic ideologies. Keynes favoured interventionist government policies in the time of a crisis when ‘animal spirits’ as he puts it are very low and only government stimulation can stop the continuous decline or stagnation of an economy (Parguez, A, & Thabet, S 2013). He believed that a market economy wasn’t self-stabilizing, especially when private money was drying up thus government help is needed. Hayek, however was entirely against government intervention. He was in favour of the free markets. He argued that government intervention prevents the economy from returning to normalcy. Today the basic argument for bailing out large banks is that a single failure could contaminate the whole financial system and thus public good must be satisfied by the government.

However, the irony of bailouts is that, whether a government carries one out or not, it will still be involved economically in the situation that created the demand for a bailout (Smith, 2011).

\textsuperscript{120} €70bn: The total cost to the taxpayer of the bank bailout ... but bondholders will pay nothing http://www.irishexaminer.com/ireland/70bn-the-total-cost-to-the-taxpayer-of-the-bank-bailout-but-bondholders-will-pay-nothing-150015.html Accessed 20th June 2014.


Furthermore, Arthur-Andersen’s demise was argued not to have served the public interest\textsuperscript{123}, as there were thousands of innocent victims and redundant workers. Nevertheless, it puts auditors, lawyers, regulators and other financial watchdogs on notice. Andersen’s actions shaped the Sarbanes-Oxley legislation that tightened rules for corporate internal controls and public disclosures, while clarifying the obligation to preserve important business documents.

Hence the arguments for and against the likely economic benefit of CF or whether government’s should bailout ailing corporations is important in order to meet the research aims/objectives.

It is the researcher’s opinion that failures can be of economic benefit due to the cleansing of old wrongs and arguable improved efficiency for surviving firms. However, the losses and destruction in value as a result of huge corporate failures does indicate why governments are reluctant to allow economic forces to take their course and are therefore pressed into bailout system critical firms.

2.7 Conclusion on literature-review

The researcher has explored and pooled together a broad range of sources in order to understand the causes of corporate failure. This has therefore allowed for a greater understanding and awareness of the relevant issues.

Furthermore, it has equipped the researcher with the knowledge base required to further explore the causes and themes in failure through the collection of primary data via semi-structured interviews. Consequently, it permits the researcher to induct and theorize as to the recurrent themes in corporate failures.

The literature indicates that the causes of failure are not one fold, because CF emanates from a result of a combination of factors.

\textsuperscript{123} Andersen died in vain: 10 years after an ill-fated indictment, March 14, 2012
Figure 2.16 – Some themes derived from the literature-review
Chapter 3: Research Methodology & Methods
3. Research Methodology & Methods

Research is undertaken by individuals to discover things in a methodical manner thus increasing their knowledge (Saunders L, Lewis P and Thornhill A 2009)\(^{124}\). Methodical means that it is based on rational relationship and ‘Things’ signify the plethora of possible purposes for the research, it may involve describing, explaining, criticising and analysing data (Ghauri and Gronhaug 2005, cited in Saunders 2009). (Kumar R, 2011) agrees that research is for the search of knowledge & understanding and an activity undertaken to meet an aim/objective.

Methodology is described by Saunders (2009) as “the theory of how research should be undertaken, including the theoretical and philosophical assumptions” upon which the research is based and its implications on the choice of methods adopted. Furthermore researchers disagree on a commonly accepted definition of corporate failure. In this research we define "corporate failure" as the date of occurrence of the Chapter 7 or Chapter 11 bankruptcy petition filing, or the date of initiation of an involuntary liquidation proceeding, as provided by the Wall Street Journal Index or the their equivalents in countries outside of the U.S (Kane et al 1996). To explain the research process followed and the research methodologies adopted, the Research Onion as depicted by Saunders (2009) is used as the guide for this chapter.

![The Research Onion](image)

**Figure 3 – The Research Onion**

*Source: Saunders 2012*

3.1 Research Question, Aims & Themes

The research question: What are the recurring themes in corporate failure, will be answered by a combination of the themes identified in the literature-review and data collected from interview participants. Consequently, an induction is made about the causes & recurring themes in CF based on the literature-review and research findings. Furthermore, the questions listed below will be answered by conducting the research.

1. What are the causes of corporate failure?
2. Do the causes of failures vary by time or industry?
3. Who is to blame?
4. Are failures of any economic benefit? (The debate on bailouts)

These questions were devised based on the themes identified in Chapter 2. Therefore, to answer the research question, the research findings will be discussed with respect to literature. Furthermore, as interviews will be the method for primary data collection, investigator bias or coercion will be avoided in order to enable the establishment of grounded theories and other relevant themes in the area.

3.2 Research Philosophy

Research philosophy is the overarching term for the development and nature of knowledge, with Johnson and Clark (2006) cited in Saunders arguing that being able to reflect upon and defend our philosophical choices in relation to the possible alternatives that could be adopted is more important than whether our research should be philosophically informed. It is important to note that ‘no one philosophy is better than the other’, rather they are each better at doing different things (Saunders, Pg. 108, 2009). They differ on the goals of a research and the way to achieve these goals.

According to the research onion there are many types of research philosophies. Nevertheless, two of the most distinguished philosophies in literature are positivism and interpretivism (also

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called phenomenology)\textsuperscript{126} and between them, other philosophies that exist rely on some principles in positivism or interpretivism, the most notable of which is realism (Blumberg B, Cooper D, Schindler P, 2005). Moreover, they could be distinguished based on their ontological or epistemological assumptions \textsuperscript{127}(Venable 2011). Ontology studies the reality or nature of being while epistemology is concerned with the theory of knowledge & ‘what establishes adequate knowledge’ in a field of study.

Positivism is the epistemological position that views the world as external and objective, with the researcher, independent & value free in terms of his influence in the research process. It assumes that what is observed is usually quantitative & objective and that knowledge is developed by reducing a phenomena to simple elements representing general laws, similar to physical and natural scientists Saunders (2009) & (Blumberg, 2005). It emphasis on a structured methodology to facilitate replication. Whereas, interpretivism is the epistemological position in which the world is viewed as socially constructed and subjective. The researcher is part of what is observed (‘a social actor’) and sometimes even actively collaborates. The research is driven by human interest, it assumes subjective interpretations of meanings and takes a broad view of a phenomena to detect explanations beyond the current knowledge (Blumberg, 2005). Saunders describes phenomenology as the way humans make sense of the world and the researcher has to be empathetic.

On the other hand, realism is the epistemological position in which objects exist, independent of our knowledge of their existence. Therefore it is quite the opposite of idealism, the theory that only the mind and its contents exist. If follows the positivist view, by accepting a methodical approach to the development of knowledge.

Positivists assume that respondents understand the meaning of their questions identically. They measure their success by measuring how closely the results are aligned with those of other researchers. They work informed guesses or hypotheses and seek to test them. They take a

\textsuperscript{126} Boris Blumberg, Donald R. Cooper, Pamela S. Schindler: Business research methods. 2005, McGraw-Hill Education limited, United Kingdom.

neutral role and use standardized instruments. They focus more on testing existing theories and handle large sample sizes (Taylor P & Medina M)\textsuperscript{128}.

However, Post-positivism was derived from positivism and here the researchers argue that no one can argue that a theory is certain, only that it hasn’t been proven to be false (Willis, Jost, & Nilakanta, 2007, p. 73 cited in Sage). Total neutrality of the researcher is not possible. It values qualitative over quantitative research. It favours the interaction between the researcher and his research participants and uses additional methods such as survey research and qualitative methods such as interviewing and participant-observation (Creswell, 2008)\textsuperscript{129}. Nonetheless, these different philosophies could supplement each other.

Consequently, this research follows a post-positivist and interpretive research philosophy, based on the argument that the interpretative perspective is highly appropriate for business and management research particularly fields such as organisational behaviour. Moreover, it allows for subjective interpretations, qualitative data and doesn’t assume that participants understand questions identically. Furthermore, the data collection techniques of small samples for qualitative in-depth investigations will be utilized and the rationale for this is justified by the fact that the post-positivist approach favours interaction with the primary research participants and allows for research flexibility.

3.3 Research Design

The research design is the blueprint for the collection of data in order to obtain the answers to the research question Blumberg (2005). Saunders (2009) and Blumberg (2005) both concur that research method can be threefold: they can be exploratory, descriptive and explanatory. Exploratory studies are a means to find out ‘what is happening’. They include searching the literature, interviewing experts in the subject and conducting focus group interviews. Therefore, this design to be adopted by this research as it allows for interviewing experts and exploring the literature. Adam and Schvaneveldt (1991) cited in Saunders argued that although the


exploratory design allows for flexibility, it doesn’t mean an absence of direction in enquiry. Descriptive studies portray an accurate picture of persons, events and situations, it allows the researcher to put forward a clearer picture of a phenomena, whereas explanatory studies aim to establish a causal relationship between variables, thereby explaining a situation or problem.

There are two parts to this research. The first requires an investigation into the causes of corporate failure. Furthermore, the hypothetic-deductive approach is used in the literature-review in order to ascertain specific aims and objectives. The second part to the research will be the use of primary data through semi-structured interviews to meet the aims & objectives. The interview participants will be purposively selected due to their knowledge of the themes in CF. Furthermore from the data collected, the themes and theories about the causes of failure will be analysed and theorized (inducted). Therefore the research design is predominantly exploratory and retrospective in nature because failures have occurred in the past.

3.4 Research Approach

The research onion points out the deductive and inductive approaches to research. The inductive approach allows the researcher to gather data and then develop a theory as a result of an analysis of data collected. Whereas the deductive approach allows for the development of a theory or hypotheses that will be subjected to a rigorous test based on the research design (Saunders et al 2009). As deduction favours the methodical approach of positivism, it will not be adopted in this research.

In the deductive approach, quantitative data of sufficient size will have to be collected and the scientific approach (structured methodology) will enable replication, while induction allows for the use of small sample subjects and the ability to work with qualitative data. The key point here is that the inductive approach is vital for a researchers interested in understanding why something is happening (Saunders et al 2009) and permits for flexibility in research emphasis as the research progresses. Hence the inductive approach is justified as the approach in this research and is also in line with the research philosophy.
3.5 Research Strategy

Case studies, experiments, grounded theory and surveys are some of the leading research strategies. Saunders notes that your research question influences your choice of research strategy and therefore influences your choice of data collection techniques and analysis procedures. Since no research strategy is inherently superior to another, the strategy chosen must answer the research question. The strategy chosen is further underpinned by the research objectives & philosophical linings.

Experiments are used mostly in social sciences to test causal relationships between variables. There is usually a control or experimental group, with a selected sample and a defined hypothesis. Whereas, surveys allow for the collection of quantitative data, which could be analysed using statistics and usually helps to answer investigative questions. Experiments are deductive in nature and require data to be collected from a sizable population in an economic manner. However, due to their deductive nature surveys and experiments will not be used in this research because surveys do not permit for the qualitative nature of this research and experiments follow a methodical approach which goes against the interpretive philosophy of this research.

A case study is important for researchers who wish to get a rich insight of the context of research and process being enacted Morris & Wood (1991) cited in Saunders (2009). It doesn’t answer the how and what questions of a survey. It allows for the ‘triangulation’ of various data collection techniques & multiple sources of data. Saunders notes that this strategy could arouse unscientific feelings but argued that it is worthwhile for the exploration of existing theory. This strategy could be adopted for future research, however due to the timing of this research, it will be difficult to conduct an in-depth study into a particular company or be able to gain access to its employees. Therefore this strategy will not be adopted for this research. Furthermore, ethnography though an inductive approach is very time consuming and therefore it’s not a dominant research strategy in business & as such would not be adopted for this research.

Grounded theory has been thought of as the best inductive approach (Glaser and Strauss 1967 cited by Saunders). The emphasis here is on building theory through a possible combination of induction and deduction. It can be messy and doesn’t necessarily involve a set amount of interviews or the use of statistical software’s. Tacit knowledge and feel for the data is required.

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130 Who, what, how and where
It allows for the discovery of theory during data analysis. Consequently, this strategy will be adopted because it favours the use of interviews to find themes & theories in CF and therefore is aligned to the inductive approach of the research.

### 3.6 Research Choice

There are 3 choices for research: the mono-method, the mixed-method and the multi-method. To better understand our research choice. We distinguish between quantitative and qualitative data. The former is predominantly used to mean any data collection technique that requires the use of questionnaires or that produces numerical/graphical data (Saunders 2009), while the latter is synonymous with the generation of non-numerical data which may include words, pictures or video clips i.e. interviews

The mono-method allows for a single data collection technique and a corresponding data analysis procedure. The multi-method allows for multiple data collection techniques and analysis procedures, it may contain a mixture of quantitative and qualitative procedures. The mixed method allows for the application of both a ‘quantitative & qualitative data collection techniques and analysis procedures’.

The mono method will be applied in this research due to the collection of data by way of purposively selected participants for the in-depth interview (Kumar, 2012). The adoption of this method is justified as it favours the small sample of experts and professionals to be questioned, which is a drawback of using the quantitative questionnaire approach. A mixed or multi method cannot be applied due to time constraints and the research philosophy (phenomenology) which doesn’t favour quantitative techniques.

### 3.7 Time Horizon

Research studies can either be cross-sectional or longitudinal. Cross sectional studies are the study of a particular phenomenon at a particular time. It allows for the establishment of the prevalence of a phenomenon by taking a cross-section of the population. It is useful when there isn’t a sufficient amount of time due to research constraints and it further allows for qualitative data (interviews) to be collected over a short period of time. Therefore it is the relevant time
horizon for this research because the longitudinal approach neither favours the time frame for this research nor does it favour the convenience of the interview participants. Longitudinal studies only favour a continuous collection of information at intervals and could be affected by the condition effect whereby the sample begin to lose interest or have a perception of what is expected of them (Kumar, 2012).

