

THE DECLINE OF LARGE BRAZILIAN COMPANIES

Alexandre Pavan Torres*, Fernando A. Ribeiro Serra**, Manuel Portugal Ferreira***, Emílio Araujo Menezes****

Abstract

This article focuses on organizational decline and specifically on the evolution of a selected group of large Brazilian firms. The firms under scrutiny were included in the ranking of the *Largest and Best* of the Brazilian *Exame* magazine, in the period comprised between 1974 and 2005. Our descriptive analysis shows two main effects: first, a high rate of decline among the largest Brazilian firms, and second, an acceleration of the rate of decline over the years. That is, the firms are increasingly less capable of maintaining a superior level of competitiveness for an extended time horizon. By studying organizational decline we are better able to understand what firms should do to sustain an advantage.

Keywords: Organizational Decline, Brazil, Strategy

*Graduate Program in Production Engineering, Federal University of Santa Catarina, Brazil

**Corresponding author, Graduate Program in Business Administration, University of São Paulo, Brasil
HSM Education, São Paulo, Brasil, Av Prof Luciano Gualberto, 908, 05508-010 São Paulo – SP, Brasil
Email: fernando.serra@hsmeducacao.com.br

***School of Technology and Management, Polytechnic Institute of Leiria, Portugal

**** Graduate Program in Production Engineering, Universidade Federal de Santa Catarina, Brazil

Introduction

Wheten's 1980 study entitled "*Organizational decline: A neglected topic in organizational science*", has brought to the academia attention the importance of researching and teaching organizational decline. Admittedly, the majority of studies in management have focused on the success of businesses and well performing firm. The histories, factors and driver of failure, or decline, have been rather disregarded in the extant research. Additional studies may help identify and explain one of the basic questions in strategic management: why some firms are poor performers and eventually fail where others succeed.

The growth and longevity of organizations is a current topic, even if perhaps tangential, to various business-related studies and a multitude of authors. Chester Barnard (1938), for instance, argued that the ability to survive is the true measure of a company's success. Other authors, such as Scott (1976), Bedeian (1980) and Ford (1980), argue that growth is a normal state of organizations. Even Penrose's (1959) study, often considered foundational to the *Resource-based view* (RBV), deals with organizational growth. According to Penrose (1959), firms' expansion is mainly based on the opportunities for using heterogeneous production resources in a more effective and efficient manner.

Despite the focus on developing an advantage and capturing abnormal returns, the empirical evidence shows that a substantial number of firms do not survive. Some companies fall various positions in

the performance rankings – such as popular rankings of the largest corporations –, other try to undergo some form of transformation (undertaking some form of restructuring or turnaround) with varying levels of success. However, the fact is that fail and extinguish. Large national and multinational enterprises are not immune to this path and the existing evidence is far from anecdotal. Firms, following the analogy with humans, also follow a life cycle, decline and disappear (Hoy, 2006). It is not surprising thus that several theoretical life-cycle models have emerged, even if moderately, in the study of organizations (for example, Adizes, 1988; Chandler, 1993; Gersick et al., 1997). These cycles of emergence, growth and decline are part of what we term "organizational dynamics" (Weitzel & Jonsson, 1989, p.91).

Albeit the increased interest in studying the temporal aspects of the organizations (Miller & Friesen, 1980; Cameron & Wheten, 1981; Wheten, 1987) and their life-cycles (Kimberly & Miles, 1980), the research on firms' decline has only gained greater momentum since the 1980's (see, for instance, Bedeian, 1980; Mites, 1980; Wheten, 1980; Cameron & Zammuto, 1984; Murray & Jick, 1985; Cameron, Wheten & Kim, 1987; Sheppard, 1994). Studying decline, some scholars concentrate on defining what is organizational decline (Greenhalgh, 1983; Cameron, Kim & Wheten, 1987). Whereas, other authors seek to explore models that describe environmental changes which influence decline and their impact upon the organizational structure (Zammuto & Cameron, 1985; Sutton, 1990). Yet

other scholars focus on the consequences of organizational decline in firms (for example, Freeman & Hannan, 1975; McKinley, Ponemon & Schick, 1996). However, in spite of the increase in research, the subject is far from saturated, even if only due to the difficulty in accessing data to empirically test theoretical propositions. In truth, we do not yet hold a clear idea of how characteristic or typical the decline process truly is.

