



# **RETROSPECTIVE ANALYSIS OF FAILURE CAUSES IN SOUTH AFRICAN SMALL BUSINESSES**

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## DECLARATION

I declare that the thesis,

“RETROSPECTIVE ANALYSIS OF FAILURE CAUSES IN  
SOUTH AFRICAN SMALL BUSINESSES”,

is my own work, that all the sources used or quoted have been indicated and acknowledged by means of complete references, and that this thesis was not previously submitted by me for a degree at another university.

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## ABSTRACT

One of the major development problems in the southern African region and South Africa in particular relates to the phenomenon of high failure rates among Small Medium and Micro Enterprises (SMMEs). The important role of SMMEs in creating jobs and incomes is widely acknowledged. SMMEs are relatively inexpensive to establish and have the potential to generate economic growth in the southern African region. One major dilemma of this sector, however, is the short lifespans of SMMEs.

Past research has focused on understanding failure of small businesses by mainly identifying factors of failure without subjecting them to step-wise causality testing. This research closes that gap and uses a retrospective study, coupled with the critical realist approach, to understand the causes of the high failure rates of SMMEs. The merit of this approach lies in the attention it gives to an historical understanding of past processes and how a determined effort could be initiated to change the current “historical reality” of the factors behind the failures, specifically in South Africa.

A sample comprising 254 owner-managers of SMMEs from the Gauteng, Limpopo and Mpumalanga provinces in the Republic of South Africa as well as from Gaborone in Botswana was subjected to an interview between January 2007 and December 2007. Data were collected by means of a semi-structured research instrument which probed the failure of the interviewees’ businesses across a period spanning seven years between 2000 to 2006. The analysis of the data involved the use of both quantitative and qualitative research methodologies. The findings indicate that four explanatory factors were paramount: “monitoring and control” (factor 1); “experience and planning in finance and marketing” (factor 2); “income constraints” (factor 3), and “cash control” (factor 4). Based on the findings,

the following recommendations, if implemented, may assist with lowering the high failure rates:

First, the mindsets of the owners of the failed businesses were found to be a fundamental factor in the closure of the businesses. Radical programmes for changing these mindsets are therefore critical.

Second, with the mindsets changed, venture skills training programmes could then be introduced involving learning and training. By so doing, it is hoped that the void left by low levels of education and business experiences in the SMME sector would be reduced.

Finally, at the policy-making level, the required assistance should be tilted more towards government-corporate involvement, in assisting the SMME sector in the form of financial subsidies for start-up capital, small business-builder programmes, and business mentoring programmes, among others.

**KEYWORDS:** causes of small business failure in South Africa, failure of small businesses in South Africa, failure of SMMEs.

I dedicate this thesis to my wife, Angelina,  
and my four children  
for the forbearance shown when denied quality time  
often enjoyed by many families

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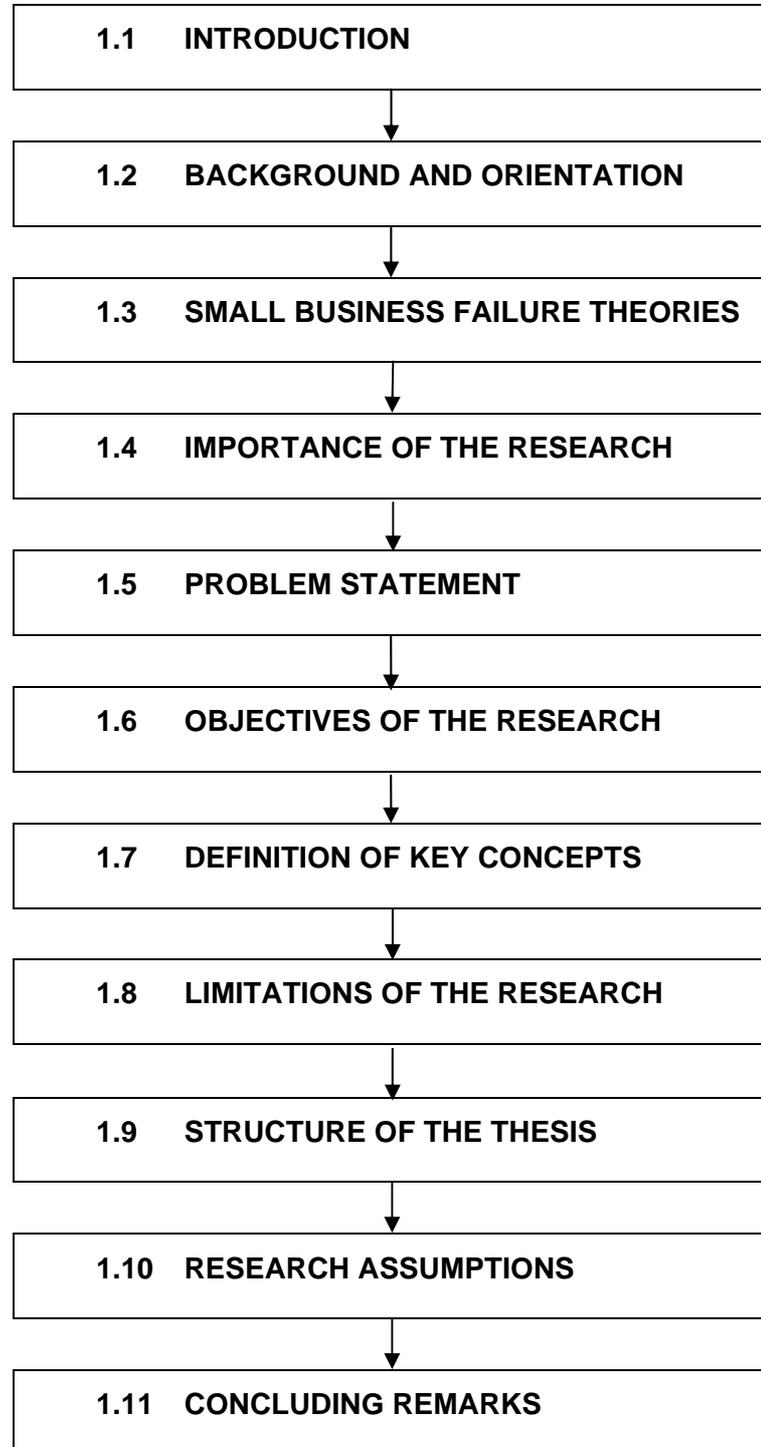
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## ABBREVIATIONS, ACRONYMS AND GLOSSARY