3.8 Population & Sample

A sample is the subgroup of the population which is the focus of a research enquiry. It is selected to represent the study population (Kumar 2012). The overall population for corporate failures is unknown, but the bankruptcy filing database BankruptcyData.com has over 1000 firms who have filed for bankruptcy in the US. Consequently, because the themes in failure are global, during the literature-review we explored 6 cases where there was complete failure, 2 cases that would have resulted in failure and 1 case of government intervention following a bankruptcy. This is in addition to references & studies which used significantly larger samples during primary data collection. However the philosophy here favours a small sample size of 2 experts’ interviews for primary data collection.

A non-probability sampling technique is adopted in sample selection because according to (Kumar 2012), it is used when the elements of a population cannot be individually identified or is unknown. Therefore purposive or judgemental non-probability sampling is adopted because it favours the use of the researcher’s judgements in selecting participants who can provide information that enable the achievement of the research objectives. Moreover, the small sample size facilitates coding and analysis within the time frame for the research. Hence, a probability sampling technique is not adopted because it requires a high response rate, in addition to the requirement that the elements in the population should have an equal chance of selection.

An interview is a purposive discussion between 2 or more people (Saunders, 2009) and it is the approach to collect valid and reliable primary data relevant to the research questions. Interviews could be standardized or non-standardized and although there are different types of interviews, semi-structured interviews will be used, as they allow a one to one approach with a list of themes & questions to be covered. Moreover semi-structured interviews favour the exploratory

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approach of this research and answers could be probed, further justifying the interpretive philosophy. Furthermore, interviews can be conducted until the saturation point. The saturation point is key in a primary qualitative research approach, it is a point where no new information is derived from the interview sample (Kumar R, 2011). Therefore structured interviews will not be adopted because it is predominantly for the collection of quantifiable data.

One interview was a telephone interview and the other was face to face. Generalizability is justified to the extent that response can be related to existing literature and theories. Although telephone interviews facilitate for speedy data collection, there is a loss of non-verbal behaviour of the participant and the ability to pursue more complex questions. But this is remedied by a face to face interview. However a limitation of interviews is that it could contain both interviewer & interviewee bias.

3.9 Ethical issues & procedures

Researchers are required to exhibit ethical behaviour during a research process. Ethics is the study of right behaviour which addresses conducting research in a moral and responsible manner (Blumberg, 2005). Issues such as deception and the fabrication of data are deemed unethical and void for this research.

Ethical treatment of participants include (Blumberg, 2005)

- Explaining the benefits of the research
- Explaining the participant’s rights and protection
- Obtaining informed consent

The research is approved by the appropriate review panel at DBS, ensuring that it is viable and that all ethical procedures will be adhered to. The interview participants will be informed of the objectives of the research. Caution must be taken to maintain confidentiality and this is mentioned in an email to participants and again on the interview date. Before the interview begins, the informed consents of participants for the interview recording will be necessary. They would be assured of their rights to anonymity and the right to withdraw, should they feel the need to at any point during and after the process. Data protection via restricted access would be applied to the research if the participants so wish. After the interview, their rights to feedback and also to a summary of research findings will disclosed.
3.10 Data Collection, Editing, Coding and Analysis

Coding in qualitative research allows for the recognition and re-contextualization of data, allowing for a fresh view of what is there (Coffey A. & Atkinson P. Pg. 45 1996)\textsuperscript{132}. Furthermore by coding, meaningful bits of data will be organised and retrieved, tags and labels will be assigned and it will link different instances in the data collected. Primary data collected through semi-structured interviews will be coded to derive the themes in CF and to aid in data analysis, while secondary data collected during the literature-review from secondary sources will aid in the discussion & conclusion in Chapter-5.

NVivo\textsuperscript{TM} a qualitative software will aid the coding process. The interviews are first transcribed, then it is coded manually using NVivo. References relating to the research question are coded in-vivo (the exact word is coded) as a node. Each node contains the coding references pertaining to the relevant interview themes as assigned by the researcher. From the raw data, there will be preliminary codes and then final codes from which themes and concepts can be derived, thus enabling theories to be inducted. Coding might result in the identification of other themes which might require further exploration. Coding will follow the descriptive coding\textsuperscript{133} approach and during data interpretation, codes will be used to look for patterns, themes, regularities, in addition to contrasts, paradoxes and irregularities. The use of computer software’s such as NVivo permit for further analytical abilities such as the creation of models and association of themes in data collected.


\textsuperscript{133} Introduction to Coding: http://www.sagepub.com/upm-data/24614_01_Saldana_Ch_01.pdf Accessed 24th April 2014.
Chapter 4: Data Analysis & Research Findings
4. Introduction

Analysis is the interplay between the researcher and data, it is the separation of something into its component parts and it filters data to provide evidence\(^{134}\) (Ryan A. 2006). In qualitative research, the findings are not derived from statistical procedures, the focus is on non-mathematical processes for interpretation (Strauss A and Corbin J)\(^{135}\). Primary qualitative research through the mono-method of conducting semi-structured interviews allowed for an open-ended approach to answering the research question. Consequently, due to the research philosophy of interpretivism, the researcher’s self plays a significant role in the production and interpretation of data\(^{136}\) (Denscombe M, 2003).

4.1 Data Collection & Analysis

Primary data collection was achieved by conducting interviews with experts. Non-random purposive-sampling was used to identify and contact participants. This led to 2 expert interviews (one phone interview and one face to face) that resulted in over 75 minutes of data as regards the research objectives. As noted in Chapter 3, NVivo a qualitative software was used to code the interview transcription into themes via nodes, therefore aiding analysis. Transcription took over 14 hours to complete, whereas coding was achieved over 2 days and was a continuous process. Consequently, the findings from the literature review and the experts can be appraised.

4.2 Validity & Reliability

Validity is the ability of an instrument to measure what it was designed to measure (Kumar R). The validity of interviews is ensured by carefully listening to the recording to ensure that the research question can be answered after transcribing the interview recordings and coding. Expert non-random purposive-sampling ensures that the participants provide responses that will help to answer the research question. In order to maintain the reliability of the research, care is taken during data analysis and neutrality is maintained in the interview process to prevent bias


following a suggestion by Saunders that semi-structured in-depth interviews do raise reliability concerns. Hence reliability is maintained to the extent that whenever the research is replicated, the interview responses are applicable to answering the research question.

4.3 Findings

The participants were asked to give a synopsis of their educational and professional background before further inquiries commenced as a way to ask warm up questions and make them feel comfortable. Interview 1 was a telephone interview and Interview 2 was a face to face interview. [See appendix for transcripts].

4.3.1 Participants Background

Participant 1[KENNETH]: denoted by KK in the transcripts studied Economics at Stanford University and has a Law degree from Harvard Law School. He is a partner at a top law firm and a top bankruptcy attorney with over 30 years of bankruptcy experience having worked in the drafting of bankruptcy legislation and representing clients in bankruptcy litigation. He is also a professor at one of the top colleges in California.

Participant 2[DECLAN]: denoted by DW in the transcripts, studied Accounting and Finance in Ireland. He is a Chartered Accountant & a bankruptcy/insolvency manager in one of Ireland’s top global accountancy practice. He has worked within 2 top public accountancy firms in Ireland, carrying out audits and working in corporate recovery & restructuring, including roles involving examinerships, receiverships and insolvencies. He has 10 years of experience in the industry and has carried out investigations into a lot of fraud related cases.
Figure 4. – Participant background child nodes

The model above depicts the child-nodes that resulted in a background of the interview participants.

From the above descriptions, the term expert is justified because all participants based on their level of education & professional experience have a relevant knowledge of the issues and themes related to the research question. Therefore, they constitute a valid sample with the ability to provide reliable & valid responses during the interview process. Consequently, the adoption of non-random purposive-sampling is again justified.

4.3.2 The normality of corporate failure

In chapter 2, corporate failure was specified simply as when a limited company goes out of business and previous failures such as the collapse of the Medici Bank in 1494 and the failure of Lehman-Brothers in 2008 further indicated why this it is not a new phenomenon. Moreover, according to KENNETH, corporate failure is “part of any capitalistic system and for that matter any business system”. In accordance, DECLAN stated that there has to be a degree of CF in order for people to take the risk of setting up businesses and if it doesn’t work out for whatever reason, they could liquidate the company and try their hands at something else. Furthermore, DECLAN suggests that failures are a “fact of life”, in view of firms who have failed without any managerial wrong-doing.
“But in some many instances, they didn’t do anything wrong, the company might have gone into receivership or liquidation but that is a fact of life as well.”

4.1 – Corporate failure primary nodes
This model shows the themes coded for CF and Normalcy is one.
4.3.3 The causes of corporate failure

What are the causes of corporate failure?

Figure 4.2 – Causes of corporate failure nodes

This model shows the nodes for the causes of CF and some sub-nodes.

The participants were asked about the causes of CF in their various jurisdictions i.e. KENNETH in USA and DECLAN in Ireland. According to KENNETH, there are different causes of CF. Essentially we could have out-moded products & product externalities whereby a product has become toxic, bad management, expansion of a business beyond its capacity to control, rising interest rates, a lack of liquidity & capital, over population in an industry, competition, fraud every now & then, high leverage and over regulation. Some of these causes were repeated during the interview. He further suggested that in other countries government regulation could lead to failure.
Extract 1 - “bad management, lack of liquidity, out-moded products, over-competition and expansion. I would say those would be the main causes of failure”.

Extract 2 - “Lack of liquidity, over regulation, out-moded products all of these things can lead to failure”

When asked why some causes of CF are more prevalent than the others. He replied that: “There can be reasons why liquidity is a more prevalent cause, when you have central banks and governments that take action that cause a crisis in confidence”. This indicated one of the ways through which firms develop liquidity issues. Similar to his view, DECLAN somewhat agreed that a change in policy by the government at the micro-level could lead to failure but that at a macro-level it was up to managers to adjust accordingly.

DECLAN identified that liquidity was the main issue across industries. “Liquidity would have being a huge problem for a lot of business, as it was across the board”. Long-term liquidity issues result in insolvency and companies may have to be liquidated through the sale of its assets to settle any outstanding liabilities. He stated that liquidation is of two types a “creditor’s voluntary process or by high court liquidation”. A liquidation usually leads to the winding up of a company & consequently failure; “that ends up in the company being wound up, dissolved and struck off the register”. He noted a lack of funds & capital as one of the causes of CF, thus agreeing with KENNETH that a lack of liquidity is a problem.

According to DECLAN, poor information systems was predominantly a problem in many big insolvencies, stressing that companies were unable to detect that there was a problem before the 11th hour because surplus cash, growth in profits & turnover had masked the underlying issues.

Extract - “So poor information systems kinda led to that scenario were people don’t know when they are in trouble and leave it too late to get professional advice”.

According to DECLAN, another issue that could lead to failure; “this is quite a subjective one but the way I would put it is as not sticking to the knitting”. He confirms that it is when individuals & companies move away from their core business or competence. This was coded under the node deviation as one of the causes of CF. He reasons that individuals might do this to prove that they possess great business acumen. He identified a managing director, who had founded a successful pharmacy chain and was a “good pharmacist” but had “mistakenly assumed” that he possessed great business skills. Moreover, he had used the company’s reserves
to fund projects completely unrelated to the pharmacy industry such as in the retail & IT sectors, in addition to some property investments. Furthermore, the parent company had bailed out the other unsuccessful ventures, resulting in liquidity problems when business got tight. His opinion was that if the managing director had stuck to the knitting then there would have been plenty of cash in the bank.

Extract - “Rather than allowing those companies to go into liquidation and fail as they have just failed, they were bailed out by the pharmacy companies which had strong cashflow and plenty of reserves”

Furthermore, he identified the Quinn Group in Ireland as another company that should have stuck to the knitting. The Quinn Group was a large construction company but it had entered the Insurance industry. He had worked on the administration of the Group, finding that huge losses were built-up in the company and that if the Group had stayed away from the Insurance industry and the CFD’S (contracts for difference) a kind of derivative bought by its former billionaire owner Sean Quinn, it would have survived. “Ultimately the failure of those businesses that led to the receiver was as a result of the CFD’s”. Moreover, the group wasn’t equipped to go into the insurance industry. “I don’t think they were sufficiently well equipped to go into the insurance market”. In his view, the company would have survived the fall in the demand of construction materials if it hadn’t diversified. This issue of not being well equipped to enter an industry further justifies the argument for bad strategy as a cause of CF.

When asked why entities deviate from their core business, he speculated on the likelihood of greed and optimism “there is probably of mixture of…optimism, greed, I suppose to an extent”. He acknowledged that it was difficult to pin-point the exact motives behind deviation. Nonetheless, he agreed that; “….greed probably does play a large part”. In contrast to his view, the researcher argued for the case of diversification in which DECLAN stated “there is an element of diversification which is good, but you do need to stick to your core strengths”, furthermore, he stressed the need to diversify in such a way that you “don’t put your core business at risk”.

Extract - “If you want to go down the route of buying a few hotels, go for it but make sure that your hotels don’t bring down your IT business”
The participants agreed that rapid expansion does lead to CF. KENNETH stated that the expansion of a business beyond its capacity to control & over expansion are causes of CF, while DECLAN identified the case of a retail chain which had grown rapidly from 10 outlets to over 42 outlets within the space of half a decade. He indicated a lack of responsibility as a problem “No one was paying any attention to, what if it all goes wrong, are we adequately protected here”. The total lack of responsibility & complacency was confirmed by the expert in the statement “they certainly took their eye off the ball”. Rapid-expansion could lead to a “loss of focus” but nevertheless, expansion is pursued by many in management.

