CAUSES OF BANKRUPTCY IN EUROPE AND CROATIA

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1. INTRODUCTION

Bankruptcy[1] is an interesting object of research, being habitually perceived as a shocking and scandalous event, tarnishing management reputation, stigmatizing its owners, and regularly leading to a dishonourable death of the company, leaving outstanding debts in legacy. Its interdisciplinary character makes it even more challenging and extends the reasons for researching it in depth. Apart from these motives, recently a number of researchers significantly contributed to this field, and some of them will be presented in this paper.

On its way to becoming a member of the EU, the Croatian economy (and society in general) extensively compares its characteristics with the existing members. Since Croatian bankruptcy law is for the most part transferred from the corresponding German Insolvenzordnung (Insolvency law), German experiences in this field are especially interesting for Croatian bankruptcy researchers.
Even though being a part of the EU, the United Kingdom's Anglo-Saxon legislative theory and practice is relatively different from those of mainland Europe, therefore making it attractive for comparison.

This triangle of country-specific bankruptcy features, where Germany and the United Kingdom embody rich diversity of the European Union, and Croatia symbolizes new member states (although not yet being a constituent) with their particular transition traits, is fit into Ooghe and Waeyaert's (2004) universal, conceptual failure model.

Thus, first presented will be a general bankruptcy cause model. Ooghe and De Prijcker (2006) presented four main types of failure processes. Their findings of bankruptcy causes are based on a case study of bankrupt Belgian companies but can be generalized as universal bankruptcy causes. They are examined in the second section. According to this model country-specific (the United Kingdom, Germany and Croatia) insolvency causes will be studied.

[1] In this paper the terms 'bankruptcy' and 'insolvency' are synonyms, and they refer to the procedure of general distraint of legal persons property, excluding private bankruptcies.

Euler Hermes Kreditversicherung and the Center for Insolvency and Reorganization at the University of Mannheim published in November 2006 a comprehensive study of bankruptcy causes. This research and its results are exhibited in the third section, as well as an overview of the less recent Wieselhuber & Partner (2003) study of the insolvency causes and success factors of reorganization from the insolvency.

At the same time the Euler Hermes and the Center for Insolvency and Reorganization study was being finalized, unacquainted with it, a somewhat similar research was being conducted in Croatia. Our research of bankruptcy causes in Croatia is presented in the fourth section.

Finally, the concluding remarks will summarize the main findings of this paper.

2. GENERAL BANKRUPTCY CAUSE MODEL

Based on previous studies, interviews and a selected sample of 12 bankrupt Belgian companies, selected by the criteria of size, age and industry, Ooghe and De Prijcker (2006) proposed four main types of failure processes. These processes relate the fundamental causes of bankruptcy to the financial and nonfinancial consequences, and are presented as follows[2]:

1. The first failure process describes the deterioration of **unsuccessful newly established companies** led by a management with a significant lack of managerial and industry related experience.

2. The second is the failure process of **ambitious growth companies**, which have (after a failed investment) insufficient financial means to adjust their way of doing business to the changes in the environment.

3. Third is the process of **dazzled growth companies**, led by an overconfident management without a realistic view on the company's financial situation.

4. Finally, the fourth type of failure process is describing **gradual deterioration of established companies** where management had lost touch with the changing environment**.**

As stated before, even though these four processes are drawn from analysis of Belgian companies, they reflect general and universal principles that could be attributed to failure processes elsewhere, in all European economies, including Croatia.

The predictions of corporate bankruptcy mainly focus on financial factors (i.e. indicators, ratios), often excluding nonfinancial variables. In order to achieve a wider perspective Ooghe and Waeyaert (2004) suggested a 'conceptual failure model', in which they differentiate five intertwined groups of external and internal causes of bankruptcy. These groups are:

- **general environment** (economic, technological, political and social factors or factors related to foreign countries; for example - functioning of financial markets and institutions, the behaviour of the government),

[2] According to Ooghe and De Prijcker, there are only few differences concerning the financial indicators between the distinctive failure processes.

