

## CONCEPTUALIZATION OF CRISIS SITUATION IN A COMPANY

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**Abstract.** The paper highlights theoretical construct of crisis situation in a company emphasizing the methodological positions of a social phenomenon. Applying systemic analysis of crisis situation in a company the paper discusses hardly spread social phenomenon, i.e. occurrence and expression of crisis situation in a company. On the basis of retrospective analysis of crisis situation, both crisis environment and bankruptcy features are presented and principal keywords defined with reference to crisis in a company as a social phenomenon and related to its environment: human, company-based, national and global. It shows the complexity of the scientific research object, that brings meaningful input into the analysis of crisis features in company life cycle. The paper aims at discussing and presenting critical reviews of crisis situation interpretations with emphasis on methodological positions of social phenomenon in different disciplines. The differences and links between crisis and crisis situation are also explained. Through explanation of logical construct of the paper, the authors specify crisis concept in a company: distinguishing negative changes in a company, that make the company staff apply crisis communication process and instrumentalities. In the above mentioned context the problem of crisis situation in a company remains significant from psychological, social and economic and managerial perspectives.

**Keywords:** crisis conception, crisis levels, crisis indicators, bankruptcy.

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### 1. Introduction

Nowadays a modern and successfully going company experiences continual changes and improvement undergoing rapid political, economic, social and technical changes or even running ahead of them. Usually crisis is defined as a negative phenomenon (Rosenblatt, Sheaffer 2002), however, it is important to notice the close links of crisis and changes, which reflect positive impulses to overcome crisis in a successful company development. In this context the problem of conceptualization and the analysis of the discussed phenomenon still remain important in social, economic and managerial aspects.

**Scientific analysis object** is the concept of crisis situation in a company.

In order to analyze the identified scientific problem, the following scientific works of different researchers have been taken into account. They deal with crisis reasons and causes, bankruptcy, crisis management, company state estimation, bankruptcy prediction and its methods. Characteristics of crisis situation were analyzed by Augustine (1995); Ayres (1996); Booth (2000); Burn, Redwood (2003); Demirguc-Kunt, Detragiache (1998); Hart (1993); Hwang, Lichtenthal (2000); Milburn *et al.* (1993); Ravid, Sundgren (1998); Rogov (2006); Jasilionienė, Tamosiunienė (2009); problems of crisis management were discussed in the works of Ashcroft (1997); Alas (2008); Boin, Lagadec (2000); Darling *et al.* (1996); Darling, Kash (1998); Davidavičienė (2008); Donoho (1994); Escarraz, Chong (1998); Fink (2002); Kurosheva (Курошева 2002); Lalonde (2004); Maynard (1993); Milesi-Ferritti, Razin (1998); Mitroff (2005); Murphy (2006); Ponikvar (2009); Paraskev (2006); Parsons (1996); Pearson, Clair (1998); Ulmer *et al.* (2007); Valackiene (2009); Virbickaite (2009); causes of crisis and bankruptcy in a modern company were dealt with by Argenti (2005); Birch (1994); Grigaravičius (2002); Kaminsky (1998); Kash, Darling (1998); Martin (1991); Preble (1997); Ren (2000); Rosenblatt, Sheaffer (2002); Rosenthal, Charles (1998); Shrivastava *et al.* (1998); Udo (1993); Ucal *et al.* (2010).

**The paper aims** at discussing and presenting critical reviews of crisis situation interpretations with emphasis on methodological positions of social phenomenon in different disciplines.

Consequently **research goals are** to analyze the variety of crisis concepts and to offer the general definition of crisis in a company as well as to identify crisis indicators in a company's life cycle.