In this study we reinforce the call for more investigation on organizational decline; and specifically the decline of Brazilian firms. Although the importance of this theme has been recognised and decline may be observable in many large corporations, a bibliographical research into the main academic magazines indicate a notable shortage of academic studies related to decline and turnaround strategies. Nevertheless, the fact remains that the study of decline within Brazilian businesses is important as confirmed by a field research by Fundação Dom Cabral (EXAME Maiores e Melhores, 2008) according to which the mortality rate of the top 500 Largest and Best in Brazil is of 77% within a 35-year period. This same research observed that there were only 2% of centenarian companies among the top 500 in 2007. This figure come in sharp contrast to the 39% in the Fortune 500 ranking, for North American corporations. Nonetheless, our understanding of this subject is still rather piecemeal and we aim at contributing to this line of research by targeting this problem in Brazil. We contribute to the identification of organizational decline factors and strategies to avoid this degeneration.

This paper is organized as follows. First, we proceed with a brief literature review on organizational decline. Second, we present the method and data employed and the results of an analytical observation. The third part comprises a discussion, points out limitations, implications to the theory and practice and a set of suggestions for future inquire.

Literature Review

Defining Organizational Decline

There is no exact, unique or decisive definition of what organizational decline truly is in the academic literature (Kimberly, 1976; Cameron and Wheten, 1983). Work related to decline was developed through the use of the same conceptual foundations used by studies aimed at explaining success. For instance, studies scrutinizing the inter-dependencies between firms and their external environment (Lawrence and Lorsch, 1967; Meyer, 1978; Aldrich, 1979), studies focused on resource dependency (Pfeffer and Salancik, 1978) and even the possession of superior strategic resources (Barney, 1986, 1991). Other contributions come from research on uncertainty (Simon, 1962; Thompson, 1967; Cohen and March,

1972) and crisis management (Smart and Vertinsky, 1977; Starbuck, Greve and Hedberg, 1978; Milburn, Schuler and Watman, 1983). Some authors consider decline to be somewhat inevitable, given that companies follow a more or less pre-determined life-cycle which will eventually lead to their demise. Mintzberg (1984), for example, argued that organizations reach a maximum point and afterwards start declining.

Decline looks to be related to the ability of being competitive. Competitiveness, according to Ferraz, Kupfer and Haguenaer (1996, p. 3), can be defined as “the ability of a company to develop and implement competitive strategies, which allows it to broaden or preserve, in a lasting way, a sustainable position within the market”. Thus, studies on firms’ competitiveness are related to decline. It was the loss of competitive ability in transformation by the North American industry, especially in the face of competition from the Japanese industry during the 80’s, that gave an incentive to studies on decline (Possas, 1999). In Brazil, from the 1990’s onwards, with the opening of its economy to foreign markets, businesses and industries began suffering the same effects felt by the North American firms – faced with competitive inability, companies are gradually put out of the market.

Decline has also been associated with factors such as size of the organization, loss of market space, reduction of assets, decrease of profit margins, falling share prices, reduction of the organization’s dimensions (refer, for example, to Greenhalgh, 1982, 1983). Nonetheless, in their majority, these will be consequences of decline and not *ex ante* factors that would predictably lead to decline. Other authors argue that decline is a consequence of a retracting market and the firms’ inability to react to mutations in demand (Miller and Friesen, 1984; Cameron et al., 1987; Weitzel and Jonsson, 1989; Castrogiovanni, 1991).