- **immediate environment** (interactions with stakeholders: customers, suppliers, competitors, banks, credit institutions and stockholders),

- **characteristics of management** or the entrepreneur (management's motivation, qualities, skills, and personal characteristics are considered to be the most critical factor in a company's failure),

- **corporate policy** (set up by management; involves strategy and investments, marketing and sales, operations, administrative, financial and human resources, management and corporate governance), and

- company's characteristics (size, maturity, and industry).

Combining the abovementioned types of failure processes with groups of bankruptcy causes (excluding the group of company's characteristics, as it has previously been broadly examined, and its characteristics can easily be quantified), one can gain insight into specific sources of bankruptcy for each type of failure process, systematically categorizing them into the above groups of bankruptcy causes.
It is important to stress that the causes are interdependent, and should not be examined separately.

2.1. Bankruptcy causes of newly established companies

This type of failure process is the most common. Many companies fail within five years after their start-up; with no significant growth and no profits many have almost no chance of survival.

Using previous cause groups, the underlying causes of bankruptcy in newly established companies could be categorized as follows:

- **general environment**:
- recession in the industry,

- **immediate environment**:
- lack of customers / customer dissatisfaction,
- mistrust on many levels (banks, customers, suppliers, …),

- **characteristics of management or the entrepreneur:**
- insufficient competences and skills in many areas,
- rashness, authoritarian leadership,

- **corporate policy:**
- no strategic advances,
- inappropriate capital expenditures,
- lack of customers / customer dissatisfaction,
- insufficient financial planning,
- severe operational errors.

The most common bankruptcy cause in this particular failure process is inadequate management quality, as newly established managements are deficient in knowledge and experience in many areas of business.

2.2. Bankruptcy causes of ambitious growth companies

This type of bankruptcy process is somewhat similar to the next one (failures of dazzled growth companies). The differences are mainly in the financial structure and in management characteristics.
Ambitious growth companies have a weaker financial structure, because their failure process starts at the level when they are still new and/or small. Therefore, those companies are more vulnerable to bankruptcy when the expansion strategy has a worse outcome than expected.

Most often origins of failure amongst ambitious companies can be found in these groups:

- **general environment**:
- weak stock market,
- price increase of raw materials,

- **immediate environment**:
- shortage of customers,
- mistrust,

- **characteristics of management or the entrepreneur:**
- flawed turnover estimation,
- extensive risk takers,
- over-optimism,

- **corporate policy:**
- exaggerated capital expenditures,
- overestimated sales,
- lack of expertise.

Specific to the second failure process is the large overestimation of the demand for the company’s products despite the experience and capabilities of management, as a consequence of over-optimism or misinformation about the market size.

2.3. Bankruptcy causes of dazzled growth companies

Opposite to the second type (ambitious growth companies), dazzled growth companies have existed successfully for several years before considering extreme expansion and have stronger financial structure.
These companies deploy a new strategy that initially becomes a success, which overwhelms the management as it becomes extremely overoptimistic and unrealistic.
However, in contrast to the type 2 companies, type 3 companies have more possibilities of outliving a catastrophic investment plan, as a consequence of their financial reserves, and they only go bankrupt if the management loses touch with reality. Hence, this failure process is an example of the dangers of healthy companies taking risks when there is no adequate management.

While examining the sources of failure of dazzled growth companies the usual grouping is applied as follows:

- **general environment**:
- weak stock market,
- recession in the industry,

- **immediate environment**:
- mistrust,
- competitors as a consequence of inflexibility,

- **characteristics of management or the entrepreneur:**
- too optimistic; dazzled / overwhelmed / astonished,

- **corporate policy:**
- exaggerated capital expenditures,
- extreme gearing,
- unadjusted management and operational structure.

2.4. Bankruptcy causes of established but deteriorating companies

These types of companies have existed for several years and are distinctive by the lack of motivation and commitment of rigid company's leaders, who keep believing in strategies that were successful in the past. Their indifference and lethargy leaves them unaware of gradual changes in the environment.