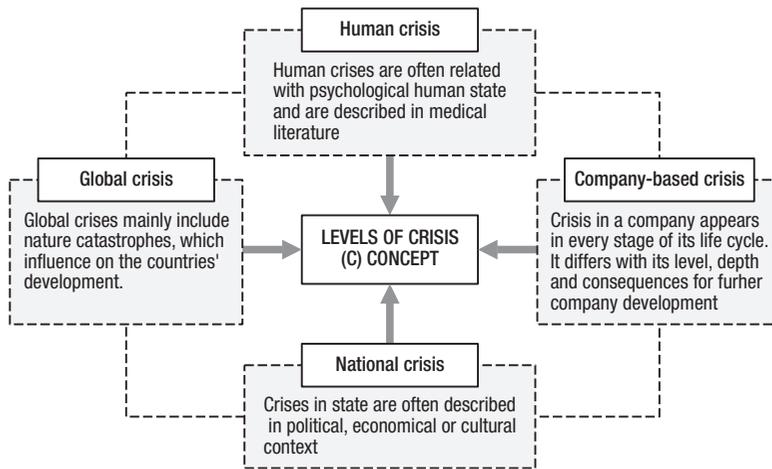
The formulated goals determined the structure of the paper. In order to solve the above mentioned problem, the interpretative – constructive methodological approach was chosen, which made it possible to reveal the estimation of the subjective phenomena as well as to develop the researchers' attitude to the analyzed problems.

## 2. Genesis of crisis concept

Researchers such as (Webster 2000; Shrivastava 1987; Hauschildt 2000; Fink 2002; Millar, Irvine 1996; Ren 2000; Maksimovic, Phillips 1998; Hauschildt 2000, Kash, Darling 1998, Peters 1995, Pearson 1998, Coat, Fant 1993) explain that crisis concept coincides with its manifestation area. We face global, often natural crises, psychological, national and company-based crises (see Fig. 1). Though the total number of problems is much bigger, four defined crises areas prove the complexity of the problem and necessity to focus on its particularities.

**Crisis situation in a company** has more often been related to macro environment crisis especially in its primary stage. Growing instability of the environment increased the consideration of crisis research in a company. In the classical literature Hermann (1993) pointed out three crisis indicators: surprise, threat and short reaction time. Generally crisis in a company is considered as a negative phenomenon. However, we cannot agree

with Ulmer’s *et al.* (2007) opinion that “crisis is a unique moment in the history of company’s performance”, because today crisis situation is a normal state in a developing company. Therefore a positive crisis aspect has to be considered (see Table 1). Crisis creates a possibility to learn and improve. In Chinese the symbol of crisis means “a dangerous possibility”. Because of its nature a crisis is dangerous for organization’s life cycle, but still it gives company a possibility to become stronger (Ulmer *et al.* 2007).



**Fig. 1.** Levels of crisis concept (modified by the authors)

**Table 1.** Positive and negative aspects of crisis expression (modified by the authors)

Crisis position	Negative aspects	Positive aspects
General organizational crisis	Trouble and disorder in organization (Denis 1993; Lagadec 1996; Offer 1996)	Necessity of systemic research, restoration of social structure (Meyer <i>et al.</i> 1990)
Operation crisis	Inertia, paralysis, flurry (Denis 1993; Pauchant, Mitroff 1995)	Necessity to identify new and efficient operations (Milburn <i>et al.</i> 1993; Denis 1993)
Relation crisis of the whole system members	Conflicts, competition (Rosenblatt <i>et al.</i> 2002)	Cooperation, alliance, coalition (Rosenthal <i>et al.</i> 1989)
Behavior and stress crisis	Stress, unconsidered behaviour (Lagadec 1996)	Identification of stress source, analysis of decisions (Milburn <i>et al.</i> 1993)
Value crisis	Banality, routine (Toft, Reynolds 1994; Pauchant, Mitroff 1995; Perrow 2003)	Solidarity (Kaniasty, Norris 1995)
Learning crisis	Seeking for quick results and standards (Hedberg 1981; Rosenthal <i>et al.</i> 1998)	Experiments (Hedberg 1981; Meyer <i>et al.</i> 1990)

Company is a complex socio-technical system, which performs in the complicated environment, therefore company crises are closely related to global and crises in state, for example, economic crises, which often appear as the cause of crisis in a company, as well as to psychological crises which can become the consequence or the cause of it.