Wheten (1980, p. 577) in his precursory article about the subject, stated that “organizational decline, although of important and fundamental concern to organizations, has been given little attention by research”. Cameron, Sutton and Wheten (1988) argued that about three-quarters of the academic literature on organizational decline appeared after 1978. From then onwards an understanding of decline and success of organizations has turned into a central topic of international academic research in management (Fleck, 2004), but not, at least not in clear terms, in Brazil. Nor in Brazil has it been approached in an extensive manner so as to allow us to retain a comprehensive understanding of why companies lose their competitive ability to such a level that will perhaps lead to their dissolution.

In table 1, below, we summarize some definitions of decline, based on foundational work published since the 1980s.

Table 1. Definitions of organizational decline

| Author | Definition or sense | Note |
|---------------------------------|--|---|
| Grenhalgh (1983, p. 232) | “Decline occurs when the organization is unable to maintain the ability to adapt in response to a stable environment, or when it cannot increase or extend its control over the market niche where it faces gradually increasing competition.” | Decline in this case is defined as the opposite of adaptation. The environments, in general, are not stable and the static concept is limited. |
| Levy (1986) | Defines organizational decline as the lack of awareness of environmental threats, organizational weaknesses and not establishing remedial actions under these circumstances. | The definition adds lack of attention to environmental threats and lack of action. |
| Weitzel e Jonsson (1989, p. 94) | “Organizations go into a state of decline when they fail to anticipate, recognise, prevent and neutralize or adapt to internal or external pressures that threaten the organization’s long-term existence”. | The authors incorporate to the previous definitions the difference between decline and periods of consolidation as well as the additional organizational answers to demand for products and services. |
| Rozanski (1994) | Decline is a condition of substantial and absolute decrease in the base of the organization’s resources. | In this definition, the loss of resources indicates decline. |

An often emerging theme on decline research is that it seems to develop over an extensive period of time. An additional commonality refers to the distinction between the types of decline. Whetten (1980), for example, classifies decline in two types: stagnation and reduction. *Stagnation* is more likely to occur in passive and less flexible organizations (Greenhalgh, 1983; Cameron & Zammuto, 1984), and *reduction*, which points to a loss of market share and dwindle competitiveness. Pandit (2000) argues that the firms’ failure has been defined as “a threatening decline of existence” in performance. Walshe et al. (2004) distinguish between abrupt and gradual decline, noting that these can be precipitated by internal acts or inactivity, but also by external events in the environmental domain.

Evidence of Decline

Jim Collins and Jerry Porras (1994) presented, in their best-seller “Made to last”, eighteen visionary companies that had constantly surpassed their rivals between 1950 and 1990. Hamel and Välikangas (2003, p. 1) observed that “only one-third of these companies managed to maintain themselves above the Dow Jones index in the last ten years”. Among the companies that were not able to remain in the Dow Jones were names of renowned multinational companies such as Disney, Motorola, Ford, Nordstrom and Sony. Even considering the Dow Jones index in 1896, when it was created, it was made up of twelve companies; however only one of these original companies currently remains on the listing: General Electric (Waite, 2003). Given its ability to grow and survive, General Electric has been extensively studied, including in Brazil (see, for example, Fleck, 2004; Serra and Ferreira, 2010).

Mische (2001, p.3) whilst arguing about “strategy renewal”, noted some interesting data: 70%

of the largest existing companies in 1955 had ceased to exist by 1983; about one-third of the companies listed on Fortune’s 500 in 1970 were no longer listed by 1996; 40% of the companies listed on Fortune’s 500 in 1980, had disappeared from the list by 1996; the average life expectancy of a large industrial company is of approximately 40 years.

Hamel and Välikangas, (2003, p. 1) assured that “the large companies are failing more frequently (...) Of the twenty North American bankruptcies occurring in the last two decades, ten occurred in the last two years”. It is worth pointing out that in Brazil the scenario is not much different: we witnessed the rise and fall of big Brazilian companies such as Facit, Mesbla, Ultralar, Enxuta, Arapuã, Transbrasil, Vasp, Varig, Bombril, Gradiente, and Casas da Bahia, among several others. It is further worth weighing the reasoning here described; the reasons as to why companies fail to maintain their competitive ability, or superior profitability, for an extended period of time is not clear. In other words, it is not clear why these top performers failed to sustain their competitive advantages and decline to the point of, at least in certain cases, their demise.