One can find causes of failure of gradually deteriorating companies within these groups:

- **general environment**:
- change in legislation,
- economic changes in foreign countries,

- **immediate environment**:
- competitors with strategic advantages,

- **characteristics of management or the entrepreneur:**
- insufficient motivation & commitment,
- inertia,

- **corporate policy:**
- no adjustments to changing environment,
- unadjusted capital expenditures,
- operational inefficiencies.

2.5. Origin of the most frequent bankruptcy causes

It is obvious that the most frequent causes in all four types of failure processes could be found in the field of management, and subsequently, corporate policy (which is designed and implemented by management).

Immediate environment is also affected by the actions of management, and company's stakeholders (customers, suppliers, banks,…) are not blind nor eager to support bad decisions. Retaining customers and gaining new ones is difficult for everyone, including the best companies, therefore making it crucial for the survival of the business.

On the other hand, the most often used excuse by the management is found in the general environment of the company[3]. Ooghe and De Prijcker (2006) stated that the general environment influenced all four types of insolvent companies equally, and no company in their case study research failed as a result of an industry-effect. Therefore, in the general model external sources of bankruptcy are minor in effect.

3. BANKRUPTCY CAUSES IN THE UNITED KINGDOM

A study published by the UK Insolvency Service (hereinafter: UKIS) reports causes of failure in bankruptcy[4] and compulsory liquidation cases in England and Wales, with the aim of ascertaining the reasons that lead to an insolvent entering bankruptcy or compulsory liquidation proceedings.

3.1. Study characteristics

Details of the causes of failure compulsory liquidation cases have been extracted from reports to creditors for the periods 01.04.2003 / 31.03.2004 and 01.04.2004 / 31.03.2005, while this paper presents and analyzes only the latter, more recent period.

The Official Receiver (i.e. bankruptcy administrator in the UK) issues a report to creditors in **every** compulsory liquidation case. A sample of 1,000 reports to creditors from the total of 4477 (22,3%) was randomly selected, and in this sample in **861** cases (86,1%, or 19,2% from the total population) there was available information about the causes of failure.

3.1. Study results

When grouped according to Ooghe and Waeyaert (2004), analysis of the 861 business failures in England and Wales performed by the UKIS shows the primary insolvency causes in the period of 01.04.2004 / 31.03.2005 as follows:

- **general environment**:
  - no data,

- **immediate environment**:
  - no data,

- **characteristics of management or the entrepreneur:**
  - **47%** of cases went bankrupt because of 'other management failures',

- **corporate policy:**
  - **47%** of cases went bankrupt because of 'losing market',

[3] This pattern of deferring responsibility (blaming others) is often found in bankruptcy procedures.
[4] In the United Kingdom the term 'bankruptcy' refers to private person bankruptcies, while 'compulsory liquidation' refers to business failures.

- **28%** of cases went bankrupt because of failure to deal with tax affairs,
- **18%** of cases went bankrupt because of bad debts.

'Other management failures' comprise excessive overheads (including remuneration), under-capitalization, lack of/poor planning, over-optimism, and lack of management information (which contains poor accounting).
'Losing market' includes loss of customers, legal disputes, competition, increased costs, and supplier problems.

The UKIS report clearly shows that primary causes of bankruptcies in the England and Wales (and presumably, in the United Kingdom in general) are not found in external surrounding, that is neither in the general, nor in the immediate environment of a bankrupt company, which is particularly interesting when compared to Croatian cases (5th section).
Hence, these results coincide with the general bankruptcy cause model of Ooghe and De Prijcker (2006) and indicate corporate bankruptcy to be a consequence primarily of management failures.

4. BANKRUPTCY CAUSES IN GERMANY

Analysis of bankruptcy causes in Germany is based on two recent studies: a) Euler Hermes Kreditversicherung and the Center for Insolvency and Reorganization at the University of Mannheim (hereinafter: EH&ZIS), and b) Wieselhuber & Partner (hereinafter: W&P).
Keeping in mind the typology of bankruptcy processes, and insolvency cause groups presented in the second section, it is interesting to observe if the German country-specific causes correspond to the British ones (especially because of the legislative differences[5]), and if they fit into the Ooghe and De Prijcker's (2006) model.