Negative phenomenon for company's existence can appear from any problematical situation which is provoked by the external factors (macro-economic, social – political, etc.) or the company's internal factors (work processes, financial state, management, marketing, resources, etc.). The indications of negative phenomenon are usually the same: decrease of liquidity and profitability, loss of financial stability, cost increase, loss of market and competitive ability (Blume *et al.* 1998; Cantor, Packer 1994; Dwyer and Stein 2006; Gupton 2005; Foster *et al.* 1998). When economic links among the factors are strong, decrease of one financial rate in a company determines the negative changes of the other financial rates that influence the loss of company's position and profit decrease. This sudden loss of company's competitive ability is called 'the effect of falling muggings' (Murphy, Winkler 1992). However, such changes are necessary in a company for its further development.

The changes in a company can become the essential point to seek for the leader's position in the market because the results are closely related to the success of changes. Companies are often faced with radical changes, so it is very important to understand the essence of them. Management of changes solves the problems of business management related to falling rates and inefficiency of company performance as well as it stops the growth of crisis situation and helps avoid the crisis itself. In order to control the changes, a company should implement the management of changes before they start, what will help decrease the problems and possible stress situations in the future, which are not avoidable even for the market leaders. Therefore, it is very important to manage the changes in a company and do not cross the crisis bounds which are difficult to control.

Despite the clear understanding of crisis, it is necessary to define normal and necessary **changes, crisis situation and crisis in** a company.

Situation when company's performance is fractionally reduced and can be easily liquidated and do not bring much loss for a company can be defined as normal **changes in a company**. While **crisis situation** is an unstable company state when usual business operations are failing and the results of company's performance fall down. Any crisis situation culminates in crisis. Crisis situations differ from each other in their duration, depth and consequences. Therefore, they require the implementation of some operations and application of some instrumentalities to reduce possible loss and renew system functioning while crisis depth is not deep yet. The importance of crisis diagnosis is emphasized in order to notice crisis situation as soon as possible while crisis did not reach the deepest point and did not make big loss for a company. Consequentially the earliest crisis stage has been analyzed in the work.

The scientific literature provides a lot of crisis interpretations. Oxford dictionary (2004) explains **crisis** (C) as incident or situation related to threat which is fast growing and creates the critical diplomatic, economic, political or military conditions and obliges

to use all resources to reach the goal. Crisis concept is often related to the moment or period of time when company faces difficulties and situation becomes dangerous for its further performance (Webster 2000; Shrivastava 1987; Hauschildt 2000). The other scientists relate crisis to the crucial changes which can be corrected (Fink 2002; Millar, Irvine 1996; Ren 2000; Maksimovic, Phillips 1998). Therefore the problem appears:

- when usual changes are over and crisis begins. Though the problem is relevant, however, it is very complex and multistage.
- When is crisis over and the stage of bankruptcy and liquidation begins? The formal solution of this problem is clear. But informal solution ways – avoidance of bankruptcy – depends on the solution level of the first problem.

From practical point of view crisis is the first situation indicator when increased risk, rating fall, problems in usual business operations, danger for the public image, performance decline, etc. are typical (Fink 2002; Kuroseva 2002; Mitroff 2004). Crisis is the event, consequences of which make the threat for organization's strategic aims (Beech 2000; Maynard 1993; Hart 1993). Crisis heart is usually local, however, unnoticed negative indicators can involve the whole system. According to Hauschildt (2000), Kash, Darling (1998), Peters (1995), Pearson (1998), Coat, Fant (1993) it can be claimed that crisis is the accidental critical moment determined by the formed factors which disturb normal functioning of the system and it cannot develop according to the planned trajectory.

Having analysed the crisis conceptions of different authors (Fink 2002; Kuroseva 2002; Mitroff 2004; Webster 2000; Shrivastava 1987; Hauschildt 2000; White 1989) crisis can be defined as the event, consequences of which cause a big threat to organization's strategic goals and it cannot develop according to the planned trajectory.

The crisis definitions of different researchers are shown in Table 2.