Management have been blamed for over-expansion. In the motor-industry, there was excessive borrowing to invest in business infrastructure such as state of the art showrooms. They didn’t foresee the financial crisis which caused a fall in demand and thereafter business closures. DECLAN stated that “the guys that survived were the guys that were in a gravel yard”. Moreover when asked who was to blame he noted that “you have to blame the directors there, they decided on a strategy” that resulted in a dive in operations. Furthermore in line with various reports indicating that there was a lack of adequate skill sets by top management & directors in CG failures, DECLAN acknowledged that companies who failed did not have the capacity and ability to make the right decisions, “you know internally, they didn’t have the management, they didn’t have the ability to be able to restructure their business”. He noted that the companies who had the right management and who made the right decisions survived while others “weren’t and a lot of those are gone”.

According to KENNETH, product & other externalities such as products becoming toxic, outmoded products and a fall in demand according to DECLAN are causes of CF. Failure could stem from a plethora of factors such as trends in market & economic conditions i.e. a recession & competition. Furthermore, natural disasters, a change in taste, the loss of a key customer or the failure of a key supplier and cost drivers can are causes of CF. For example DECLAN cited the fall in demand for rooms in the hotel industry and a fall in demand for cars in the motor industry following the financial crisis in 2008 as a cause of CF. These array of factors result in a reduction in profits and ultimately insolvency. He revealed that in the baking-industry, the campaign against white bread & cost drivers made having many big bakeries inefficient. Consequently it led to insolvencies, mergers & acquisitions and a reduction in the number of large bakeries in the country.
Extract - “we only need only ten large bakeries in the country and we’ve, we are seeing a couple of insolvencies in that area.”

Furthermore, cost drivers & a fall in demand in Ireland’s carpet industry led to the collapse of the sector because the production process became inefficient. Consequently carpets in Ireland are now sourced from the UK.

Extract - “there was a lessening demand for carpet on the one hand and serious cost drivers on the other hand in the manufacturing here, it just made it uneconomical to produce carpet in this country”

The competition in industries such as the hotel-industry emanating from the financial crisis, led to closures because hotels in secondary & third rate locations didn’t have the capacity to compete with the hotels in the primary locations. DECLAN blamed failures on the size and capacity of firms to compete. Moreover, the lack of a secondary use of assets made it impossible to generate revenue.

Furthermore, various industries made “passive investments” in the property market and the burst of the real-estate bubble made debts uncollectable, resulting in a “huge drop in revenue” for large suppliers & failure for a number of suppliers.

Extract - “a lot of them had invested very heavily in properties”.

Figure 4.3 Products, Changing Trends & Economic Conditions Associated

The nodes are associated based on coding
Figure 4.4 - Economic conditions & Changing trends Associated

This model depicts the coded association between the nodes; economic conditions & changing trends. Furthermore the child nodes for the themes coded are traced to the node causes of CF.
Distinction between Examinerships & Receiverships

DECLAN was questioned about the distinction between examinerships and receiverships, this led to the clarification between the two terminologies. In an examinership, he states that the idea is to restructure a company to reduce costs so that it can continue to trade into the future:

Reference 1 - “An examinership then is a different process were by, the goal is that the company will continue”

Reference 2 - “the idea is to restructure the company”

Reference 3 – “that the company will emerge at the other side in a position to continue to trade into the future

Whereas in a receivership, a receiver is appointed over the assets of a company. The disposal of assets by the receiver realizes funds that can be used to settle charge-holders such as banks. But in some instances the assets are core assets and as such a company becomes “a shell of itself” and thus a liquidator is then appointed to wind up the company. When asked if a receivership leads to CF he stated “Exactly”, “Ultimately it usually ends up in corporate failure and a liquidation”.

4.3.4 The Degree of Variation

Do the causes of failures vary by time or industry?

The causes of failure were stated to vary by time, pre & post the financial crisis and by industry specific issues. DECLAN revealed that fraud and businesses without a backbone during the Dot.com bubble would have been causes of failure pre the financial crisis and that failure were usually dominated by the two industry specific issues such the loss of a key customer or the failure of a key supplier.

Post the financial-crisis, he described a “wave” which swept away companies, with the causes of CF now related to consumer trends & a fall in demand, uncollectable-debts and insolvency. KENNETH also noted that post the financial crisis liquidity was a pretty unique factor. However, he stated at the moment, we have a normal array of causes such as bad management and product externalities.
Extract - “after 2008 you had a liquidity crunch around the world and it was just difficult to find capital, investment capital”

Figure 4.5 – Variation Nodes
The model above depicts the link between economic conditions & the parent node Variation. Furthermore, it indicates the nodes & themes coded for failure pre & post the financial crisis.
4.3.5 Who is to blame?

![Diagram showing relationships between Who is to blame, Directors, and The government.]

**Figure 4.6 - Who is to blame?**

The model shows the two the themes coded under the theme who is to blame.

According to DECLAN, “it’s hard to look past the directors...in any corporate failure”. Usually failures are looked at from the perspective of the roles individuals played preceding to failure. Furthermore, the blame is trickled down to other parties “ultimately...the directors would blame various other parties”. He argues that although the banks have taken the blame for the financial crisis that companies & individuals would still have ended up with either huge deficits from a liquidation or wouldn’t have survived the recession. He maintains the blame of directors by stating that realistically directors are to blame where after diversification “some directors might take their eye off the ball” & “they don’t pay enough attention to the company and it fails unnecessarily”.

He stated that although the government could be blamed for CF at the macro-level that it is still up to the directors to make the right decisions and adjust accordingly “as a director, the buck stops with you”. He stated that directors at the micro-level, firms who are faced with a sudden withdrawal of credit might have no option but to put the company into a liquidation.
4.3.6 Economic benefits & Bailouts

Are failures of any economic benefit? (The debate on bailouts).

According to DECLAN “to a degree, a lot of corporate failure is good, it needs to happen as well in a normal functioning economy”. He notes that it helps to “weed out the weak companies and separates the wheat from the chaff”. Furthermore, he stated that like “the herd, it thins out the weak ones”, especially in industries where there was over-population e.g. the hotel industry. KENNETH notes that you can learn from failures the mistakes people make in order to avoid them in the future. However, regardless of the normalcy & benefits of CF, the participants both concur that systems should be made available to aid companies who go out of business either through a liquidation or by filing for bankruptcy.

KENNETH: “it’s something that the legal systems should have in place a way to deal with it from a societal standpoint”

DECLAN: “you need to have those facilities in place to set up a company and if it doesn’t work out for whatever reason you can put that company into liquidation”

As regards the issue of government intervention & bailouts, KENNETH stated that “it depends on whether the company is critical to the economy or not”, remarking on the too big to fail controversy as explored in Chapter 2. “You know in America, we had our too big to fail controversy”. He believed that the companies that were saved in America needed to be saved but that however people have different views on bailouts.

Extract - “we had some businesses that were saved. I happen to believe, they should have been saved but there a lot of people, who believe that they shouldn’t have been, so you know...Those are the breaks, that’s what you have to look at.... people have different views on these things”.

Although the participants had different geographical, educational and divergent professional backgrounds, DECLAN nonetheless agreed that bailout was necessary in the Irish context because Ireland is a small economy and the implications of letting the banks go burst would have resulted in civil unrest due to the many ordinary families and individuals tied to those institutions. However he stated that bigger economies would be able to cope with letting a bank go burst.

Extract - “The bailout in Ireland and for Anglo and for those other banks was necessary”
“I think civil unrest would have broken out and if had been let go to the wall” …“a lot of depositors are you know John and Mary”,

He stated that the bailout in Ireland was basically a redistribution of the problem and it meant that the load was shared by all Irish citizens. Furthermore, he pointed out that bailing the bondholders was less credible but it had to be done, to allow for access to future finance and so as to portray Ireland as a first world economy.

“It’s really just a redistribution of the problem so instead of the problem of Anglo collapsing affecting 20% of Irish citizens, it is effectively, a 100% of Irish citizens”

“I think in terms of bailing out depositors, absolutely. Bond holders it is less credible”

“but in a big economy perhaps like in America, they can afford to let a bank [?] because the impact won’t be as widespread on the nation as a whole”
Figure 4.7 – The Set

The model above shows the set (Background, Corporate Failure & Corporate Survival), which constituted the primary nodes for coding. Included are some child nodes.
Figure 4.8 – The coding process

The model depicted above, shows the flow of coding & child-nodes to one primary node (corporate failure).
4.3.7 Corporate Survival

The model depicted below, shows the nodes that contain references & themes interpreted and coded under corporate survival. These themes came about through the data analysis process and thus gives an insight into the ways companies can survive failure in an ever competitive and risky environment.

The findings presented in this chapter will be further discussed in Chapter 5.

Figure 4.9 – Corporate Survival Nodes

N.B: All models only indicate the themes coded under the nodes. The more Complex models with many nodes & sub-nodes are built to be simplistic. Furthermore, the size of each node wasn’t built to the scale of any themes or in relation to the number of references made.
4.3.8 The factors that lead to failure

The researcher based on observations & thought, having explored the causes of failure in literature & analysed the primary data, argues that all the causes of CF can be categorized under four main headings. This finding is new & relevant and the headings are presented below.

- **Economic Factors**: The causes of failure in this category include; a recession, inflation, interest-rate changes, aggregate demand & supply, a financial crisis or the burst of a bubble etc.
- **Human Factors**: As the term suggests, it includes causes such as greed & hubris, corruption, fraud, personal ethics & background, risk-appetite, human-error etc.
- **Systemic Factors**: They include inadequate risk-management, risk-appetite, poor-information systems, corporate culture and corporate governance, corporate codes of conduct, ethics, rules, regulations and standards.
- **Other Factors**: All other causes of CF which do not fall under the above headings i.e. war, natural disasters & other unfavourable unforeseen factors etc.

Figure 4.10 Factors that lead to failure
Chapter 5: Discussion & Conclusion
5. Introduction

This chapter seeks to interpret and make a judgment about the research findings. The aim is to induct from the findings & literature review, the recurring themes in CF. Finally, it states the scope and limitations of the research, the contributions of the research and the opportunities & recommendations for future research. Finally, there is a conclusion on the whole project (Saunders, 2009).

5.1 Discussion

5.1.1 The Normalcy of failure

The finding that failures are a part of life justifies Suter’s (2003) statement that CF is not a new phenomenon. Furthermore, it validates the finding that failures are a part of the business or economic system and that failures are inevitable given the risks & competition faced by firms in an ever globalized world (ACCA, 2008).

5.1.2 The causes of corporate failure

The lack of liquidity, funding or capital based on the findings is a cause for CF. It is a problem because liquidity or cash is the life blood of any business and without liquidity businesses cannot survive. A lack of liquidity could stem from a ‘crisis in confidence’ in the markets or in a firm. In literature, many of the firms who failed, experienced a loss of liquidity when investors lost confidence and began to dump their stocks. Moreover, liquidity issues could also stem from a decline in turnover, a change in consumer taste & a fall in demand due to an economic downturn. This result was expected as an economic downturn or the burst of a bubble in literature usually led to a dry up of liquidity and a fall in demand for items previously highly sought after i.e. the financial crisis lead to a fall in demand in the construction & real-estate sectors, in addition to loss of liquidity in the financial markets.

Insolvency, a long-term liquidity issue also leads to CF, without liquidity, a firm loses its ability to finance daily-operations or settle immediate liabilities. Ultimately, its creditors or the courts could demand that the company be liquidated to settle liabilities. Moreover, the charge holders
i.e. banks could appoint a receiver to realize the assets of the company. When assets are realized, firms with limited or no assets cannot survive, hence they are liquidated & dissolved. This was something new found during the research that wasn’t emphasized in the literature-review.

The demise of The SSC, The Mississippi-Company, Enron and Lehman’s all share a loss of liquidity as one factor for failure. Moreover, bad-management can lead to liquidity issues when cash-reserves are used to acquire or prop-up a bad company during good times. Therefore the lack of liquidity, funding or capital is inducted to be cause and a recurring theme in CF.

**Bad-management** & directors have been blamed often as causes of CF. Bad-management manifests itself through the lack of responsibility, a loss of focus, bad-strategy, complacency and the deviation of businesses into unknown markets & industries without the appropriate information, capacity and skill sets to go into those industries. The liquidation of the Medici-Bank was attributable to excessive & reckless-lending due to managerial discretion and irresponsibility. The case of the pharmacy chain & The Quinn-Group both suggest that hubris can lead to bad-management and that poor information-systems are reflected in the inability of management to make survival critical decisions. Poor information-systems was emphasized as a cause of CF in the Nyberg report, thus it is a plausible cause of CF. Furthermore, when managers or directors pursue expansionary strategies, and they expose the firm to risk & future liquidity issues.

Bad-management was identified as a cause of CF in the collapse of the Medici-Bank, when Sassetti permitted greater managerial discretion to the branch managers. In addition, the findings indicate that “not sticking to the knitting” can be as a result of hubris and risk-taking. Hubris was maintained in Chapter-2 as a cause of CF. Moreover, the Enron and Lehman debacle emphasized hubris & deviation as causes of failure and as such it was expected. Furthermore, the Arthur-Andersen & Lehman fiasco was due to a move away from their traditional audit and investment values respectively. Facets of bad-management was evident in General-Motor’s bankruptcy and Goldman-Sachs abacus fine. However unlike the other firms, GM was bailed out by the government and Goldman-Sachs survived that crisis. Moreover bad-management is a facet of CG, which was seen to be a cause of failure in many instances (Kumar N, 2013). Therefore, it remains plausible that bad management is a cause and a recurring theme in CF.
Excessive risk-taking was expected to be a cause of failure as suggested in the reports on the financial-crisis. The hubris, optimism and risk-appetite of Sean Quinn forged a now defunct empire similar to the likes of Enron, Lehman’s, Andersen and Sachs who had undertaken risky investments. The findings recognized the risk-appetite of the Quinn-Group in its willingness to enter the insurance-industry without the required capabilities. Moreover, the CFD’s invested in by Sean Quinn, was similar to other risky-derivatives that led to the financial crisis. Moreover, the managing-director in the pharmacy chain exposed the parent-company to the risks of failure having used up its reserves, hence further implicating management as a cause of failure.