Literature regarding business longevity has studied certain factors that are likely to contribute to firm failure, such as inertia, discontinuities within the industry, changes in the product life-cycle, internal dynamics of the organization (Romanelli, 1986), leadership crisis, excess in bureaucracy (Greiner, 1972), among others such as ease of imitation by rivals. McKiernan (2002) classified these factors in four groups that include symptoms of physical decline, management decline, behavioural decline and financial decline.

Also, research on organizational decline, in a more detailed perspective than this paper presents, focuses on inertia and the inability to adapt to an environment in constant flux; the inability of

companies to develop internally or acquire strategic market resources (Barney, 1986, 1991) that allows them to sustain an advantage over rival firms. In some cases researchers identified factors associated with executives (see, for instance, the work on managerial hubris by Hambrick and Cannella, 2004).

The factors that contribute to a loss of relative competitiveness, as observed by studying companies included in existing rankings or the Dow Jones index are varied. It is reasonable to suggest that some factors are associated with the industry given that previously the index comprised industrial companies that manufactured and commercialized commodities, mineral extraction companies and energy companies. Of the twelve original firms only one has survived to the present day. In reality, the index today is more sophisticated, including companies of various other industries (Waite, 2003).

Although many authors focus on organizations when they are successful and advance methods and models for additional growth and for overcoming hazards (Pascale, 1984, 1996; Porter, 1980, 1985, 1999; Collins & Porras, 1994; Ghemawat, 2000; Kim & Mauborgne, 2005), Hamel and Välikangas (2003) put forward that during the past four decades the volatility of the rate of return of the firms listed in the North American S&P 500 has grown approximately 50%. In the 1990s less than 5% of the companies listed in the S&P 500 and the English FT100 were able to maintain profit margins for their shareholders for a consecutive five-year period within the limits of the upper quartile. Finally, a survey conducted by *Exame's* magazine in the "Largest and Best" in 2002 noted that 80% of the companies included in the first ranking, in 1973, were no longer listed in 2002. Although these are rather simplistic statistics, they also suggest that there are powerful processes hindering firms' ability to continue accruing value (Williamson, 2003) in a sustainable and unique way.

In summary, empiric and casuistic evidence points to a dazzling level of decline among firms of which the Brazilian firms do not seem to be an exception. This evidence is intriguing however has not yet been the object of clarifying research and consequently, we cannot clarify what is happening in the business world, or what has changed in the competition. The fact is that this line of inquiry is a corner-stone for business strategy as it is aimed at studying, explaining and aiding firms develop and sustain a competitive advantage.

Review on Performance Decline in Organizations

The extant literature on organizational decline has adopted various perspectives and objectives. Pandey e Verma (2005) argued that academic studies point to two main approaches, one targeted at examining various factors in organizational decline and turnaround, resorting to analyses based on cross-data

(Hambrick & Schecter, 1983; Barker & Duhaine, 1997; Castrogiovanni & Bruton, 2000). Other approach is concerned with various firm processes related to decline and turnaround (Van de Ven & Huber, 1990). Schendel e Paton (1976) and O'Neil (1986), for instance, consider a process by which turnaround strategies are implemented to avoid decline.

The perspectives adopted comprise distinct objects. For example, Starbuck, Greve and Hedberg (1978) and Taber, Walsh and Cook (1979) studied decline in companies, and particular Levine (1978) and Biller (1980) studied the decline specifically in public administration. Jick and Murray (1982) studied decline in healthcare administration, and Cyert (1978), Petrie and Alpert (1983), Berger (1983) and Cameron (1983) in educational administration.