It is noticed that the phrase 'it disturbs the normal system functioning' (Peters 1995; Pearson 1998; Clark 1995) differs crisis from normal system functioning. Normal functioning is solved by the standard procedures, it is not a crisis, but it is operative and strategic operations regulated by the standard procedures. However, the moment of crisis beginning is still indefinite, though it is clear that the standard instrumentalities have to be applied and only when they are inefficient, crisis situation begins.

In the modern crisis concept a crisis has to be defined as the specific state of a company as well as the causes that influence the crisis appearance. The necessity of its overcoming has been pointed out involving the whole staff in a company.

Having generalized crisis conceptions in the scientific literature, crisis can be defined as *a situation characterized by significant negative changes in a company, which stimulate company staff to apply crisis communication process and instrumentalities as well as to form new operations in order to renew and guarantee the success of the further performance.*

Interpreting the complemented crisis concept it is emphasized that when crisis situation appears, company's strategy becomes meaningless and it is necessary to update operations and create a new strategy.

**Table 2.** Conceptualization of crisis definitions (modified by the authors)

Crisis definition	Interpretation	Authors
Crisis is the moment, when company faces difficulties and such situation becomes dangerous for further company development	Only the situation until the threat is emphasized in order to define dangerous activities but further company activities are not discussed	Webster 2000; Shrivastava 1987; Hauschildt 2000
Crisis is the crucial change in a company which can be corrected	Changes do not always mean crisis in a company. Only the changes in a company are pointed out	Fink 2002; Kash, Darling 1998; Ren 2000
Crisis is the first feature of the situation which is defined by the increased risk, rating loss, problems in usual business operations, danger to the public image, performance decline	Only one factor of the risk is assessed not considering the influence of the other factors. Crisis situation is described but not crisis itself	Donoho 1994; Mitroff 2004; Mitroff <i>et al.</i> 2006
Crisis is the event which consequences make the threat for organization's strategic aims	The threat is emphasized for the company activities but the factors which oblige to act are not considered	Beech 2000; Hills 2000; Hart 1993
Crisis is a condition which obliges to take actions	Narrow crisis assessment, not considering the further company activities	MacKen/ze 1994; Paraskev 2006
Crisis is the event or situation related to threat which grows very fast and creates a condition of political, diplomatic, economic or military importance which oblige to use all resources to seek the aim	The situation and its conditions are pointed out but the purposes and aims are not discussed	Dictionary of international words 2004; Ulmer 2007; Laitinen 1999
Crisis is the set of accidental or formed factors which determined the appearance of the critical moment in a company that disturbed the normal system functioning	Crisis process is assessed very narrowly emphasizing only the moment case	Peters 1995; Pearson 1998; Clark 1995

If a company cannot or does not want to notice crisis situation in time and to foresee and realize its liquidation reasons, then the juridical instrumentalities have to be applied: restructuring and bankruptcy processes. **Restructuring** (*R*) is the act of reorganizing operations of the company which has temporal financial difficulties in order to avoid bankruptcy. Restructuring is often the only way to avoid bankruptcy and to keep developed business. It is noticed that company's situation in this stage is very bad, however, company owners and direction still foresee here a possibility to change the far-gone company's state by applying all afforded privileges.

**Bankruptcy** (*B*) in many countries, including Lithuania (Lithuanian Republic Bankruptcy Law No IX-216, 20 March 2001, Restructuring Law 2008), describes the last moment of crisis situation and is related to company insolvency, when company debts

make more than a half of its capital. In the USA bankruptcy is a legally declared inability or impairment of ability of an individual or organization to pay its creditors (The United State Bankruptcy Code 2008). Bankruptcy in England and Wales is governed by Part IX of the Insolvency Act 1986 and by the Insolvency Rules 1986. The term bankruptcy applies only to individuals, not to companies or other legal entities. Therefore the boundary of bankruptcy is clear. It is the juridical far-gone crisis level which requires the intervention from outside.