The experts are right to maintain that firms should pursue strategies in a way that doesn’t endanger the core business and that risk-management should be a priority. Moreover there is a need to seek professional advice and implement better information-systems. Besides, as evident in Enron, Fannie Mae and Lehman’s, when top-management champion aggressive risk-taking it could be a recipe for crisis & failure. The managers at The Medici-Bank and John Smith in The Mississippi-Company took-on risks that ultimately were a cause of failure.

The findings didn’t link excessive risk-taking to managerial incentive-schemes & compensation as noted in the literature. Nonetheless it doesn’t invalidate the literature as the experts didn’t argue for/against such a link. Regardless, it is plausible to justify excessive risk-taking or risk as a cause and recurring theme in CF.

Rapid & over-expansion was noted by the experts to be a cause of failure, however it is the researcher’s opinion that over-expansion alone cannot lead to failure. It is the loss of focus, complacency, the lack of adequate skills sets and inability of management that leads to failure. This was expected as the literature often cited overtrading and expansion beyond a firms capacity a cause of failure. Moreover, the financial-crisis reports stated that banks took on more risk to gain make share. Consequently, it is a plausible cause of failure and is maintained to be a recurring theme in CF.

Externalities, such as the failure of a key supplier, changing trends in an industry, competition in the market and over-population in an industry, may result from a decline in the economy or cost drivers. The findings noted that a fall in demand after the financial-crisis affected the bakery, motor & hotel-leisure industries and the professional-services firms. Although certain externalities could be beyond the control of management and absorb them of blame, a contrasting view suggests that if management sought the relevant professional advice on time,
they would have been able to foresee a change in trend and therefore would have been able to take actions that result in corporate survival.

Nevertheless, the bankruptcy of General-Motors was attributed to the change towards fuel efficient cars and the decline of The SSC and The Mississippi-Company could be attributed to externalities in the market such a loss of confidence. Therefore, externalities was expected in the findings and is a cause and a recurring theme in CF.

*The Recession*, was expected as a cause of failure because in the literature we examined the role of the economy-cycle and recession-induced stress in failures (Kane et al 1996). Furthermore, stress emanating from a decline in turnover and a loss of confidence results in the many failures and insolvencies, including billions in loses. Moreover, the ripple effect from the failure of a key supplier or uncollectable debts cannot be underestimated or ignored. Literature tied the decline of The Medici-Bank to a general depression in that era, consequently in addition to suggestions that the rate of failures were amplified during the financial-crisis. Moreover Lui J in her research had stated that the economic cycle is a cause of failure. Therefore, is a valid reason to induct that a recession or the economic cycle is a cause and a recurring theme in failure.

*Fraud* has been mentioned as a cause of failure at WorldCom, The SSC and Enron and as such was an expected finding. It is a recurring theme in failures, with experts indicating that it occurs frequently regardless of time & industry. Fraud is associated predominantly with monetary matters and it bleeds a company, which can result in liquidity issues. Moreover, when investors lose confidence in a company due to fraud or through corrupt practices like in the case of Arthur-Andersen or The SSC, we see a decline in the customer base or a dumping of stocks. Ultimately, this results in failure.

Furthermore, ethics and the corporate culture is called to question. The cases of conflicts of interest & fraud at Enron, Andersen, The SSC, Goldman-Sachs and Ernst & Young, have shown how fraudulent & corrupt practices can impact adversely on survival. Therefore it is inadmissible based on literature & the findings that fraud and other malpractices are causes and recurring themes in CF.

The researcher remains sceptical about the case for natural disasters as a cause of failure. Moreover, it wasn’t an unexpected finding because war had been implicated as one factor that led to the failure of The Medici-Bank. Nonetheless, the reason for maintaining this stance is due
to the rarity of natural disasters, the globalization of certain firms and the diversification of many business. Some might argue against this standpoint. Nonetheless, the induction is that natural-disasters though a cause of failure, may not be a recurring theme in CF.

Finally as in the literature, the findings suggest that the causes of failure are more than one fold and that failures could result from a range of underlying issues.

5.1.3 The Degree of Variation

The causes of failure were different pre and post the financial crisis thereby answering the question that the causes of CF does vary by time and industry. A lack of liquidity was a pressing issue in failures following the financial crisis, whilst industry specific factors such as the loss of a key customer would have being a cause of CF pre the financial crisis. This implies that the causes of failure are determined to an extent by the prevailing economic condition or circle and thus the link in literature is valid. This link is further justified by evidence to the fall in demand which led to closures in certain industries following the financial crisis.

Pre the financial-crisis, cases of CF were less prevalent but fraud was noted to be a cause of CF. Fraud was further noted to occur often thus justifying the claim that fraud is a recurring theme in failure. However, the extent to which the causes of failure vary would also depend on firm specific issues such as bad-management, corporate-culture and risk-taking etc. Moreover, failures after the financial-crisis can be argued to be industry-specific, with the failures in the hotel-leisure industry and the financial-sector due to a lack of liquidity justifying this calm.

5.1.4 Who is to blame?

The findings blamed the directors and management for CF, because they are meant to oversee the operations and strategies of a business, including risk-management. This findings confirm the numerous reports which have found management at fault in many instances (Wells J, 2006). Moreover, the reason for many of the issues explored in Chapter-2 are attributable to the management and thus provide the evidence to justify this claim. Nonetheless, experts acknowledged that blame could trickle down to the lower levels of an organisation.
Although the findings indicate that governments can be blamed for failure, particularly in instances were a change in economic policies result in failures without any managerial wrong-doing at the micro-level. It remains the duty of management or directors to adjust in light of the changing conditions. Indeed, in many cases it is managerial inability and a lack of responsibility & foresight that ultimately leads to failure. Therefore the researcher agrees with the argument that directors are to blame for CF in most instance.

5.1.5 Economic Benefits & Bailouts

The arguments for the benefits of CF include, that it serves as a lesson as to why companies fail and in turn could possibly reduce the prevalence of certain CF issues. However with significant losses to shareholders and the rise in unemployment that permeates from failures and the ripple effect, it is safe that to argue that ultimately failures have more disadvantages than benefits. If we think that the financial-crisis came about as a result of letting Lehman’s go bust then it is clear to imagine the inevitable destruction that would have resulted if AIG, RBS and other national banks were not bailed by governments. This leads to the debate on bailouts.

Government intervention or bailouts have been debated through economic ideologies or based on personal standpoints. The participants agreed that the bailout was necessary in their respective jurisdictions. The justification for bail out in America being that the firms where critical to the economy and in Ireland, the bailout was necessary due to the small nature of the Irish economy and the ripple effect & devastation that would have ensued had the Irish-banks not being bailed-out. Furthermore, the bailout in Ireland might also have been to keep face with the bondholders in order to be able to access future finance. The findings were expected because it is essentially a yes or no question. The findings imply that if a firm is not critical to the economy then they shouldn’t be saved and failure should take its course. However if the firm is critical, then it should be saved in order to save the entire economic system. From the literature and findings, it is clear to see why the debate is highly-subjective. Nevertheless, the researcher backs government intervention when it is critical and necessary, thus favouring a Keynesian standpoint. Moreover there is no need to let the heart fail when it can still be saved albeit through a cocktail of complicated surgeries.
5.1.6 Corporate Survival (CS)

The findings about corporate survival were anticipated as a by-product of this research and most of the themes in CS emerged during the coding process. The implication of the findings is that firms can survive failure when actions such as restructuring their operations via an examinership or management mitigating excessive risk-taking by conducting risk assessments occur early. Prediction models such as the Altman Z-score or financial-ratios can be used for assessments to take pre-emptive decisions that lead to CS. Furthermore, the courts through an examinership is able to protect a company from its creditors during the restructuring process, meaning that companies who know they might be in future distress could restructure early as emphasized by the situation that led to the bankruptcy of GM.

The capacity of the company to compete is a factor for survival as firms who have the funding, capital and liquidity will be more capable of resisting failure. However, fraud or a loss in confidence can have a significant say as regards CS. Furthermore, the size of an entity’s assets can be a determinant for survival, in cases where a firm has been put into a receivership. Moreover it is possible to survive failure if the assets of a company has a secondary use i.e. In the retail-industry unlike the hotel-industry, alternative services or products could be offered in order to survive. Finally, location could lead to survival and the justification is that if Lehman’s was an Irish Bank it would have survived given that bailing-out all Irish banks was paramount for the economy well-being. Furthermore, if we imagine that an airline company which operates in the U.S might be able to survive a crisis compared to one which operates mainly in Afghanistan, then it is plausible to suggest that a firm’s location could be a factor for CS.

5.1.7 The causes of corporate failure by factor

The hypothesis that all the causes of failure can be categorised under 4 main headings is something new and consequently, it narrows the broad area of CF to these factors. Indeed to the extent of the depth in the literature search & review, no attempt was made to categorize the causes of CF. The reason for this argument arose from the researcher’s analysis of both the causes of failure explored in literature and those established in the primary data.

If you indulge in a simple pen and paper exercise and try to group any of the causes of failure, they would fall into one of the four factors. Consequently, the theory is that there a four main
factors that could lead to corporate failure. Nonetheless, future research should test the validity of this argument.

5.2 Scope & limitations of the research

The focus of the study was on why corporations fail, particularly trying to determine the recurring themes in CF. Furthermore, with the population of CF’s being unknown but vast, literature explored a number of cases for the possible causes of CF and this is epitomized in the expansive look at literature through academic journals, the web, documentaries and books. The research was conducted within a 4 month period, allowing for an exploratory approach to the research, with the data analysis procedure adding richness to the study.

The depth of the literature-review meant that the researcher understood the issues that could lead to failure, the causes of failure and the ways through which a corporation could survive. Consequently, the research question was answered and the aims of the study were met.

Furthermore, the qualitative approach enabled the researcher to describe the causes of failure in ways numbers can’t. It permitted for coding and an interpretation of the causes & the recurring themes in CF. Moreover, the different geographical, educational and professional backgrounds of the experts permitted for a global perspective to primary data.

Nevertheless, a limitation of the study could be the small interview sample of 2 experts. The small sample was primarily determined by the availability of relevant employees in the top professional services firms which were in “the busy season” during the interview requesting phase. Consequently this led to a poor acceptance rate with only two interviews granted for the over 15 firms contacted. Moreover, some would argue that the use of a telephone interview would limit the personal touch and complexity of questions.\footnote{Advantages & Disadvantages of Telephone Interviews in Business Research: Rick Suttle \url{http://smallbusiness.chron.com/advantages-disadvantages-telephone-interviews-business-research-24285.html}. Accessed 16\textsuperscript{th} August 2014.}
5.3 Contribution of the research

This study has contributed to literature by closing the gap on the recurring themes in CF, thus adding a new dimension to the literature. Furthermore, it led to the observation that all the causes of CF could be grouped under four main categories. Moreover, having explored the literature on failures expansively, it has pulled together a range of themes under one research, thereby updating the literature on corporate failures and becoming a reference for future research. Consequently, the findings on the recurring themes in corporate failure is new and relevant to the extent of literature sourced. Finally, the research has identified the themes that could result in corporate survival and as such presents an opportunity for further research on the topic.

5.4 Opportunity & Recommendations for future research

During the research, themes concerning corporate survival arose and as such it presents an opportunity for future research to explore the recurring themes in corporate survival. This can be achieved by adopting the research’s approach to data collection or through the use of quantitative approaches i.e. a survey. Moreover a research on the recurring themes in CS will lead to a more updated literature on corporate-failure & corporate-survival.

Furthermore, exploring the accuracy of various bankruptcy prediction models in relation to corporate failure, which was dropped due to the time limitations of a bigger research project will led to an identification of the relatively most accurate model and also determine why Altman’s Z-score is still a preferred technique for predicting corporate distress and failure. Moreover, John Argenti points out that that the reason for the ineffective attempts to predict failure is that we keep looking for the wrong signs at the wrong place at the wrong time. He notes that the first signs of corporate failure may not be financial and that failures can be predicted years before they happen (Argenti, J 1976)\textsuperscript{138}. Hence these issues present an opportunity for research.

Finally the finding that all the causes of failure can be grouped under four headings present an opportunity for further research as to the truth of those assumptions.

5.5 Conclusion

The project through a combination of exploring the literature and collecting & analysing primary data met the primary research objective of determining the recurring themes in CF. It also allowed for the categorization of the causes of CF into four factors:

- Economic factors
- Human factors
- Systemic factors
- Other factors

The research answered questions about why the causes of CF vary, who is to blame?, in proving an insight to the various perspectives on bailouts. Furthermore, themes that result in corporate-survival were discovered, with the findings indicating that CF is normal and that it ought to occur.

The research indicated that the recurring themes in failure include:

- A lack of Liquidity
- Bad management
- Externalities
- Fraud
- The Recession or Economic cycle

And that natural disasters are not are recurring theme in failures. We find that the causes of failure do vary by time and that they could be industry specific and that although governments could be blamed for CF through the change of polices, that ultimately directors and management are blamed for failure because that are the key decision makers. We find that the need to bailout failing companies is subjective but that based on the criticalness of a company to an economy, a firm could be saved from failure.

In conclusion proper information systems should be implemented by corporations, they should seek professional advice and should not pursue aggressive-expansion strategies. Furthermore management should be actively responsible in discharging their duties as they are ultimately to be held responsible for failure.
Finally, to paraphrase Shakespeare’s play on Julius Caesar, the fault lies not in the stars\textsuperscript{139}, but in us, with a documentary on the fall of Lehman’s indicating that “people are 99% animal and 1% human and it’s the human part that causes all the problems (BBC 2008). Therefore, it is the researcher’s opinion that ultimately corporate failure is due to human frailty.