Jas and Akelcher (2005), when studying the decline of public sector organizations classified the causes of decline (refer to Levine, 1978; Whetten, 1988; Meyer & Zucker, 1989; Anheier, 1999; Mellahi & Wilkinson, 2004) in two groups: internal and external, and noting the (in)ability of these organizations to influence or manage the decline. The sources of external decline include those important changes that hinder how the company is run and those changes in the preferences of the consumers. The internal sources of decline are related to the lack of competence in running the company efficiently (Jas & Akelcher, 2005).

Walshe and colleagues (2004) argued that the literature on organizational decline and turnaround may be divided in three areas: (a) quantitative research, using data to analyze cross-sectionally or longitudinally the population - often aiming at identifying patterns or examining theories on the causes of failure or the outcomes of strategic intervention; (b) qualitative research, mainly using a single or a small set of case studies - these studies resort to data from interviews, secondary documents and other sources for observing cases in which failure and turnaround situations occur, and (c) theoretical work aiming to describe and explain empirical findings and develop new concepts.

In Brazil, considering the works presented at Enanpad, the leading Brazilian academic congress in the area of Business administration, there has been little research specifically focusing on decline, or organizational failures and turnaround. Given this void and the importance of the practitioners we contribute by calling attention to the topic and showing actual figures on the relevance of the phenomenon in Brazil.

Method

This is an exploratory and descriptive study focusing on a set of Brazilian firms - the largest and best firms. It is exploratory in that it delves into a subject where the accumulated knowledge is sparse and still little is

known, which requires gathering preliminary information. This study is descriptive in presenting and analyzing data collected from secondary sources on the present the status of the strategic decline in Brazil, especially in relation to the timeline for the loss of competitive capacity.

This research is documental and *ex post facto*. It is documental since the data was collected from Exame magazine's "Largest and Best" ranking for the periods from 1973 to 2006 – a 34 years period. This procedure resulted in the examination of 2.859 companies that at least in one of the years made it to the ranking.

Results and Analysis

All listings of Exame "Largest and Best" 500 Brazilian companies that were published between 1973 and 2006f were collected. The data included the company names and several other indicators of activity and performance. Ultimately, performance may be assessed by the profit captured, hence, using the criteria of net profit we classified and separated the companies in quartiles. The firms in the upper quartile (the 25%, or 125 firms, better performers in net profit) for each year were identified. Our choice to use as reference the upper quartile is relatively random as other criteria could have been used, however it permits us to restrict the analysis to the

"best of the best". Companies that are capable of maintaining a higher performance – superior to the industry average, or the average of the companies – during a longer period should also hold a competitive advantage, regardless of whether the source of this advantage is internal and based on strategic resources, or external, and supported, for instance in a governmental policy.

We then observed which companies remained in the upper quartile each year, and for the entire 36 years examined (1973-2005). The result is depicted in Figure 1. In Figure 1 the vertical axis reveals the number of companies that were able to stay in the upper quartile during these years, and the horizontal axis details the year.

Reading figure 1 it is obvious a strong decline rate. For instance, only 83 of the 125 (or 66%) companies in the upper quartile in 1973 remained as top performers in 1974 (point A of Fig. 1, first curve from right to left). Of these 83 companies, 65 were able to stay in the upper quartile until 1975 (point B of Fig. 1), as shown in Table 2. From 1973 onwards it only took 8 years for the number of companies remaining in the upper quartile be reduced to less than 25 – that is, 5% of the 500 Largest and Best Brazilian companies.

Table 2. Number of companies that remained within the Upper Quartile from 1973 onwards

| from 1973 (base-year) until... | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 |
|----------------------------------|------|------|------|------|------|------|------|------|
| Corresponding to the point (Fig) | A | B | C | D | E | F | G | H |
| Number of companies | 83 | 65 | 54 | 50 | 39 | 32 | 27 | 23 |

Figure 1 also shows that from 1984 onwards less than 5% of the companies maintain net profits enough to remain within the upper quartile for more than four consecutive years. Graphically we observe this effect looking how steeper the curves gradually become. The increase in the rate of decline starts in the 80s. Between 1973 and 1983 seven or more years were required for the number of companies within the upper quartile of net profitability to fall to less than 25. However after 1983 it only took six years, and from 1987 onwards, 3 to 4 years. In sum, we observe an acceleration in the pace of decline.