Though the rehabilitation mechanism is defined in the bankruptcy law, still the practice shows (Miškinis, Kvainauskas 2009) that better results in the bankruptcy stage are gained when company is sold out – liquidated.

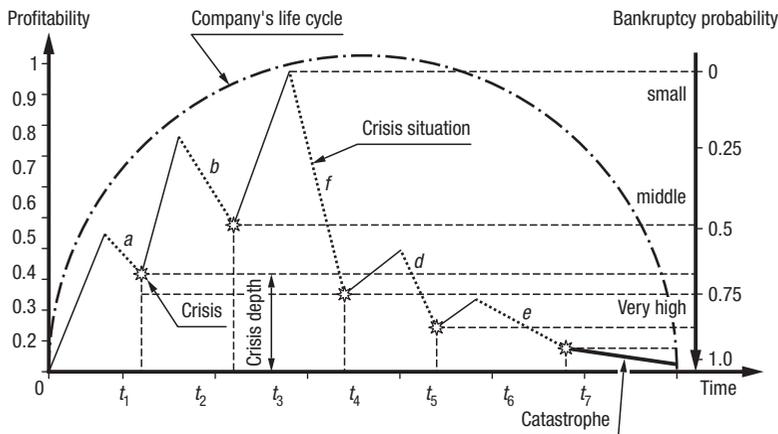
### 3. Crisis indicators in company life cycle

The boundaries of crisis situation, crisis and bankruptcy can be defined analyzing company life cycle, which is made of changing phases of growth and fall. When fall is being changed by growth, a company grows up improving its performance and financial state. But when growth is being changed by fall a company faces some difficulties and comes into crisis situation which requires taking some actions.

In Fig. 2 the detailed company life cycle, the deepest crisis points and crisis situations are defined. When company profitability is high, bankruptcy probability is low, but when company profitability falls down to 0, bankruptcy probability goes up and becomes very high. Therefore crises become very dangerous when their depth goes up to 1 in the bankruptcy probability scale.

Having analyzed the company development in its life cycle and the possible crises there, it can be claimed that there are two main points emphasized there:

- if a company does not face any changes, even a successful one falls into desuetude and fails in the changing environment;
- crisis is a feature of the company desuetude as well as a feature of its development through some stage fall.



**Fig. 2.** Bankruptcy possibility in the different stages of company life cycle (designed by the authors)

The second reason determined the development of many crisis cause theories and models development. The classification of crises is step one for their identification, their causes definition and control.

In a quickly changing situation the proportion of evolutionary and revolutionary development is changing, too, – the period of stable development shortens, and a company more often is faced with crisis, overcoming of which requires revolutionary reformations.

The factor of company growth is very important for company development. The importance of this factor has been explained by the Greiner conception (Laumenskaitė, Vasiliauskas 2006) (see Fig. 3).

In the Greiner’s model it is claimed that a developing company passes through five evolutionary stages, which match with the particular management stages where typical crisis situations can be formed out.

In the creativity stage a company development and growth depends on the creativity of the company establishers in business. When a company is growing a company manager falls behind solving all the problems. Then *leadership crisis* is formed out. The Greiner’s conception offers to change the manager’s attitude or to change the manager, and to form the managerial system with exchanged work scope (Laumenskaitė, Vasiliauskas 2006).

In the direction stage when a company solves leadership crisis, *autonomy crisis* is formed out. Hard functional management structure begins to limit the initiative, responsibility and motivation of the employees. The increase of the delegation level is recommended for this crisis situation solution releasing the decision right and increasing the privates and responsibilities of the lower level employers. The establishment of accountability centres is possible in the different activity areas.