\textsuperscript{139} Shakespeare Quotes: The fault, dear Brutus, is not in our stars http://www.enotes.com/shakespeare-quotes/fault-dear-brutus-our-stars . Accessed 16\textsuperscript{th} August 2014.
Chapter 6: Learner Engagement & Reflection
Phase 1: The Origins

Undergraduate studies
B.A (Hons) in Accounting & Finance

Graduate studies
M.Sc. in International Accounting & Finance

Advanced International Accounting

The Financial Crisis & Recession

Enron “The smartest guys in the room”

Research Topic
Corporate Failure

Research Plan & Proposal

Research Methodology Lectures

The recurring themes in Corporate Failure

- The last days of Lehman’s
- Economic Ideology
- Government Bailouts
- The financial crisis

Awareness of data collection & analysis procedures

- Literature Review
- Research Methods
- Data collection & analysis
- Discussion & findings
- Submission

The Research Process
6. Introduction

This is the final chapter of this dissertation and it is in line with the research guidelines as provided by the college. Furthermore, it explains how the researcher developed an interest in the research topic and reflects on the learning process and skills acquired and enhanced by the process. The cognitive map is divided into three phases discussed below.

6.1 Phase 1 – The Origins

The road to this research topic was paved years ago during my secondary education, with the financial crisis in 2008 and the proceeding recession sowing the seeds that developed a plumule
for an interest in further study. Furthermore, the study of corporate governance in one of accounting modules led to an insight into the issues that led to the demise of Enron in the documentary “The smartest guys in the room”. So following my undergraduate degree, I pursued a goal of completing a master’s degree in accounting and this presented the opportunity for research, with a module on the operation and governance of financial markets galvanising my desire to further explore the themes in CF.

Having made up my mind on a research topic, full-year lectures on research methodology together with the prerequisite research plan, presentations and proposal enabled me to narrow down the topic to the exploration of “The recurring themes in corporate-failures & bankruptcy prediction models”. However, as with many big projects, I made a decision to drop the bankruptcy prediction aspect of the research due to the anticipated complexities of combing the two aspects of the research within the limited time-frame.

Prior to that, I was finding it hard to assimilate the research method terminologies during lectures, so I took forged with an intense study of the relevant books to increase my understanding of the various techniques and procedures discussed during lectures.

Consequently, with a heightened understanding & awareness of the various research techniques & terminologies, an excellent showing at the exams backed-up by excellent individual reports and group projects, the research process began in earnest.

6.2 Phase 2 – The Process

Using the skills I had enhanced through critical and comprehensive reports, I began the research process by planning the structure for my dissertation. I had just completed the first chapter when I was informed in a meeting with my supervisor that primary data collection was critical to my ability to forge ahead. This hit me hard, as I was told that I would have to change my research topic if data collection wasn’t achieved. Consequently this led to a week’s delay filled with anxiety as regards the ability to get my primary data and a plan for a back-up topic ensued. However, as luck was on my side, having made a lot of phone calls and sent a good few emails. A participant granted my request for a research-interview thus galvanising me to forge ahead with the literature-review. That was the second time I was genuinely worried about my research. That first was before my induction.
The research progressed steadily and I often answered and gave advice to some MBA students who wanted clarity on the different aspect of their research. Furthermore, the skills enhanced through my projects, together with the knowledge of the causes of the financial-crisis and the themes in failures enabled me to complete the research process, including mastering the use of the qualitative software NVivo.

6.3 Phase 3 – Reflection & the future

With the research process completed before deadline, I felt a sense of accomplishment. My mantra during the year was:

*Think positively and masterfully with confidence and faith, and life becomes more secure, more fraught with activity, richer in achievement and experience*\(^{140}\). *Eddie Rickenbacker*

Moreover, I had worked smartly as emphasized by many lecturers especially Mr Brennan the personal and professional development lecturer. Those long winter days and early Saturdays in the library had paid its dividends. Furthermore, I was able to enjoy the World-Cup whilst meeting weekly deadlines as regards the research. Thus emphasizing my organisational abilities.

Moreover, I had acquired live long skills as shown in the map through the research process and have utilized and sharpened my skills in analysis & project-management. Furthermore, I believe that I’m now an expert on the issue, having broadened my knowledge in the field of corporate failure & research methodologies. Moreover with a career in corporate audits and the financial services ahead of me, it is certain that I have acquired the necessary skills personal, interpersonal and otherwise to be able to pursue my dream and add value to the workplace and to clients. Besides, with an awareness of the themes in CF and my research capabilities, I will now be able to understand and observe CF issues first hand.

Furthermore, master’s studies was favoured by my learning style\(^{141}\) of being a reflector/theorist, thus (See Appendix 3) and in the future, I hope to pursue an Executive-MBA degree or even a doctorate because education and learning is a continuous process. But until then, in contrast to


the conclusion in Chapter-5, I would ensure that the 1% of human in me doesn’t lead to another corporate failure.
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Appendices
Interview No: 1

Method: Telephone

Sector: Bankruptcy Law

Company: XXXXXXXXXX

Date: 3rd June 2014

Interview Duration: 15 minutes

Transcription Duration: 2 hours

Transcription

KK: Hello

VE: Hi Kenneth

KE: Hi, How are you?

VE: eh, it’s valentine

KK: Yeah

VE: First So em it as regards em you know the research on the recurring themes in corporate failure,….Are you ready?

KK: Am ready

VE: Alright

VE: So I just do, I will go through like, just em protocols and then we would start, so em first of all, I would just go through like introduce myself [nervous] I am valentine and am currently em doing my masters in accounting and finance and …my research topic, em what am looking into is the recurring themes in corporate failure and also bankruptcy prediction models, so most of the questions I will be asking em will be in that direction and by agreeing to take part in the interview, you are giving me your informed consent as regards em you know data collection
and at any time during the interview process you’re free to withdraw and if you’re not sure of a question you could ask for clarifications or if you don’t want to answer a question, you could just say just next and we would move on to the next question………………Alright?

KK: Sure I understand.

VE ok

KK: Yeah

VE: So. We would just start with an introduction of yourself. Say an overview of say of your educational and professional background and we would start from there.

KK: you want me to send you a CV.

VE: [not expecting that reply] No, you,you, you could go you could do that but em but for the interview you could just do a brief overview emm..

KK: Umh I went to Stanford university and got a…. degree in economics,

VE: Yeah

KK: I went to Harvard law school …..and could a law degree.

VE: So you would be aware of issues in corporate failure and bankruptcy predictions

KK: I am aware of it because since uh 1974, I have practiced bankruptcy law ….em or worked on the drafting of bankruptcy legislation for 36 years.

VE: Alright

VE: would corporate failure be a big problem, like would it really be... Is it something that would be like… like a problem or is it just normal [nervous question]

KK: I don’t understand the question.

VE: is corporate failure based on your experience, is it like a problem or something major we should be worried about.
KK: …[Pause] corporate failure is part of any capitalistic system and for that matter any business system… and it’s something that the umm legal systems should have in place a way to deal with it from a societal standpoint. So if that’s what you’re asking that’s my answer.

VE: Alright

VE: So em, what would be your company’s role, say in relation to cases of corporate failure, what kind of em activities would you be carrying out as regards corporate failure?

KK: am uh a bankruptcy lawyer so I represent different parties and interests in corporate stress, I have represented …. And advised boards of directors, creditor committee, inquiries, equity committees, I have served as an examiner in cases, so I have done all of those things over the scope of a 40 year career including being a Drafter of laws in the area.

VE: Alright. You have, you seem to have a huge knowledge in the area.

VE: So now we have finished the introduction. So we would be going over to…you know em the causes of corporate failure. So based on your experience, like in America. In Ireland over here the causes of corporate failure would be different or it might be similar, I don’t know. So based on your experience em what are the causes of corporate failure in America?

KK: Umh…. there are many different causes, essentially you can have out-moded products that’s one, you can also have a situation where you have bad management...

VE: Yeah [Soft pitch]

KK: Uh you can have a situation where you have expansion of a business beyond its ability to control

VE; Um [murmur]

KK: All of those are circumstances that can lead to corporate failure. Rising interest rates uh can also lead to corporate failure

VE: Yeah [low soft pitch]

VE: and are these causes em prevalent in… em in cases you have been involved with or would they vary …Are they similar or will would they change from firm to firm.
KK: well the causes um vary depending upon um the time you’re looking at, so for example, after 2008 you had a liquidity crunch around the world and it was just difficult to find capital, umh investment capital.

So that was a time when that was a pretty unique factor but um...since then you’ve had just a normal array of things, you’ve have industries that get you know… overpopulated, you get fraud every now and then, bad management, externalities where you find out that the products you are dealing with have become toxic, all these kind of things can eventually lead to corporate failure.

VE: So em… would you like to give like say five….top five causes of failure

KK: I thought I just did.

VE: …Uh I was thinking you just went through em like the different causes, like say bad management.

KK: Yeah, yeah

VE: So would they be the top ones?

KK: I think, I think those would be the top five causes

VE: Alright

KK: What you could have … [Thinking] bad management, umh lack of liquidity, out-moded products umh..... [Long pause] over-competition and expansion. I would say those would be the main causes of failure.

VE: is there a reason...

KK: In order countries you can have government regulation or something like that

VE: Oh yah, yeah

VE: is there, would there be a reason why these causes are always coming up, like why don’t they change, say why they are always like the same causes. Say something like bad management, why is it always, you know, a recurring themes in corporate failures?

KK:………. [Pause], I don’t just understand the question. These are the causes of corporate failure and umh it’s like saying why, is it that people who get cancer die, you know like I mean, I don’t understand the question
VE: yeah, yeah [soft pitch]

KK: Bad management leads to business failure, this is a no brainer.

VE: No, what am trying to say is like why is it like, say ,you said that bad management, over-competition em, sometimes interest rates and like what am trying to get through to you , is that is there a reason why before and after the crisis, that there would be like, the causes might be different …and what am trying to get is that is there a reason why is it always bad management coming up as a cause of failure, why over-expansion and causes are more prevalent than the others is what am trying to get ..Em No ?

KK: ……………Uhm. There can be reasons why liquidity is a more prevalent causes, when you have central banks and governments that um take action that cause a crisis in confidence,

VE: yeah,

KK: you’re going to have consequences.

VE; so would there be like particular symptoms that would indicate emm that a company is heading for failure?

KK: Yes, the Altman Z-score is a well-known measure of business failure.

VE: So would you be, you would be a promoter of bankruptcy prediction models… Would you be promoter?

KK; I think that they are useful, I don’t think that they are perfectly predictive, nobody predicted 2008 …right?. So if you look at a company that is over levered, it doesn’t take a genius to figure that that can result in business failure.

VE: [Pause]…So now the issues like who is to blame as regards corporate failure , I know you were talking about in countries where the central banks and the government take decisions, this could affect like say the firms operations and you were talking about interest rates . So would you em say that decisions outside the control of a firm determine failure, like say economic policies or government intervention or something like that, would they like, what factors outside the control of the firm would you know determine if its gonna fail or would lead to failure.

KK: lack of liquidity, over regulation, out-moded products all of these things can lead to failure.
VE: is there something you would say that people not in the bankruptcy or corporate law sector. Is there something like the society at large doesn’t understand about the issues, causes and themes, say in failure.

KK: Umh I don’t know what society understands or doesn’t understand, I don’t know how to answer that

VE: Yeah yeah [low pitch]

VE: and em …I know you were saying that corporate failures is part of any capitalist system and there have been arguments as to if corporate failures are … is corporate failure of any economic benefit or not. So in your opinion or in your view, is corporate failure of any economic benefit, is there anything to learn from it, or does it…..what would be your view on that?

KK: Sure you can learn from corporate failure, mistakes that people make and how to avoid them in the future & that is one of the principal benefits of studying corporate failure.

VE: I think we’ve gone through most of the themes, causes and…You know the symptoms in corporate failure and who is to blame, would you be in favour of government intervention, say for failing companies?

KK: it depends on whether the company is critical to the economy or not .You know in America, we had our too big to fail controversy.

VE: yeah [soft pitch]

KK: and we had some businesses that were saved. I happen to believe, they should have been saved but there a lot of people, who believe that they shouldn’t have been, so you know...Those are the breaks, that’s what you have to look at…. people have different views on these things.

VE: Right KK I thank you very much for you know your time, you know for agreeing to take part in this interview and I say thank you very much and if you would like to you know, know the results of the research of my research say by august, you could, I could get your email and I could forward you the results.. [ details taken out]

VE: Alright, thanks very much for agreeing to take part in this interview

KK My pleasure, bye, bye

VE: Bye .thanks [voice fades]
Interview No: 2

Method: Face to Face

Sector: Corporate Recovery, Insolvency & Bankruptcy

Company: xxxxxxxxxxxxxxxx

Country: Ireland

Date: 9th June 2014

Interview Duration: 60 minutes

Transcription Duration: 8 hours

Transcription

….. Small talk [about 2 minutes].

VE: So I will just do the formal bits first

DW: Yeah [very low pitch]

VE: So the research….we’ve already talked about the research topic, which is on em the recurring themes in corporate failure and permission to record, so could you just like for warmups, just an overview of your educational and professional background.

DW: Yeah, em! I am a chartered accountant, I was...let me see, we would start I suppose with the degree [laughter] in xxxxxxxx. I graduated in 2005 and went to work xxxx, in, initially in Audit

VE: Yeah [low pitch]

DW: and did my professional exams, qualified as a chartered accountant in 2010. I did two years in Audit and then a year and a half in corporate restructuring & recovery..em moved to xxxx in 2010, still here now.

VE:  [chuckle]
DW: em and I the meantime, I done a diploma in insolvency and am shortly undertaking a certification in fraud examinership and in terms of the work background if you like. I said the first couple of years in my career I spent auditing and then moving over in 2009 into the area of corporate restructuring & recovery, working in that since, em mainly on the enforcement side, so the formal appointments, liquidations, examinerships, receiverships and that kind of thing. Also I have taken over a lot of special investigations and fraud related matters.