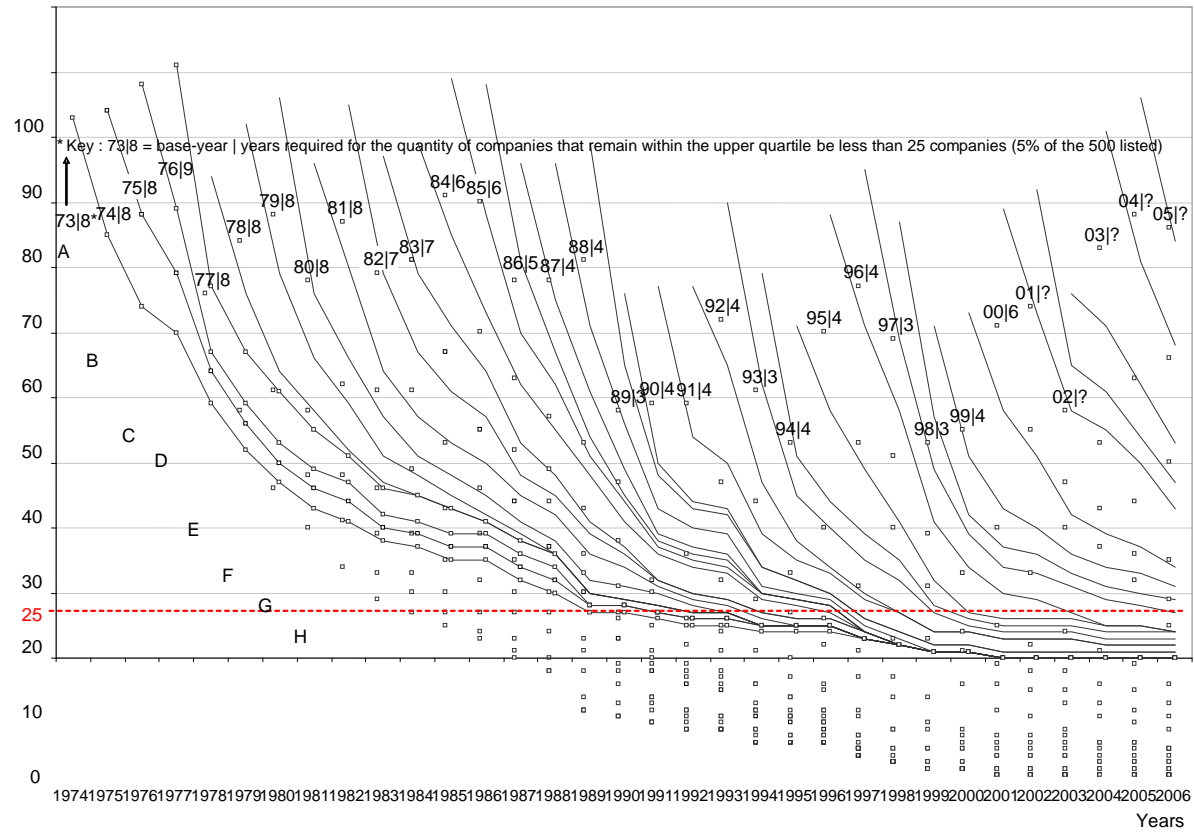
Figure 2 represents the number of years firms remain at the top (refer to each number indicated at

the right of each curve in Fig. 1). Note that the slight increase in 2001 and 2002 is only due to data restrictions, since the time elapsed to 2005 is only 3 to 4 years. It shows a cycle that presents a decline which accentuates from 1989 to 1992.

Only one company remained within the upper quartile of profitability since the first ranking, in 1973 until 2001: Brahma. In 2001 the company is acquired and becomes part of the Ambev group. Ambev, currently Inbev after the merger with the Belgium Interbrew, with the exception of the year 2002 in which it reported losses, also remained in the upper quartile from 2003 to 2006.