ANOVA	Analysis of variance
<b>dti</b>	Department of Trade and Industry
Khula	Khula Enterprise Finance
Ntsika	Ntsika Enterprise Promotion Agency
RSA	Republic of South Africa
SADC	Southern African Development Community
Seda	Small Enterprise Development Agency (superseded Ntsika in December 2004)
SMME(s)	Small, medium and micro enterprise(s) (used interchangeably with “small business/venture” in this research) This definition is in accordance with <b>dti</b> (2004:33) and <b>dti</b> (2008:4)
Start-up	A small business/venture that has been in existence for less than two years

**CHAPTER 1**  
**BACKGROUND AND PROBLEM ORIENTATION**



**Figure 1.1: Layout of Chapter 1**

## CHAPTER 1

### BACKGROUND AND PROBLEM ORIENTATION

#### 1.1 INTRODUCTION

Failure may seem obvious and its understanding simple; in fact, failure is an elusive concept and the simplicity commonly attached to its understanding is dangerously deceptive (Kam 2005:399).

This research has the primary objective of probing the underlying causes of the failures of certain SMMEs in three provinces of the Republic of South Africa, that is, Gauteng, Limpopo and Mpumalanga, as well as Gaborone – the national capital and the major economic hub of Botswana (Afribiz 2010). The inclusion of Gaborone is to illustrate the scope of the problem and to enrich the generalisability of the research as Gaborone is regarded as a district (province) in Botswana which is an integral part of the southern African region.

Past research has focused on the use of causal description or descriptive explanations to account for failure in small businesses. The present research uses a novel, critical realist, approach – causality or causal explanations – to account for failure in small businesses, thereby validating failure factors as root causes of failure in small businesses.

This chapter provides the direction to the research by emphasising how important the small business sector is as a contributor to the economic development and stability of South Africa and southern Africa as a whole. The prime aim of this chapter is to exposit the problem statement, the objectives and research questions in respect of the challenges faced by South African small businesses, which revolve around why small businesses are successful in some parts of the world but are struggling to survive in South Africa and are experiencing high failure rates (Tables 1.1, 1.2 and 1.3).

The failure rate of the developed world's SMMEs ranges between 40 % and 90 % occurring any time within the first seven years after their birth (Table 1.1). The failure rate for SMMEs in South Africa hovers between 30 % and 90 % (Table 1.3). For Botswana the failure rates are greater than 80 % (Table 1.3). In stark contrast, the rate of failure of small businesses in Australia each year is between 4 % and 8 % (Craig, Schaper & Dibrell 2007:9) (Table 1.1). There would be a substantial beneficial impact on the economy, job creation and poverty alleviation of South Africa if the failure rate of small businesses could be reduced from the higher levels prevalent in the rest of Africa and some of the developed world (on average 70 % to 80 %) towards the prevailing 4 % to 8 % in Australia. Monk (2000:12) supports this thinking by stating:

if [a] larger percentage of the SMMEs were able to survive and grow into larger competitive players in the global economy, this would have a very positive impact on world economy.

The information in Table 1.1 and Table 1.3 should beg the question: "If the small business sector is so economically, socially and politically important, why are governments around the world, including South Africa, paying so much attention to the creation of new small businesses, but so little to the survival and failure of these small businesses?". South African small businesses featured last in a South African Global Entrepreneurship Monitor survey conducted in 2005 (von Broembsen, Wood & Herrington 2005:20) of 35 developing countries. The present research notes that the failure rates are unacceptably high when compared with, say, Australia.