In the delegation stage further company development is reached when implementing decentralized organizational structure, however, while a company is growing its execu-

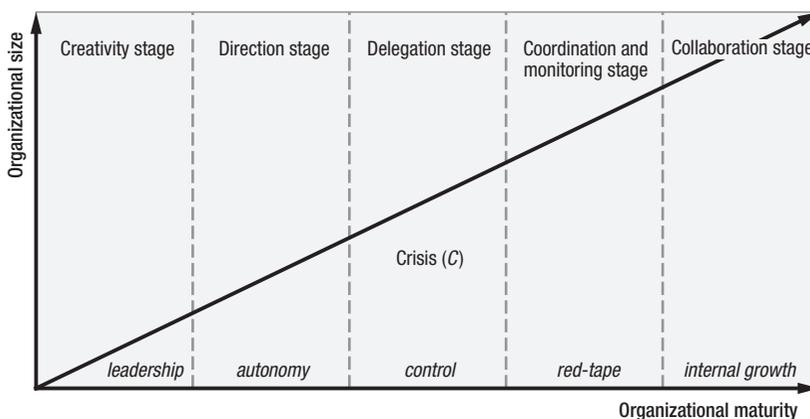


Fig. 3. Greiner’s conception of company development and crisis stages (according to the Growth Phases Model)

tives feel that they are losing the control of decentralized company. The executives of autonomous departments often contrast their own interests with the interests of the whole organization.

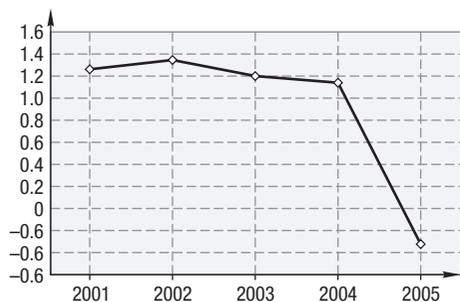
The presumptions for *control crisis* have been formed out. It is mistaken to try to return central management because of the grown company size. At this point Greiner (Lau-menskaite, Vasiliauskas 2006) offers to increase the coordination of the company activities: to involve the decentralized departments into the product groups; to re-establish formal planning procedures; to employ new workers to create, implement and apply new control programs; to assess and share the financial resources between all departments; to value every product group as the investment centre, where the investment change is an important criterion dividing financial resources; to centralize some technical functions such as data processing, while daily operational decision still remains decentralized.

In coordination and monitoring stage company growth is gained managing the limited company resources. Besides, the company executives have to assess their own needs as well as the whole company interests. Therefore, they are forced to act according to the company plans. In this stage it is very important to overcome formal red-tape system. So the presumptions for *red-tape crisis* have been formed out.

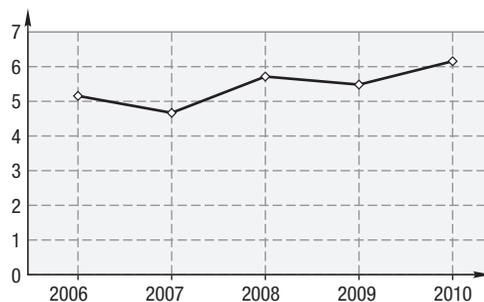
In collaboration stage the theories of teamwork and different personality adaptation to it have been pointed out. Formal management has been changed into social management and personal discipline: teamwork has been emphasized.

Greiner in the Growth Phasis Model foresees *internal growth crisis* or “psychological tiredness” crisis because of the lack of collaboration among the employees in a company. This crisis is described as physical and emotional tiredness of the employees from the intensive teamwork and too high requirements for employees’ innovations. Greiner offers for solving these problems to create new structures and programs which will let employees periodically take a rest, relax and restore power. He also suggests creating the double organizational structure, which would be made of a usual organizational part to do daily works as well as of the “mirror” organization, where the personal and perspective achievements of the employees could be stimulated. In this double structure an employee can move from the usual to “mirror” structure and back dependently on the energy, i. e. if an employee is tired he goes to the ‘mirror’ structure, relaxes and returns back to the usual.

Several attempts had been made for evaluating and describing the research. One of the most comprehensive studies was carried out over the failed AB “Ekranas”. It is an extraordinary case, because AB “Ekranas” was one of the biggest factories not only in Lithuania but in Europe, too, where more than 4000 employees worked there. The year 2000 was the most successful year of its performance, though in 2006 it went bankrupt. The analysis of its financial rates applying Altman model showed that bankruptcy probability was high during all this period from 2001 to 2005. Especially high it was in 2005. The results of AB “Ekranas” bankruptcy probability applying Altman model are shown in Fig. 4. Having analyzed the results of the surveyed company it can be claimed that the first features of crisis situation could be noticed at the very beginning of 2001.