EH&ZIS and W&P studies are discussed in the following paragraphs.

4.1. EH&ZIS study

4.1.1. Study characteristics

In order to compare the EH&ZIS with the study of bankruptcy causes in Croatia (as presented in section 5), certain aspects of the EH&ZIS study will be stressed out:

- 125 bankruptcy practitioners, chosen by the criteria of professionalism in business insolvencies, were interviewed by phone,
- examinees were willing to participate in the questioning[6],
- research was carried out by the KOHORTEN-Institut[7] (Wiesbaden) in the summer of 2006.

In conformity with the Ooghe and De Prijcker's (2006) study, examinees found that the typical case of a German insolvency is a consequence of mistakes made by its management, which also coincides with the UKIS report.

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[5] Legislative framework of bankruptcy procedure is of utmost importance, since the law defines every aspect of the process.
[6] "*Die Bereitschaft der angesprochenen Experten war groß, an der Befragung teilzunehmen.*" EH&ZIS, p. 8.
[7] Web-site: http://www.bvm-net.de/kohorten-wiesbaden-forschungsinstitut.html

To be more precise, bad management of capital employed (relating to controlling, financing, and debtor management) was considered to be one of the primary origins of bankruptcy in Germany.

4.1.2. Study results

What are the most frequent insolvency causes in Germany? After grouping answers according to Ooghe and Waeyaert (2004), insolvency practitioners responded to EH&ZIS as follows:

- **general environment**:
- **81%** considered bureaucratic application of work and social rights,
- **60%** considered negative influence of Basel II on financing possibilities,
- **57%** considered unexpected problems in projects abroad,

- **immediate environment**:
- **82%** considered bad payment behaviour[8] of customers,
- **73%** considered impediments to personnel restructurings by the labour courts[9],

- **characteristics of management or the entrepreneur:**
- **64%** considered inadequate debtor management[10],
- **57%** considered authoritarian, rigid leadership[11],
- **42%** considered investment mistakes[12],
- **41%** considered erroneous product planning,

- **corporate policy:**
- **79%** considered bad or no controlling,
- **76%** considered financial underperformance[13], and
- **44%** considered lack of transparency and communication.

After performing factor analysis of the 58 possible insolvency causes implied in the research, EH&ZIS stated these as the primary causes of bankruptcy in Germany:

1. **bad or no controlling** (79%),
2. **financial underperformance** (76%),
3. **inadequate debtor management** (64%), and
4. **authoritarian, rigid leadership** (57%).

In contrast to Ooghe and De Prijcker (2006), EH&ZIS found that age does not make a German company more or less inclined to bankruptcy. In other words, younger companies in Germany are not particularly predisposed to insolvency, as a failure can easily happen to companies of all ages:

[8] ger. *Zahlungsmoral*
[9] “Instead of laying off some employees, all business went down.” EH&ZIS, p. 23.
[10] Financing too short-term oriented, unreasonable regulation of the financing periods
[11] Also: dominance of private over company interests
[12] Wrong evaluation of capital needed to complete the investment, flawed investment timescale
[13] Shortage of own capital, low credit rating, high interest rates, no reserves for unexpected events.

- **age of a typical German bankrupt company:**
- **35% - 1** to **14** years,
- **33% - 15** to **394** years,
- **29% - 40** years and older,
- **3% -** no answer.

To summarize, according to EH&ZIS a typical case of a bankrupt German company would be caused by a mix of bad financial management, no/poor controlling, and an authoritarian leadership style, not necessarily recently established.

4.2. W&P study

Even though it is not done relatively recently, Wieselhuber & Partner research was chosen to confirm and approve EH&ZIS study results.

4.2.1. Study characteristics

These are the W&P study characteristics:

- research was done by Dr. Wieselhuber & Partner GmbH, in co-operation with 9 selected expert insolvency practitioners,
- a sample of 52 cases of insolvency was analyzed, and
- the study was carried out in spring of 2003.