VE: would you clarify the whole issue of say, cause I get …sometimes I get confused with the whole… what’s the difference between say an examinership and …. like insolvency & liquidation are kinda straight forward, you get like the company can’t like fund or they need to like sell assets

DW: umh

VE: to pay debtors but the whole issue of an examinerships and a receivership what’s the difference.

DW: ok the difference I suppose, if we start with liquidation and when a company is insolvent

VE: yeah

DW: they can go into liquidation of one of two ways, either through a court process or a voluntary process. You hear about a creditor’s voluntary liquidation or a high court liquidation, both essentially are the same thing, the company goes into liquidation

VE: Yeah

DW: it just different methods of having a liquidator appointed

VE: yeah

DW: and the oversight role, in one is by the creditor, the other is through the high court and that ends up in the company being wound up and dissolved and struck off the register. A receivership then is the appointment of an individual or individuals by a charge holder, 99% of the time that’s a bank, over either certain assets or of all of the assets, an undertaking; being the entire business of the company. A receiver can also be appointed over the assets of an individual and in effect a certain assets receivership will result in a disposal of those assets by the receiver and the funds realized then are payable first to the secured charge holder, again debt, in theory a company can
continue on trading, while a receiver is appointed over certain assets and after the receiver is been discharged. It doesn’t happen often though, usually the assets the receiver has being appointed over are the core assets of the business and as such the business stops trading and once the receiver has been discharged, when he is finished, while the company many still technically be live,

VE: Yeah

DW: It is a shell, a lot of cases, you’ll find that a liquidator will be appointed at some point either during the receivership or after the receivership to wind the company up.

VE: So it usually leads to corporate failure then?

DW: Exactly, em it does happen as I say sometimes a receiver will be appointed over perhaps a property and that the business may continue to trade either from that property or from another property.

VE: Yeah

DW: Em! Ultimately it usually ends up in corporate failure and a liquidation, the other thing to point out as well is not all corporate failures will go through liquidation, some companies will be struck-off the register without a liquidator having been appointed and which is a legal … em and the director of corporate enforcement does pursue individuals who are directors of those companies for disqualification for failure to appoint a liquidator where the company was wound-up without having discharged all of its debt.

Em that I suppose happens when there are no assets left in the company and you can have a situation, where the directors aren’t in a position to fund the appointment of a liquidator and their left in a sort of catch-22 [both laugh] were by no liquidator would take the job on because there is no asset to cover the cost of it and if the directors don’t have the funds to cover the cost of it, the company just sits there and eventually after a couple of years, it is struck off by the company registration office for failure to file returns. An examination then is a different process were by, the goal is that the company will continue

VE: Yeah
DW: and that it is a formal restructuring process. The same individuals in the various if you like in the various firms around town will take appointments as examiners as liquidator as it is a very similar skill set but the outcome is completely different in that the idea is to restructure the company

Usually there would be one or two core reasons why the company goes into examinership, in recent years a lot of them has been to do with leases, we have seen a lot of large retail companies going into examinership to restructure their existing lease arrangements, em essentially to get their rent bill down and maybe to vacate a couple of non-performing stores. The examiner then puts a scheme together, usually there is an introduction of additional forms and sometimes from third parties, sometimes from existing directors or shareholders and as I say the idea then is once the scheme is been approved by the court and it is a completely court driven process, That the company will emerge at the other side in a position to continue to trade into the future, creditors will take a write down, there is a better outcome for all than a liquidation, usually in a liquidation, the creditors will be worse off than if the company goes through examinership because of the introduction of the new funding, enables a payment then to go to those creditors, whereas otherwise they would be relying on the liquidator realizing the assets of the company to get any return out of it.

VE: Yeah [low pitch]

DW: Unfortunately, frequently there is no return from majority of creditors in a liquidation and you’ll find that the creditors that have preference, so any banks that hold security and then what are known as the preferential creditors, which is in effect the State, the Revenue commissioner for certain other debts, local authorities for rates in the periods immediately prior to the liquidation and the Department of Social Protection for any funds that they pay out to the employees for arrears of mortgages or redundancies are classed as the preferential creditors and they rank above the other creditors if you like who are unsecured and as I say who frequently don’t get any returns out of m an insolvency process. Except for an examinership where they would normally get a return, in some cases below 10% but better than none at all.

VE: So like, based on your experience what would be like the causes of corporate failure say in Ireland?
DW: The main cause in recent years, for I suppose the SME sector have been property investment. With the property market having taken such a huge dive in 08, through say 2010, 11,

VE: Yeah [low pitch]

DW: a lot of companies that would have borrowed against property and I suppose the other side of the property is the leverage that they have taken so they would have quite substantial borrowings against the property assets. Either property assets that are used as part of the trade or property assets that they’ve acquired as a sort of passive investment whereby they’ve had surplus cash and decided the investment in property with some leverage will be a good use of that spare cash to generate a return. That’s has taken down an awful lot of otherwise reasonably good companies. Em B, certain markets, various different markets that have taken massive hits, the motor industry took a massive hit in 2009 and 2010, the amount of new cars sold dropped by about three and a half and two thirds quite specific to that industry, I think there was about 151,000 units sold in 2008 of new cars but that dropped to something like 79,000 in 2009, [Yeah low pitch] so half the market was wiped in one year. Em! That hit them very hard and coupled with that a lot of them had invested very heavily in properties that they traded from, em as well as perhaps some passive investments, so industry specific that took a big toll.

Em The hotel, leisure industry then took a big hit over 09, 10, 11 as well. It has certainly come back a bit now. The problem for the like of those properties is that they don’t have any secondary use, if you have a hotel, you cannot use the hotel for something else and sort of high street unit em for retail can be used for any type of retail and maybe can be converted to use as a restaurant perhaps, whereas a hotel realistically is a hotel and if there is no demand for the bedrooms then obviously you’re in big trouble [Yeah] and we’ve seen a lot of closing down over the last few years, mainly smaller hotels in sort of second or third rate locations that weren’t able…didn’t have the capacity to offer you know very low price rooms or the real cut price deals that the other hotels could afford to do to generate business and …another key

VE: So what would be….is it like the size preventing them from being able to like say restructure prices to compete with like bigger hotels or maximise [fade]

DW: yeah, you would find out that the smaller players don’t have, you know they don’t have the backing, they don’t have the capacity there to be able to lower the prices and to compete
with the larger hotels plus when you’re in the secondary or tertiary locations you’re just not attracting enough business at any price, em to be able to keep the ship afloat and you don’t have the reserves there to be able to survive the storm either em a lot of hotels had a few bad years, but if they had enough cash behind them to be able to sort of as I say weather the storm, make losses for a few years but keep the show on the road

VE: So liquidity would have being a problem then?

DW: Liquidity would have being a huge problem for a lot of business, as it was across the board. Another thing that we’ve noted is poor information systems in companies that go onto bankruptcy

VE: Yeah

DW: Big collateral form of insolvencies now, whereby, they don’t just know how bad things are and…poor information systems won’t present themselves as being a huge issue unless you’re in trouble and the problem now is you don’t know how much trouble you’re in [Yeah], so when everything is going well and you’re making good turnover, you’re making decent profits, you’re making plenty of cash. The fact that you don’t know how good things are isn’t that much of a problem when things turn bad and you don’t know how bad things are, that’s a huge problem. That’s being really prevalent in the number of and I mentioned earlier in the scenario where companies go into or are insolvent but struggle to be able to go into liquidation, because they are simply no assets left. We found an awful lot of that, I suppose back maybe 10 years ago when companies went into liquidation, there were generally assets there that could be sold off to pay the costs of the process and to provide funds then for payments to the creditors of the company. All too often now, we find that the companies either have limited or no assets. All those assets have been charged to a charge holder such as a bank, so that there are no assets available for the rest of the creditors. So you might find that a company owns a property and has some debtors and perhaps some machinery let’s say but that debtors have all been discounted with an invoice discounting company and the machinery maybe is on a hire purchase lease and building has been given as a security to a bank for a loan and the funds are all long gone and the part is, the liquidator then don’t have any assets there to realise. So poor information systems kinda led to that scenario were people don’t know when they are in trouble and leave it too late to get professional advice, and leave it too late to put the company into liquidation, that can have
an impact further down the road in terms of proceedings for restructuring and disqualification cause perhaps they could have sheltered shop 12 or 18months before they did.

VE: So would there be other causes part from say…em poor information systems, lack of assets that would lead to?

DW: yeah the, another thing I suppose and this is quite a subjective one but the way I would put it is not sticking to the knitting. [Yeah], I don’t know if you’ve heard that phrase before

VE: [mumblings] going outside your core business

DW: Exactly, so we had one case there a few years ago, it was in the pharmacy industry, it was a chain of pharmacies making very good turnover and their EBITA would have being reasonably strong but the managing director who founded the chain, who was a very, very good pharmacist had mistakenly assumed that he was a very, very good business man [both titter], when in fact he wasn’t and had used the reserves of the company to fund other ventures completely unrelated to pharmacy, he went into another area of retail and went into sort of IT type company and in a very limited way there was some property investment as well, but mainly going into other business and they’d all failed spectacularly but and it was interesting in that case cause some of them were through limited companies and rather than allowing those companies to go into liquidation and fail as they have just failed, they were bailed out by the pharmacy companies which had strong cashflow and plenty of reserves, we found that over time when things tightened up, it really presented big problems for the pharmacy business and I have seen this person at work in the pharmacies, as a pharmacist they were absolutely brilliant, but this particular person was not a brilliant business man. He was a very good pharmacist and if he had stuck to the knitting in that case, he probably would have, you know, would be retired now and have plenty of cash in the bank and…now that was an examinership case and....successfully went through the examinership process and the pharmacies are all trading today and the staff all kept their job. So it worked out ok but it needn’t have come to that I suppose [Yeah].

Another one, on the much larger scale where they should have probably stuck to the knitting is the Quinn Group and the good insurance…I have worked on the administration of Quinn insurance in a previous job and really I think if they had stayed out of the insurance market it wouldn’t have done them any harm, em certainly from what we’ve seen since the administration in terms of you know the losses that were built-up in that company, I think perhaps, if Sean
Quinn had stuck to the construction group and also clearly stayed away from CFD’S and you know that whole side of things. [Yeah] he would still be in charge of the businesses today, I have no doubt. Now they went through and presumably continually what were a rough few years in terms of demand for construction products but ultimately the failure of those businesses that led to the receiver was as a result of the CFD’s and I don’t think they were sufficiently well equipped to go into the insurance market, the way that they did say...construction materials, It’s a very different market, you know financial services and you know if they had started out of that market and if they had stayed out of CFD’s and that’s down to Sean Quinn personally. Then the Quinn Group will probably still be called the Quinn Group today.

VE: So would you say that it’s them being like optimistic or is it just greed, like to keep expanding?

DW: [release of breath], there is probably of mixture of...[thinking], yeah optimism, greed, em [thinking] I suppose to an extent, individuals as I say, they see themselves as being excellent [both laugh] business people as opposed to being good at a particular industry but that is probably more, I think, when you create a certain amount of wealth, you know to use the example of the chap in the pharmacies, instead of opening the other couple of businesses, why didn’t he open 4 or 5 more pharmacies, why didn’t he go to the next town or the next town after that and expand his chain. Probably there is a certain degree of people wanting to prove that they are excellent business men [both laugh] or business women, you know and instead of just having a large construction material group, Sean Quinn then had an empire, where he had construction materials, big insurance and then unbeknownst to us all, he had massive holdings in CFD’s in Anglo-Irish Bank and It’s hard to put your finger on that, in terms of what drives people to go outside their core industry. Em...greed probably does play a large part in.

VE: Would you say people around them say advisers, people just telling them like say analysts [...] stuff just telling them what areas, they could like push the business into, because I think the whole issue, could be about like diversification of risk or something like that. So would it be like advisers or some...people around them influencing them to like make decisions to diversify like risk.
DW: I’d say, it could happen, well the risk diversification thing is an interesting point because you know using Quinn again they were very reliant on the construction materials and also they had the hotel leisure division as well all be it…under the insurance company, [Yeah] and there is an element of diversification which is good, but you do need to stick to your core strengths and the other side of this is suppose except you’re are diversifying and going into another industry, to do it a manner that you don’t put your core business at risk [yeah] and that truly is the key point. By all means try your hand at something else, but make sure that that stands on its own and that you’re not putting your core business or other businesses at risk, that may have…you know that would be able to continue on, If you want to go down the route of buying a few hotels, go for it but make sure that your hotels don’t bring down your IT business for example, or you know in the case of our man in the pharmacies, make sure that that your IT don’t bring down your pharmacy group.

The advisers point, I suppose a lot of these people, the couple that I spoke of obviously are big personalities within their companies and would have perhaps would have ignore professional advice to extent or would have gotten professional advice that would have told them what they wanted to hear as opposed to advisers, advising them to diversify their risk. [yeah]

VE: So you said like in the industries that came up, like the motor industry, hotel & leisure, so do the causes of say failure vary by industry or like do they, does it they vary by time say pre/post the financial crisis [?]