Figure 1. Loss of firms' competitiveness

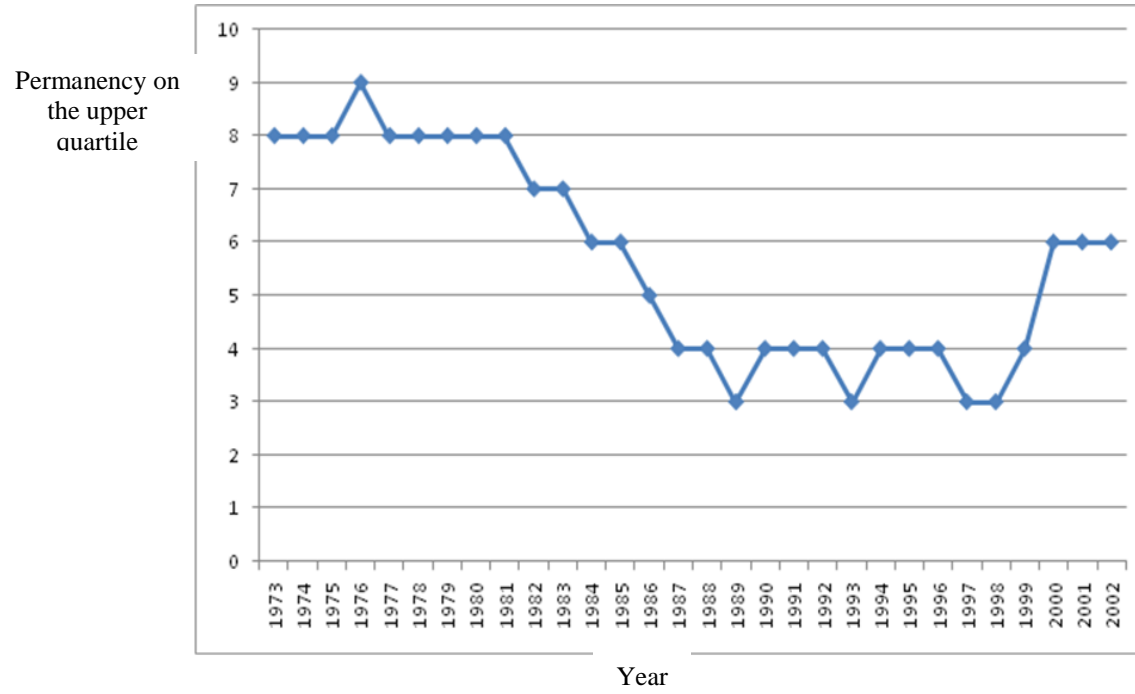
Quantity of companies that remained in the upper quartile



Note 1: Companies included in the 500 Largest and Best listings that remained within the upper quartile throughout the years (computations based on net profit margins)

Note 2: Only companies included in the list of the 500 largest, as published by Exame magazine.

Figure 2. "Cycle" of company decline



Discussion and concluding remarks

In this paper we examined organizational decline using a somewhat descriptive and exploratory analysis of large Brazilian “largest and best” companies. Specifically we were interested whether decline was a major phenomenon in Brazil and in the largest and arguably more successful firms, the rate of the decline, and whether we could establish any pattern or trend of evolution of the decline. For this endeavour we examined the largest firms over a period of 36 years. It is further worth noting that Whetten (1980) defined organizational decline as either a “stagnation” or a “reduction”. In this study we focused on organizational decline as reduction and we observed the loss of profitability (which was empirically assessed by the adjusted net profit margins).