Insolvency cases were chosen according to these criteria:

- companies were managed by their owners[14],
- upper-middle class companies, with a minimum of 15 million € turnover,
- insolvency case is closed, or its closure is foreseeable.

Bankruptcy causes were the first focus point of the research. Among other goals of the research were gaining insights into economic situation of a company before insolvency, its management and corporate structure, and (as a result) clarifying what makes an insolvency procedure successful (along with the requirements for one).

4.2.2. Study results

The most common cause of bankruptcy, according to the W&P study, are operating losses that could not be financed anymore – they lead in **94%** of the cases to over-indebtedness, and in **73%** to insolvency.
These losses resulted in refusal of banks to provide additional resources, so that existing financial requirements could no longer be covered (**44%**), or the credit lines were cut (**53%**).
These bankruptcy causes ranked highest:

- **57%** of cases went bankrupt because of mistakes made by the firm proprietors,
- **57%** of cases failed because of errors made by the firm management, and
- **38%** of cases failed as a consequence of insufficient competitive ability of the business model.

[14] ger. *Inhaberunternehmen*

However, the share of companies that declared bankruptcy that was not a consequence of mistakes made by the firm proprietors (**29%** of cases) was significantly higher than the number of companies that failed without substantial errors made by the firm management (**4%**). Hence, even though they ranked the same (57%), management faults had more impact, were further-reaching, and led to more bankruptcies than mistakes made by the firm proprietors.

The majority of the insolvent enterprises showed enduring strategic weaknesses, which reflected in business structure and market position:

- 81% of the average turnover was made in only one business field,
- 60% of the enterprises were active in only one business field,
- 45% of the examined cases were market leaders in their core business, and
- nearly all enterprises were followers in one business field.

This means that insolvent companies did not go bankrupt because of faulty decisions in their secondary businesses, but rather because of the intrinsic problems in their core business, which are mainly:

- small number of competition advantages in the core business,
- followers instead of market leaders,
- losses from price-quantity pressures, and
- stagnating markets and recession.

In conclusion, the authors of W&P state that the lack of Unique Selling Propositions[15], low productivity and efficiency generally lead into bankruptcy and render reorganization impossible.

4.3. Summary – bankruptcy causes in Germany

The two presented studies have coherent results and denote poor management as a primary origin of business failures in Germany.
If incorporated into the Ooghe and Waeyaert’s (2004) conceptual failure model, both W&P and EH&ZIS show that causes of German insolvencies lay first and foremost in characteristics of the management and in corporate policy (which is also a management creation).
These results also in accordance with the UKIS findings and indicate that causes of bankruptcy in Germany and United Kingdom are generally the same, as they both refer to the internal sources within the management.

5. BANKRUPTCY CAUSES IN CROATIA

Very few systematic researches have been done in the field of bankruptcy in Croatia. This area of expertise is in Croatia mainly under scrutiny of law experts, and economists have rarely contributed. In order to achieve a better perspective on the current situation, problems, and their possible solutions, a survey of key bankruptcy issues was performed.

[15] Unique Selling Propositions (USP) is a marketing concept that was first proposed as a theory to explain a pattern among successful advertising campaigns of the early 1940s. It states that such campaigns made unique propositions to the customer and that this convinced them to switch brand.

5.1. Study characteristics

A questionnaire was sent out to 412 addressees:

- to a sample of 270 bankruptcy administrators selected from the total population of 480. The sample was chosen by the criteria of length of their service, therefore attempting to obtain answers from the most experienced administrators,
- to full population of 132 judges at 13 commercial courts and at the High Commercial Court of the Republic of Croatia, and
- to legal departments of the 10 largest banks in Croatia. Banks are the most frequent creditors and frequently participate in bankruptcy proceedings.

The questionnaire was sent out by post in November 2006., and addressees were given four options to reply: by mail, e-mail, fax, or online (a web-site was designed and published for this purpose).

The questions were conceived mainly as short essay topics. Presuming that the query would be suggestive and biased, and that addressees would respond passively if questions with multiple choices (a/b/c/…) were offered, they were given free possibilities of an answer. Structured like this, the questionnaire was relatively more demanding, but on the other hand a neutral perspective could be obtained.