DW: I suppose, pre-financial crisis, the causes of failure for a lot of companies would have been very specific to industries and to those companies. We didn’t have a massive amount of corporate failure, I suppose in the years 2000 to 2007, 2008, there weren’t, in each case you can always pin point what went wrong. Loss of a key customer you know would have been a huge one and still is, or the failure of a key supplier and there is the knock on effect say obviously from the hotel-leisure industry, a lot of food suppliers have had you know major issues there whereby they were being owed a huge amount of money from the hotel-leisure industry [yeah] and within the 18 months, half of their customers had gone through insolvency process and a lot of hotels would have gone through receivership and would remain open but pre-receivership debts are all written off and so that has a knock on effect then on otherwise very good businesses, which are suffering as a result of their failure.
Pre the financial crisis, they are all quite industry specific. Post the financial crisis, there was a wave and the wave took out, a lot of businesses in certain industries we mentioned and the construction, the hotel-leisure industry and the motor industry were particularly badly hit. The retail industry was as well but be it that a lot of them were on the sort of scale i.e. they were one man show or they were very big groups. A lot of them didn’t manage to trade on or to close down quietly, you had a few big groups, you had the O’Brien sandwich bars and you had the like of Xtra-vision, as well which went through processes and liquidation, I think Xtra-vision went through 2 rounds of examinership and HMV as well went through pre pack receivership. So that, those companies suffered as a result of this and a drop in the consumer spending and that knocked on in the Hotel-leisure for example, one of my cases was a meat factory and it had a humongous debtor book for the size of the company, that obviously had an impact on cash but when we actually looked into the debtor book then we found the majority of them were uncollectable because they had all ceased trade. Moved out gone into a liquidation etcetera. That was if you like a secondary sort of wave if you like, coming from a primary wave which were in those main industries. Em, the like of the construction industry then had a knock on effect on a lot of building suppliers around the country [yeah] and which on one hand, so a lot of their debts wept out and uncollectable, saw a huge drop in turnover. [Yeah] so they just weren’t able to continue the trade, even if they can ride out the write-off of debtors, they just didn’t have the turnover to continue the trade that would have allowed them to do that.

VE: [yeah]

DW: So post financial crisis a few industries, hit in a big way but then everyone hit in some way [yeah] I suppose, even the like of the professional services firm came under serious pressure both in terms of bad debts and in terms of just a falloff in work. Now obviously in the insolvency industry there has been a boom in work but in other areas of services they have been serious impacted, I suppose.

VE: So you were talking about like industry specific em factors, pre like the financial crisis. Could you like give an example of what specific issues?

DW: Well, I suppose to take one example, there was em, a pig meat issue in 2008, I think it was, whereby there was a contamination of feed [?] and a lot of smaller abattoirs would have suffered as a result of that, something they couldn’t have foresaw and you know the feed suppliers as
well even one’s that weren’t directly involved would have failed as a result of that. Em! Fraud would have been a big issue for corporate failure back then, it still is today but in a lot of cases it can be masked! by the sort of prevailing economic conditions, so if companies are failing during very good times, you have to wonder you know is there a big issue here, You have the like of WorldCom and Enron and those kinda companies where it was just huge fraud.

Em! Other industry specifics [?] I suppose, you had the Dotcom bubble at the beginning of em the early in the 2000’s were a lot of those companies were built up and didn’t really didn’t have much substance behind them [yeah] and ultimately failed and they weren’t able to go to market with a decent product [?] em but it’s those kinds of some very specific issues [?] that would have floored the likes of those companies, even though, you could even look at say hotels in an area that was very damaged by storms, em that kind of thing very very specific to an area or industry, in a time when everybody was sort of doing well.

VE: So basically the recession would only like highlight issues, apart from say a fall in demand that could lead to say shops closing down and hotels closing, like would the recession in itself like maybe other issues as well or other factors could play in as well be a big [?] could the recession lead to like more corporate failures or does it just as you say does only highlight issues that were already inherent in the firm.

DW: yeah, the, it really weeds out weak companies, as well as I suppose a lot of companies that should have continued on but were completely wiped out for whatever reason. It does separate the wheat from the chaff in terms of companies that were tipping along nicely, when there were, everybody was making money and didn’t have a wear of a thought either financially or operationally, and the key is the operational part, em to be able to continue on later on afterwards when things got tough, they just didn’t have the, you know internally, they didn’t have the management, they didn’t have the ability to be able to restructure their business, informally restructure and that can be as simple as ceasing the trade in a couple of locations…em reducing your overheads, concentrating on an area where you would be able to make money for the next few years, batten down the hatches if you like to see through the tough financial times. Some companies were very good and there are still with us today, some companies weren’t and a lot of those are gone. It really I suppose separated those strong companies from the weak companies.
We have also seen this I suppose since the recession but not necessarily related to the recession, trends in consumer demand and in manufacturing that have impacted on certain industries, one that strikes me is the bakery industry, whereby there has been a move away from consumer demand for bread. Bread has gotten bad name in the last few year that it is not good for you, that you shouldn’t eat too much white bread, it’s full of calories, that kind of thing and between that and the ability for bakeries to produce larger quantities of product more efficiently, what you’ve effectively seen is a number of closures in the industry and a lot of amalgamations within the industry, whereby we don’t need a lot of bakeries in every town anymore, we only need only ten large bakeries in the country and we’ve, we are seeing a couple of insolvencies in that area and that on the one hand demand has gone down quite substantially and on the other hand bakeries here are able to produce more, so there is a gap there between the supply & demand and the way that the gap rights itself is through closures and amalgamations and some will happen in an insolvency scenario and some would happen just through sort of M&A activity. {M&A= Mergers & Acquisitions}

Another one that was the the carpet industry and there was until recently only one large manufacturer of carpet in Ireland and that was Core Carpets and now there are none, Core Carpets is in liquidation. All the carpets that is in the country now either comes from Northern-Ireland or abroad, there was a lessening demand for carpet on the one hand and serious cost drivers on the other hand in the manufacturing here, it just made it uneconomical to produce carpet in this country and now from a situation where there would have been a large number of carpet weaving companies 50 years ago, now there are none. There are carpet companies in the country but they don’t produce here. [Yeah] They only market here, so that wasn’t necessarily as a result of the inflation it was just a change.....it happened post-recession if you like and nothing those companies really could have done would have stopped their decline. Perhaps they could have shutdown sooner and moved into a solvent and just wound their activities with time but in each case they had issues with property which made them insolent straightaway and there was not sort of trading out or gradual wind down of the company, it happened quite abruptly.

VE: So em we’ve like discussed most of the causes & themes in corporate failure. Would you have worked with bankruptcy prediction models?

DW; No, it would be interesting to hear [VE: laugh/snigger] about bankruptcy prediction models and what you can tell me about that
VE: The whole issue of bankruptcy prediction models is that they can be used to predict the likely failure of a company, before one or two years before the actual bankruptcy, say one of the methods, more traditional methods would be the auditor’s going-concern

DW: Yeah

VE: and just looking at the company and seeing if it is likely to continue for the foreseeable future and the second one would be say using financial ratios and I think that’s what analysts would do, I dunno using something like say liquidity ratios to..

DW: [Joins in] ok like liquidity ratios [?] if its keep going like this the company would be in trouble..yeah yeah

VE: and then the more sophisticated ones I would say would be Altman’s Z-score method where it’s basically, he adapted the financial ratios and he places weights on each ratio and I think there are like 5 key ratios and I think they are weighted in relation to assets [?] sales turnover, EBITA turnover and most of them are like say revenue over assets and stuff like that and then has weights on each of them and say if you get a z score of say 2.6 , you could like use a normal distribution table to see em if it’s. I think if it’s above, the company is likely to survive and if it’s below it goes to failure DW: ok

VE: something like that that’s what they do with the prediction models but since you didn’t work with bankruptcy models

DW: Never worked with prediction models but it will be interesting to see how they work in a normal...you probably can’t really use them were you’ve had a massive recession and [?] a financial crisis removed the liquidity from the market, very difficult to use bankruptcy prediction models there, because one thing had caused a massive wave of insolvencies, but it will be interesting to know how it works in a normal, normally functioning economy. Can you see 2 years out? How companies is gonna go?

DW: Have you actually tested these models out?

VE: nah, I haven’t actually tested these out, the thing is like…I was just looking to promote the use, my point of view was of…like looking at the different models, say aside from the traditional ones say the going- concern and financial ratios, the Altman’s Z-score model has bee, a different company might have a different way to weight each of the ratios
VE: so my point of view is like which ones is like … I think in literature, academically they favour the Altman’s Z-score but like obviously other companies and institutions are coming up with…adaptations of the Z-score, which makes it more accurate

DW: ok

VE: So that’s my view of …so we’ve discussed failures, so in your opinion who is to the blame for the whole issue, when a company goes into failure or just fails...bankruptcy?

DW: who is to blame? It’s hard to look past the directors I suppose in any corporate failure, as to who should have done something differently or you know if you can identify something that they should have done it. The directors ultimately or the directors would blame various other parties. The banks have taken a hiding in recent years in terms of the blame and what I suppose in a lot of cases when you look at it, would you have seen through the recession if the bank had given you the extra funding that you wanted or would you have ended up just with a bigger deficit when you went into liquidation

VE: yeah

DW: em am I think probably the latter that plenty of companies sought out that additional funding but realistically they are better off haven not got it, that they were only prolonging the inevitable. Realistically directors are…and it can be a combination of management directors that diversified into other industries where you have some directors who might take their eye off the ball in terms of having got the company to a good place and having increasing their own a lot that they don’t pay enough attention to the company and it fails unnecessarily whereas perhaps if they had been a little bit more involved in the detail, they would have known sooner that we need to close down some of our operations to preserve those that are making more, em and some of them just…they just have the wrong idea I suppose and didn’t that, I think one of the greatest things that we find in the SME sector is that they are not taking appropriate advice.

So, to use an example of one of the first liquidations I worked on, was a retail chain with 42 shops and they were growing in…they started in 1992 and went into liquidation in 2009 [?] 2010 but had grown, they had grown from 2 shops to 10 shops, they had 10 shops for a long number of years

VE: yeah
DW: and had 10 shops for a number of years and generated quite significant turnovers and profits, then they hired a chap whose sole aim was to increase the amount of shops, which he duly did, quite rapidly and they went from having only 10 shops to having 42 shops over the course of say maybe 4/5 years. Rapid, rapid expansion and exactly the wrong time and obviously we operate with a great degree of hindsight as we are coming in after the event, but in each case they would have been guarantees on leases, they were financing all these shops using lease financing and no one was paying any attention to what if it all goes wrong, are we adequately protected here, em there was nothing wrong with expanding, but maybe should they have expanded in another company and protected you know the assets they already had. They might argue that if we hadn’t have secured the leasing then we wouldn’t have got the leasing for this particular shopping centre if we haven’t have been able to show that we have a strong track record. Perhaps, but they certainly took their eye off the ball in terms of the turnover and the profitability when they looked at how many more units can be open here

VE: yeah

DW: and you have to blame the directors there, they decided on a strategy and ignored the day to day and the day to day took a huge dive and where it did the whole thing came sort of crashing down,

VE: Yeah

DW: So, yeah in each case and I mean is the directors that we concentrate on in each case of our investigations and I dunno how familiar you are with the whole Section 56 reporting?

VE: nah [very low pitch]

DW: In a liquidation, but not an examinership or a receivership, the liquidator is obliged under Section 56 of the Company Law Enforcement Act of 2001 to conduct an investigation into the affairs of the company and its demise and to report then to the director of corporate enforcement on the reasons for the failures and the actions of the directors and the liquidators, this is an interesting area of Irish law, the liquidator is obliged to take an application to the High-Court to have to directors restricted unless he is relieved by the ODC, so he would report to the ODC what is called a Section-56 report and if we believe that the director shouldn’t be prosecuted then we have to set out the reasons why in the evidence and then it’s up to the ODC then to relieve us of our obligations or not to relieve us, in each case we would have to take action…and
if an action is taken to the courts, the court is obliged to restrict the directors, unless the directors can demonstrate that they did act honestly and responsibly. Those terms have sort of been set out in various case law, in [?] of what is honesty and what responsibly and conversely what is dishonesty and what is irresponsibility. So I suppose it runs the opposite to civil law whereby you are honest until proven guilty, in this case you are always guilty until you prove yourself innocent [both giggle]. So as a liquidator we are obliged to take action against a director unless relieved and if we are not relived the court is obliged to restrict those directors, unless they can prove that they shouldn’t be restricted. So that’s who we concentrate on in terms of, why? Did the company fail and did the directors act honestly and responsibly. It is very rare that directors will be accused of dishonesty but irresponsibility is the common factor in terms of having traded-on for a period where they should have called a halt to matters and incurred additional creditors as a result…if you look at a company that has gone into liquidation, the creditor position on the date until liquidation versus 12 months before that and did the credit position worsen. So if they owed 2 million to creditors of the 1st of January 2013 and went into liquidation on the 1st of January 2014

VE: yeah

DW: and there was 5 million in the creditors, it is very clear that they should have wound down the company 12 months beforehand unless, they can give some very very good reasons why not.

VE: ok so directors would be who the focus is on, but say in situations where due to economic policies, would the government say have some sort of blame as well.

DW: At a macro level potentially, but is it not up to the directors of the company to see a change in policy and adjust according, so ultimately I suppose as a director, the buck stops with you. If there is an external factor such as the liquidity being withdrawn from the market, as we saw across the board [yeah] effectively in 2008/2009, then as a director of a company it’s up to you to decide, how do I react to this. Yes at the micro-level government policy and factors such as the withdrawal of credit have a huge impact and in a lot of cases there is nothing that directors of individual companies can do if they a reliant on say an invoice discounting facility [Yeah] to be able to continue to trade in the manufacturing business & exporting. And that if that facility is withdrawn, in a lot of cases there isn’t an awful lot the directors of those companies can do except to put the company into liquidation, and you know suddenly it becomes insolvent.
VE: Yeah

DW: Construction and property development companies found themselves insolvent almost overnight back in 2008 whereby the might have constructed, say they might have a hundred units of housing on hand and they are turning that over constantly and say they have a couple of development sites and they’ve got their panning and permission and they’ve finished up in this site and they would have started work on next site [Yeah] and they would have pre-sales, deposits taken from customers, everything is moving forward nicely and all of a sudden no one could get a mortgage, no one wants to buy your stock, the price of your stock drops to half of what it cost to build it and as I say almost overnight you’ve become insolvent [Yeah] could you foresee that? Probably not, you were carried with the wave of it. Could you have done anything to stop it? With hindsight there is but at the time, again maybe not. So in that case you could say that an external factor has gazumped the company and there is nothing that the directors can do and that does happen. But ultimately, the responsibility only rests with them. I suppose at the point where something like this that happens [yeah] it’s up to you as a director then to act accordingly [yeah] and sometimes acting accordingly means to put the company into liquidation almost immediately and the difference then between, if you like a responsible director and somebody perhaps who is irresponsible is whether they do take the steps and look at information [yeah] and having good information is key, say there is no way we can trade out of this, we have to shut the company down and then try and get the best result from the creditors.