Our analysis points out that similarly to American and European companies (see, for instance, Mische, 2001; Hamel & Välikangas, 2003; Williamson, 2003) the large Brazilian firms are also

losing competitiveness at an ever-increasing rate. The opening up of the Brazilian economy that is taking place over the past decade more pronouncedly may account for at least a part of this effect. The well-known inefficiency of the human resources, insufficient investment in modern technology and in research and development, various deficiencies in the transport and logistics system, and other structural and institutional inefficiencies may also help understand the loss in competitive ability. However it is well beyond the scope of this study to identify all the causes of decline as it is to formulate an all inclusive model of organizational decline. Notwithstanding, it is relevant to speculate on some of the reasons and external factors that impact on the performance of Brazilian companies. In particular, during the 90’s numerous external factors may have had a significant impact in the competitive ability of Brazilian firms, such as the examples in table 3.

Table 3. Important macroeconomic facts in Brazil

| | |
|------|--|
| 1992 | Opening of the market |
| 1994 | The Real (R\$) plan and opening of the economy |
| 1995 | Economic stability |
| 1996 | Increase in consumption |
| 1997 | Increase in privatizations |
| 1999 | Real (R\$) fluctuation and an increase in interest rates |
| 2001 | National Blackout |
| 2002 | Rise of the US Dollar |
| 2003 | Stabilizing of the US Dollar |
| 2004 | Record in exports |

All the external and internal factors affect, at least at some level, the ability to adapt to changing environmental and market conditions as well as the product/service portfolio offered (e.g., Romanelli, 1996). Moreover, the apparent firms’ inability to develop strategic resources when faced with change reduces the ability to compete (Barney, 1986, 1991), specially in a market that is open to outside agents. Indeed the institutional changes in Brazil also influence the very listing of firms accounted for in this study - that is the case with privatization that brings in previously state-owned firms. Future research could go deeper in understanding the impact of each of these external pressures on the decline of large companies, or more broadly on their competitiveness.

Considering that the upper quartile of Brazilian companies may be viewed as the top performers, it is apparent that the declining rate is getting steeper, as it is necessary to control, identify and act in preventing organizational decline (Schendel & Paton, 1976). The conclusion is that firms are finding it harder to sustain the same level of competitiveness, in a trend that started around the 1990s. In assessing performance

we employed a commonly accepted indicator of firms’ success (Porter, 1980; Greenhalgh, 1982, 1983) – net profit. . The use of profitability was convenient due to ease of access to data and data comparability over the years. Future research may examine decline using a different measure or set of measures of performance, be it growth, internationalization, market share or the product/knowledge portfolio.

Future research on the decline of Brazilian firms will be valued given the trends we identified. For instance, to understand why these trends are taking place and what are the factors leading to increased declining rate. It is possible that Brazilian firms do not hold strategic resources immune to international competition or that these resources are losing value. It may also be possible to identify and predict industry-specific patterns such that decline is not a function of individual firms but rather of entire industries or the majority of companies in an industry.

When examining organizational decline it may be also interesting to focus on the study of stagnated firms and to explore the possibility that a period of stagnation may be followed by a period of reduction. For example, it is reasonable to suggest that the

decline of Varig Airlines may have followed a trajectory of reduction, and the same path may have been followed by many other firms.

Future research may further evolve by studying individual cases. For example, the fact that Brahma was the only company able to retain a top performing status throughout all the period studied, may render it worth of a case study. By studying selected cases it might be possible to understand what drives decline and the reason why firms are unable to react when they find themselves in this state. The traditional inertial factors or the Icarus Paradox do not hold enough explanatory power to generate an effective understanding of why companies are not able to perform a turnaround and re-structure their operations.

To conclude, we highlight that the study of organizational decline, in this case focusing on a set of Brazilian firms, is necessary and important for a variety of fields. It may be the study of appropriate indicators to measure a trajectory of decline, or the causes of decline and the understanding of why top managers' mindset does not change to create action that barriers the decline. It is also important to understand which companies are on the rise in their performance, replacing those that are falling off the rankings. Without an understanding of the reasons for organizational decline, of even the largest corporations in each industry, it will not be reasonable to expect that we comprehend the strategic dynamics on the quest for a sustainable competitive advantage. In this endeavour we position one of the core dilemmas in strategic management research: why some firms fail, or decline, where others are top performers and survive.

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