Answers to these two enquiries were analyzed and are presented in the next section[16]:

- According to your experience, what are the most frequent causes of bankruptcy in Croatia?
- What would your advice be to the management of a newly established, viable, and "healthy" corporation; what should they do or avoid in order not to end up in bankruptcy?

The second question is not directly seeking origins of bankruptcies in Croatia, but is also analyzed in this paper; when formed as a negation, answers to it lead into possible causes of bankruptcy in Croatia as well.

If compared with the EH&ZIS study (as in 4.1.1.), it can be noticed that our research was aimed at a wider audience, but using a different method (phone calls vs. post-box questionnaires[17]), and a involving less personnel[18].
Also, it was clear that addressees were not willing to participate in our research (with certain exceptions). Of course, being silent is an answer sui generis as well, and certain conclusions could be inferred despite obvious lack of interest and indifference of the participants. This will further be examined in the next section.

5.2. Study results

After facing the difficult issue of uncooperative participants, the study was closed in May 2007. By that time 41 answers were received, as presented in Table 1.

[16] The complete research, with all the questions and the analysis, will be presented in the Domagoj Sajter's doctoral dissertation (expected by the end of 2008).
[17] Even though, in the end, many participants in our research were called on the phone.
[18] Two people carried out the entire project.

The number of received responses was somewhat discouraging but indicative of the current situation; 24 administrators and 17 judges replied, and no reply was received from banks. The explanation of the relatively low response rate lies in the characteristics of the bankruptcy procedure system in Croatia[19]. On the other hand, the answers received were voluminous and filled with relevant and significant information. Thus, good insights could be obtained.

It is important to emphasize that all respondents are highly experienced, and their answers should therefore be taken seriously and with due consideration.

Table 1. Bankruptcy research in Croatia - characteristics of the respondents

Category	Description	No.	%
GENDER	Male	25	60.97
	Female	11	26.82
	No answer	5	12.19
	TOTAL	**41**	**100**
OCCUPATION	Bankruptcy administrator	24	58.53
	Bankruptcy judge	17	41.46
	TOTAL	**41**	**100**
EXPERIENCE	Average work experience (years)	**14.0**	–
	Average age (years)	**53.4**	–

Source: Research of bankruptcies in Croatia

When grouped according to Ooghe and Waeyaert's (2004) failure model, the most frequent causes of bankruptcy in Croatia are the following[20]:

- **general environment**:
- undeveloped market and market mechanisms,
- losing markets after proclaiming independence and during transition,
- technological lagging behind,
- inconsistent government strategy of the development of nation's economy,

[19] Bankruptcy judges (at the Commercial court) are the highest authority in bankruptcy procedures. They have the most extensive rights, and consequently, the highest responsibilities in the procedures. In order to be independent, sovereign, and impartial, with the aim of being a just professional, they are protected by the law in the same way as all the other judges in the Croatian judiciary system. The downside of this is that the control and supervision mechanisms of judges are very limited, in practice non-existing. They do not feel obliged to communicate with the general public. Judges present themselves as untouchable, superior professionals, and the words of a judge of the High Commercial Court of the Republic of Croatia can be a good example of their attitude: "**However, citizens cannot argue with judges, nor can they criticize their verdicts. They are simply under-qualified, in the same way the patient is not qualified to judge if a doctor has treated him properly**." (*From the speech of the judge J. K. of the High Commercial Court of the Republic of Croatia, which he gave in Zagreb at the 50th Anniversary of commercial judiciary in Croatia, on 22 October 2004. Published on the web site of the High Commercial Court of the Republic of Croatia; http://www.vtsrh.hr Accessed 27.10.2007.*). This statement outlines a bankruptcy procedure as a non-transparent process, where questions not only do not get answered, but get banned in the first place.
Bankruptcy administrators, on the other hand, are appointed by the bankruptcy judges and often feel indebted by the appointment, as some administrators do not get appointed for many years and others have dozens of cases. Therefore, they feel that it is not in their best interest to point out the problems in the procedure, as it may harm their relationship with the judges, on whom depend the prospects of their future appointments, and the outcome of the present procedures.