**Fig. 4.** AB “Ekranas” bankruptcy probability during 2001–2005, applying Altman model (the research carried out by the authors)



**Fig. 5.** UAB “Dainava” bankruptcy probability during 2006–2010, applying Altman model (the research carried out by the authors)

**Table 3.** Altman model values

Altman model Z values	Bankruptcy probability
$Z < 2.79$	Bankruptcy probability is high
$Z = (2.80; 2.99)$	Bankruptcy is probable
$Z > 3.0$	Bankruptcy probability is low

Though the situation was stable, bankruptcy probability still remained the same and crisis situation turned into deep crisis phase which determined company bankruptcy.

The other example of a going enterprise UAB “Dainava” illustrates the research. It is the successful industrial company producing processed food. It was established in 1995. The purpose of this company survey was to analyze its situation during the last five-year period applying Altman model. The analysis of its financial rates applying Altman model showed that there was not any bankruptcy probability during all the surveyed period of 2006–2010 (Fig. 5). Therefore, it can be claimed that it is a successfully growing company and there are not any crisis situation features in it at the moment.

#### 4. Conclusions

The discussed social phenomenon is significant both theoretically and practically. The research analysis demonstrates the polarity of the existing conceptions. The understanding is focused on four main crisis levels: human, company-based, national and global crisis. They all prove the complexity of the analyzed problem. Though these crisis levels appear in different times, still there is a close link among them. Company crises are closely related to those in state, e.g. economic crises often cause company crises; psychological crises can become the cause as well as the consequence of company crises;

- Macroeconomic crises (growing instability) increased the need to analyze micro-environment crises (company crises). Despite the clear crisis understanding it is important to define temporary changes, crisis situation, crisis and bankruptcy. Company crisis is related to the moment, when a company faces difficulties and the

situation becomes dangerous for further performance or it faces a crucial change, which is impossible to control;

- It is important to analyze crisis indicators in company life cycle. Growing company goes through five developmental stages in which typical crisis situations are formed: leadership, autonomy, control, red-tape and in-house psychological crises. Having analysed modern crisis conception, crisis should be defined not only as a special company state or reasons determining its appearance but also as involvement of company staff to overcome it. Crisis conception has been defined as follows: **Crisis** is a situation characterized by significant negative changes in a company which stimulate company staff to apply crisis communication and instrumentalities as well as to form new operations in order to renew and guarantee the succession of further performance. The formed crisis concept emphasizes that company strategy becomes meaningless when crisis situation occurs, in that case it is necessary to update operations and create a new strategy.

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## **ĮMONĖS KRIZINĖS SITUACIJOS KONCEPTUALIZACIJA**

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Santrauka

Straipsnis skirtas krizinės situacijos įmonėje teorinio konstrukto analizei, išryškinant šio socialinio reiškimo metodologines pozicijas. Taikant sistemingą krizinės situacijos įmonėje analizę, straipsnyje aptariamas nepakankamai plačiai ištirtas socialinis reiškinys – krizinės situacijos raiška įmonėje. Retrospektyviai analizuojant krizinę situaciją, atskleidžiami krizės aplinkos ir bankroto bruožai (ilustruojama tiriant kelias įmones) bei patvirtinami pagrindiniai moksliniai teiginiai. Jais remiantis, krizė įmonėje apibūrinama kaip socialinis reiškinys, kurio raišką galima tyrinėti įvairiose aplinkose ir jos lygiuose: psichologinėje aplinkoje kaip individo, įmonės aplinkoje, valstybės ir globalios aplinkos atžvilgiu.

**Reikšminiai žodžiai:** krizės konceptas, krizės lygiai, krizės indikatoriai, bankrotas.

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