VE: I remember that early you were saying that the whole issue of corporate failure say it helps to weed out weak companies, so in terms of an economy, would that, will the whole issue of corporate failure . Does it have its benefits or is it just disadvantages or

DW: I suppose there are benefits to corporate failure too, in that it does, like the herd, it thins out the weak ones and that has to happen too, there is no point, in having, I suppose to use the hotel example as opposed to having five hotels in the town, three good ones and 2 bad ones and no one is really making much money, when in reality if the two bad ones were to close down the three good ones could thrive and do well, there is an element of I say thinning out the herring. It’s such a small economy as well. We’ve seen it in the pub trade whereby realistically we had too many pubs and the same with hotels, we had too many hotels. There were tax breaks given for the construction of hotels, in hindsight that was a very bad idea as we just ended up with far too many hotels and the other example is, is suppose it’s not corporate, we had too many taxis
and when the demand fail no one in that industry was making any money [yeah] and what is the best thing there, the best thing there was that half would leave the industry and then leave the other half, survive [yeah] so to a degree, a lot of corporate failure is good, it need to happen as well in a normal functioning economy and I think in Ireland, we’ve seen that people aren’t prosecuted both in personal bankruptcy or as directors of companies that have been through corporate insololvency. It’s seen as a very bad thing and people are, as I say to a degree prosecuted and damned because they’ve done this and it’s taken very personally by other individuals and companies who have suffered that, in a very [?] many times, his come out in this alright but I have been left with [?] I have been done here for so many thousand euros as a result of the demise of this company

VE: yeah

DW: But in some many instances, they didn’t do anything wrong, the company might have gone into receivership or liquidation but that is a fact of life as well. People who’ve lost out as a result but you do need to have a degree of corporate failure, in order that people would take the chance of setting up a company. You need to have those facilities in place [?] to set up a company and if it doesn’t work out for whatever reason you can put that company into liquidation, regarded you haven’t done anything wrong there would be no sanctions against you personally and you can set up another company and maybe try your hand at something else, so yeah we need those mechanisms and a certain degree to almost encourage people to you know give it a go and set up their own business provided you think you can make it work.

VE: …em! So now this is the whole issue of government bailouts, we’ve seen during say Northern-Rock or say the banks in Ireland, they would have been bailed out by the government, but say in America, the likes of say Lehman’s and Washington-Mutual were let go, like burst by the government, what side of the divide would you be on?

DW: …I would be in, in Ireland on the side of bailing out those institutions and the reason I say is in Ireland as opposed to maybe other jurisdictions, Ireland is a small economy [yeah] and if Anglo-Irish Bank was let go to the wall as opposed to been bailed out then a lot of individuals and businesses and institutions in Ireland, had shares and deposits in Anglo-Irish Bank, I think civil unrest would have broken out and if had been let go to the wall because depositors would have lost out and a lot of depositors are you know John and Mary, they are not all international bond holders, so you are looking at if you know the like of a Roman Abramovich type figure
who’s the like of the person that benefits from this type, he didn’t really, it is John and Mary and you are looking at credit unions or your local church that might have their banking facilities [yeah] with the like of Anglo-Irish back in the day. So I think generally the problem would have been civil unrest if it had gone to that and is if that that the taxpayer [yeah] so everybody should help to bail out a bank like that, I think to a degree it probably is or otherwise, you are seeing an unfair scenario whereby because I chose to put my deposit with Anglo, instead of with Bank of Ireland, I lose out completely at no fault of my own because my pension fund [?] shareholder argument, the shares were all wiped out. So if my pension fund had shares in Anglo then that part of my pension fund would have been wiped out that’s caused a lot of hardship for a lot of people and that is as far as realistically it should have been allowed to go. The bailout in Ireland and for Anglo and for those other banks was necessary.

There has been a lot of false reporting as to the actual cost, no one knows yet exactly it’s gonna cost but it’s an awful lot less than the exact amount the government put down and they will get a lot of that cash back [?] the Bank of Ireland the government is on course to at least make a slight profit in terms of Bank of Ireland, AIB it remains to be seen if the government will get anything back, Anglo, a lot of cash in there will not come back [both giggle] but some of it will come back, it has already come back but in a big economy perhaps like in America, they can afford to let a bank [?] because the impact won’t be as widespread on the nation as a whole but I think certainly in this case, it really just redistribution of the problem so instead of the problem of Anglo collapsing affecting 20% of Irish citizens, it is effectively, a 100% of Irish citizens. So we’ve all shared the burden to make sure no group of people in effect bear the burden. Now the whole bond holder argument is different to I suppose do you want to get into that, and we probably have to sort out the bond holders if you like to be seen as a sort of first world economy that is not going to em just burn bond holders [yeah] and know the hell with them and struggle then the raise finance again, we kinda have to do that, in order to be able to go back to the markets to raise finance but that’s a touch subject now.

VE: Laughs

DW: I think in terms of bailing out depositors, absolutely. Bond holders it is less credible

VE: So I think we’ve come to a conclusion, so is there anything else you would like to add?
DW: anything else em... I am trying to think of any sort of things that might be useful for the like of your thesis....em! no I think I suppose the main things we spoke about there, the em! Not sticking to the knitting, taking your eye off the ball, property investment, em...yeah investment. Passive investment, being an investment in something other than an investment in the business you’re in, investing in shares or investing in property that you don’t need in your business just for the sake investing in that as opposed to keeping your money in a deposit has had a big impact and that’s happened in a personal sense with individuals as opposed to within corporates. Certainly, a lot of the corporates that we would have dealt with that had property did in fairness use the property or formally use the property for their trading and I suppose not assessing the risk of failure & the results of failure. That is probably the biggest issue that a lot of companies have. Where ok with hindsight, we can look now and say that’s where you went wrong because we know what happened after that [yeah] but very few companies will look at the time and say ok this sounds like a great idea but what if it doesn’t work out what is gonna happen then and if we gave a guarantee over this loan for this project, what if that doesn’t work out, is that gonna affect the rest of our business and that’s not quite I suppose the bankruptcy prediction models that you were talking about there but even at that level of, em this sounds like a good idea but what if it doesn’t work out it just doesn’t seem like, that assessment wasn’t undertaken. I mean we’ve talked about the motor industry as well, a lot of those entities would have invested huge funds in [?] big showrooms, state of the art showrooms and the guys that survived were the guys that were in a gravel yard with a [?] because they didn’t have the loans to build these big showrooms that the rest of the guys had, they really didn’t make so much of a profit selling every car. All they needed to do was keep an eye on the stock that they had, selling cars and they were ok

VE: yeah

DW: But em did the guys with the big showroom stop and think at the time, what happens now if i have a 10% or 20% drop in sales during the year am I going to be able to keep up repayments or is this going to bring me down [yeah]. Now it wasn’t the core trade in those companies, they were still selling cars but they had taken on liabilities that were too big to able to have any sort of a fall in turnover. So I think that the one thing that if you could sort of make it make it mandatory for the directors almost on an annual basis, to conduct an assessment of [giggle] you know there is the going-concern aspect but it’s almost tick box, you know do you think you will be able to continue as a going concern for the next year; ah yeah we are doing fine. No one looks
at what if, let’s look at a couple of scenarios here, what if that customer that buys 605 of their product decides that they don’t want to buy from you anymore or if they fail what’s gonna happen to you? Does that mean that you’re gonna? Is there something you could do now to make sure that, that doesn’t sort of happen? That is the biggest problem that people don’t kinda foresee it and I don’t want to say if it’s just to prediction models or of it’s just to common sense, that they need to employ in order to be able to foresee it.

VE: thank you

DW: ok, you had a lot of that,

DW: have you…. [Private small talk 3 minutes]…. 
Extract from the leaner style questionnaire

Reflectors

Reflectors like to stand back to ponder experiences and observe them from many different perspectives. They collect data, both first hand and from others, and prefer to think about it thoroughly before coming to any conclusion. The thorough collection and analysis of data about experiences and events is what counts so they tend to postpone reaching definitive conclusions for as long as possible. Their philosophy is to be cautious. They are thoughtful people who like to consider all possible angles and implications before making a move. They prefer to take a back seat in meetings and discussions. They enjoy observing other people in action. They listen to others and get the drift of the discussion before making their own points. They tend to adopt a low profile and have a slightly distant, tolerant unruffled air about them. When they act it is part of a wide picture which includes the past as well as the present and others' observations as well as their own.

Theorists

Theorists adapt and integrate observations into complex but logically sound theories. They think problems through in a vertical, step-by-step logical way. They assimilate disparate facts into coherent theories. They tend to be perfectionists who won't rest easy until things are tidy and fit into a rational scheme. They like to analyse and synthesise. They are keen on basic assumptions, principles, theories models and systems thinking. Their philosophy prizes rationality and logic. "If it's logical it's good". Questions they frequently ask are: "Does it make sense?" "How does this fit with that?" "What are the basic assumptions?" They tend to be detached, analytical and dedicated to rational objectivity rather than anything subjective or ambiguous. Their approach to problems is consistently logical. This is their "mental set" and they rigidly reject anything that doesn't fit with it. They prefer to maximise certainty and feel uncomfortable with subjective judgments, lateral thinking and anything flippant.
REFLECTORS:

Reflectors learn best from activities where:

- They are allowed or encouraged to watch/think/chew over activities.
- They are able to stand back from events and listen/observe, i.e. observing a group at work, taking a back seat in a meeting, watching a film or video.
- They are allowed to think before acting, to assimilate before commencing, i.e. time to prepare, a chance to read in advance a brief giving background data.
- They can carry out some painstaking research, i.e. investigate, assemble information, and probe to get to the bottom of things.
- They have the opportunity to review what has happened, what they have learned.
- They are asked to produce carefully considered analyses and reports.
- They are helped to exchange views with other people without danger, i.e. by prior agreement, within a structured learning experience.
- They can reach a decision in their own time without pressure and tight deadlines.

Reflectors learn least from, and may react against, activities where:

- They are "forced" into the limelight, i.e. to act as leader/chairman, to role-play in front of onlookers.
- They are involved in situations which require action without planning.
- They are pitched into doing something without warning, i.e. to produce an instant reaction, to produce an off-the-top-of-the-head idea.
- They are given insufficient data on which to base a conclusion.
- They are given cut and dried instructions of how things should be done.
- They are worried by time pressures or rushed from one activity to another.
- In the interests of expediency they have to make short cuts or do a superficial job.

Summary of strengths:

- Careful.
- Thorough and methodical
• Thoughtful
• Good at listening to others and assimilating information.
• Rarely jump to conclusions.

Summary of weaknesses:
• Tendency to hold back from direct participation.
• Slow to make up their minds and reach a decision.
• Tendency to be too cautious and not take enough risks.
• Not assertive - they aren't particularly forthcoming and have no "small talk".

Key questions for reflectors:
• Shall I be given adequate time to consider, assimilate and prepare?
• Will there be opportunities/facilities to assemble relevant information?
• Will there be opportunities to listen to other people's points of view - preferably a wide cross section of people with a variety of views?
• Shall I be under pressure to be slapdash or to extemporise?

THEORISTS:

Theorists learn best from activities where:
• What is being offered is part of a system, model, concept, theory
• The have time to explore methodically the associations and inter-relationships between ideas, events and situations.
• They have the chance to question and probe the basic methodology, assumptions or logic behind something, i.e. by taking part in a question and answer session, by checking a paper for inconsistencies.
• They are intellectually stretched, i.e. by analysing a complex situation, being tested in a tutorial session, by teaching high calibre people who ask searching questions.
• They are in structured situations with a clear purpose.
• They can listen to or read about ideas and concepts that emphasise rationality or logic and are well argued/elegant/watertight.
• They can analyse and then generalise the reasons for success or failure.
• They are offered interesting ideas and concepts even though they are not immediately relevant.
• They are required to understand and participate in complex situations.

Theorists learn least from, and may react against, activities where:
• They are pitch-forked into doing something without a context or apparent purpose.
• They have to participate in situations emphasising emotions and feelings.
• They are involved in unstructured activities where ambiguity and uncertainty are high, i.e. with openended problems, on sensitivity training.
• They are asked to act or decide without a basis in policy, principle or concept.
• They are faced with a hotchpotch of alternative/contradictory techniques/methods without exploring any in depth, i.e. as on a "once over lightly" course.
• They find the subject matter platitudinous, shallow or gimmicky.
• They feel themselves out of tune with other participants, i.e. when with lots of Activists or people of lower intellectual calibre.

Summary of strengths:
• Logical "vertical" thinkers.
• Rational and objective.
• Good at asking probing questions.
• Disciplined approach.

Summary of weaknesses:
• Restricted in lateral thinking.
• low tolerance for uncertainty, disorder and ambiguity
• Intolerant of anything subjective or intuitive.
• Full of "shoulds, oughts and musts".

**Key questions for theorists:**

• Will there be lots of opportunities to question?
• Do the objectives and program of events indicate a clear structure and purpose?
• Shall I encounter complex ideas and concepts that are likely to stretch me?
• Are the approaches to be used and concepts to be explored "respectable", i.e. sound and valid?
• Shall I be with people of similar calibre to myself?