[20] Since answers were in a form of an essay (not multiple-choice type), no percentages of frequency could be calculated. These causes, in general, are considered by the participants to be the most common causes of bankruptcy in Croatia.

- ownership transformation and privatization done improperly,
- war aftermath,

- **immediate environment**:
- non-payment as a pattern of "normal behaviour", including government institutions,

- **characteristics of management or the entrepreneur:**
- low quality management,
- management with the aim of gaining benefits for individuals only, not for the company itself,
- trying to trick and deceive regulations and creditors,
- no personal liability for company's debts drives irresponsible owners into over-indebtedness,

- **corporate policy:**
- avoiding due obligations, weak financial discipline,
- bad planning, harmful contracts,
- unresolved human relations issues within the company, and
- low salaries; too many employees.

Therefore, research participants see most of the bankruptcy causes of Croatian companies in two distinctive areas:

a) external causes: outside the company itself (in its general and/or immediate surrounding, and
b) internal causes: as a consequence of management actions.

The external area marks many transition countries in central-eastern Europe. The government institutions are not fulfilling their due financial obligations in time, and the downward spiral of illiquidity hits hardest companies at the end of the payment chain[21] – those that don't hold any options of delaying payment.
However, there are some country-specific external bankruptcy sources in Croatia, one of them being the Ministry of finance's Tax administration office. By not obeying the Law of payment operations'[22] provision in article 41, which binds the Tax administration office with filing for bankruptcy for all companies that have not paid their due legal obligations to the state (taxes, etc.) in a period of 60 days, it enables many companies to operate for years without paying taxes. This has a devastating effect in a way that many follow these bad examples and hold them as an excuse, which leads to extensive delays of payments. Many companies, of course cannot endure this pressure for long, and go bankrupt.

The other type of bankruptcy causes within external surrounding is the one associated with the transition itself, and the post-war problems. Conversions of public to private property, and from centrally governed to a market oriented economy were complex processes that weren't performed properly. However, it is not clear how many companies went bankrupt because of

[21] A financial director of a large commercial company in eastern Croatia in an informal interview stated the corporate policy of his company as follows: "Our strategy is delaying of payment. We are liquid, and we have financial resources, but we simply do not want to pay in time". Existing partners of this company are aware of this policy, but new suppliers often do not know his fact. In order to keep business relations with this large company (the size of which affords it to disrespect its agreements) they tolerate this kind of payment behaviour.
[22] People's papers 117/2001.

these reasons exclusively, and for how many of them these were just an excuse for bad management. The problem of investigating these cases is the documentation of bankruptcy procedures which is, at this time, unavailable[23].
War left its scars on the economy, and many companies were destroyed during war operations, there is no question about that. Companies that filed for bankruptcy few years after the war had just reasons for doing so, but today, 15 years after, quoting war as a cause of bankruptcy is an obvious case of seeking a scapegoat.

The internal area conforms to the general bankruptcy cause model and the experiences abroad (Germany and the UK). A company is run by its management which makes day-to-day decisions, as well as long-term strategies, and has the freedom and right to do absolutely everything it can (obeying laws and signed contracts) to make it a successful enterprise. With that freedom comes responsibility, and initiators of failure should first and foremost be sought in the management department. These rules apply to Croatian companies as well, even though they are operating in a challenging environment. Therefore, all internal causes already mentioned in British and German cases are valid for Croatia as well.

However, some specific internal causes do exist in Croatia. The unstable period of transition includes changes of old values and laws and initiation of the new ones. As a result, often there is a gap left, an interregnum, during which some people seek a way of gaining benefits for a very narrow group[24] by managing an ad-hoc company. These companies were never envisaged as 'going concerns', but as a way of extracting resources (from the company itself, or the community) for the account of their owners.
Even though many of them already went bankrupt, this management attitude often still prevails in small firms (managed by their owners, with few employees). Limited liability of these companies is here exploited on behalf of their managers/owners, with the single and only goal, mission, and vision being 'more money for the owner'. Bankruptcy comes as a natural outcome of this short-term, distorted mentality.
Using terminology of the Enterprise Policy Group within the European Commission, one could say that the dishonest/fraudulent bankruptcies significantly outnumber honest/non-fraudulent ones in Croatia.

If presented in an opposite way – in form of a negation, advice on how to maintain a 'healthy' and viable company (respondents' answers to the second question) can further expand significant causes of insolvency in Croatia:

- **general environment**:
- disrespecting market rules,

- **immediate environment**:
- contracting with unknown partners whose business is not investigated,
- treating partners with no respect and without care, which leads to reciprocity,
- selling without collecting,

- **characteristics of management or the entrepreneur:**
- irresponsible management,

[23] The administration of the State Archives in Osijek does not allow access to documents of closed bankruptcy cases, even though no law prohibits this.
[24] Usually for themselves only. In some cases bankruptcy procedure itself is intentionally provoked and abused in order to devaluate company's assets even more, for the account of distinct group of "entrepreneurs".

- incompetent, uneducated staff,

- **corporate policy:**
- rapid and unstable growth,
- sloppy accounting/bookkeeping, and
- bad cost and indebtedness control.

Croatian country-specific causes are again connected with the legacy of transition and lack of tradition of doing business in a market-driven economy.
Certain Croatian companies are still struggling with some non-written rules of conducting business that are considered normal and usual in developed countries. Hence, external causes mainly refer to the separation of the moment of buying/selling, and the moment of actually paying for the goods and/or services received. Before doing business one should always inspect the previous payment behaviour of the possible partner. Also, avoiding company's due obligations leads inevitably to an increase of unfulfilled claims from the company's debtors.

Internal causes of insolvencies are still inseparable associated with the management shortcomings, as it fails to implement and sustain functioning controlling mechanisms, and/or acts having in mind only short-term, narrow interests.

6. CONCLUSION

Three country-specific studies were compared with the general, conceptual failure model of Ooghe and Waeyaert (2004), and in general were found compliant.

In an effort to outline and compare the most frequent causes of corporate bankruptcies in Croatia and Europe, where Europe was represented by two distinctive and specific legislative frameworks – those of the United Kingdom and Germany, a research of bankruptcy practitioners in Croatia was carried out.

Although not eager to participate in the research, relevant information was collected from Croatian bankruptcy judges and administrators about the origins of business failures in Croatia. Most of them saw two main areas as crucial to this matter: the first being out of reach of company's management – in its surrounding, and the second within the company.

The existence of the first area is in contrast with the experiences in Germany and United Kingdom, as in these countries generally there are no substantial causes outside the company itself that could lead it into bankruptcy.
UK Insolvency Service (2007) found no such causes, while studies in Germany (Euler Hermes Kreditversicherung & Center for insolvency and reorganisation at the University of Mannheim, 2006; Wieselhuber & Partner GmbH, 2003), also state that the insolvency of a company is primarily a consequence of poor management.
Thus, causes of bankruptcy in Europe are for the most part associated with the management function, or its internal surrounding.

External causes of bankruptcy, although exaggerated in an attempt to transfer responsibility (much like elsewhere), do exist in Croatia.
The Croatian business environment is still challenging and demands extra efforts to remain solvent, especially for smaller companies that have no means of deferring due payments.

Transition aspects include short-term mentality of the management and narrow interests of the owners, which reflect to the whole business community. Therefore, management must be familiar with its immediate surrounding (customers, suppliers), because it is affected by their actions and business conduct significantly.
The government institutions do not respect the laws and good practice much too often, setting bad example and forcing entrepreneurs to follow their footsteps.

However, these facts are known to the business community and should be taken in consideration when setting up or leading a company. Consequently, in Croatia the highest responsibility for success, as for a bankruptcy, lies in the field of management, much like in the rest of Europe.

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Ad-hoc dictionary:

Insolvenzverwaltern = insolvency practitioner, bankruptcy administrator
Distraint = Zwangsvollstreckung
Überschuldung = overindebtedness
Pruegelknabe = scapegoat