Coelho & McClure (2005:18) note that the recognition of failed small businesses and a nuanced view of the reasons for their termination should be a prerequisite for taking the necessary action for success. Knott & Posen (2005:19) and Alstete (2008:584) support the foregoing assertion. South Africans have the right to know what it is about the small businesses in their country that make them perform so poorly. This research investigates the causes of failure of small businesses to satisfy such a need.

**Table 1.1: Small business failure rates in the developed world**

Country	Year	Percentage failure (%)	Source
Australia	2007	4 to 8 % annually	Craig <i>et al</i> (2007:9)
Netherlands	2000	70 to 80 % within five years	Cozijnsen, Vrakking & Ifzerlo (2000:150)
Portugal	1995	70 % within seven years	Mata, Portugal & Guimaraes (1995:466)
Sweden	2004	70 % within seven years	Persson (2004:437)
Texas	1996	77 % within five years; 82 % at ten years	English <i>et al</i> (1996:17)
United Kingdom	2003	65 % within five years	Disney, Haskel & Heden (2003:92)
United States of America	1998	70 % within 18 months	Sullivan, Warren & Westbrook (1998:4)
	1999	63 % within six years	Timmons (1999:32)
	1999	60 % within five years	Nucci (1999:25)
	2000	40 % within the first year; 90 % within ten years	Shepherd, Douglas & Shanley (2000:5)
	2001	75 % within five years	Flynn & Forman (2001:42)
	2003	70 % within five years	Headd (2003:52)
	2005	80 to 90 % within four years	Knott & Posen (2005:617)
	2006	40 within the first year; 90 % within ten years	Dimov & De Clercq (2006:207)
	2007	70 to 80 % within the first year	Bornstein & Scarborough (2007:38)
<b>Source:</b> Summary from literature review.			

The causes of the business failures addressed in this research are based on one fundamental theory in conventional business management: that there are some basic business management principles that need to be applied by the owners of businesses before they can be assured of success (Hussey 1991:46; Hill & Jones 1998:13; Beaver & Jennings 2005:9). Failure to adhere to these principles leads to the failures of businesses (Timmons 1999:536; Timmons & Spinelli 2007:637, 2009:106; Lussier 1996:79; Beaver & Jennings 2005:9). A key concern of this research is to identify those missing principles or root causes which led to the closure of the businesses. With the relevant factors identified, the necessary recommendations can then follow. Such recommendations should serve as important frameworks for policy decision making regarding the SMMEs of South Africa. The recommendations are elaborated on in Chapter 6.

It is said that if one does not understand the causes of a phenomenon, one cannot suggest remedies. This research seeks to probe the root causes of the failures of SMMEs in South Africa as a means of recommending appropriate measures that need to be taken to address and rectify the problem. The causes of failure being discussed are presented in the literature as theories of business failures. To obtain some background information on these theories an extensive literature review was conducted covering theories of failures in small businesses which are mainly from the developed world (Chapter 2). The theories were found to highlight issues largely concerning business management principles, made up of sets of variables or key success factors needed to sustain businesses. Some of the variables are highlighted in Chapter 3 (and modelled in Figure 3.3).

This research contributes to the existing body of theories and knowledge of failure of small businesses by introducing:

- Five causality criteria for explaining failures of small businesses;
- A critical realist approach as being the best approach for understanding the root causes of small business failure; and
- A model for the process of failure.

It was observed during the research that the meanings which the research subjects attached to basic business management principles, as well as the

challenges and problems that faced them in managing their businesses, had much to do with the ultimate collapse of their ventures. The assumption made in this research is that the owners of the businesses failed to apply conventional business management principles/rules or key success factors (Beaver & Jennings 2005:9; Neuman 2006:52; Nieman 2006b:19; Hofstee 2009:88), with the result that signs of business failures emerged. With time, owners of the businesses began to develop the idea that their businesses could not be rescued. The problems were thus allowed to compound themselves until they ultimately overwhelmed the ability of the owners of the businesses to cope, and the businesses ultimately had to close down. This relationship between mindsets, belief systems or attitudes on one hand and business management principles and problems on the other, constitutes an important theme in this research (Hall 1994:737; Jennings & Beaver 1995:185; Frese & De Kruif 2002:30; Morrison, Breen & Ali 2003:417).

The perceptions that people hold regarding their present situation is increasingly being realised as an issue whose impact cannot be underestimated in research into business failures (Starbuck & Mezias 1996:100; Shepherd *et al* 2000:10; Simon & Houghton 2002:107; Ojala 2002:2; Mellahi & Wilkinson 2004:241; Clover & Darroch 2005:238; van der Merwe & de Swardt 2008:450). This reality is better captured by Beaver & Jennings (2005:15) who opine:

Only those persons immediately affected by organisational failure, or near failure, have sufficient knowledge of the precise circumstances to be able to suggest more accurate cause-effect relationships.

The present study opens an important chapter in the research into the failure of SMMEs in South Africa by relating the activities of the owners of the businesses to the broader socio-economic contexts in which business owners and their immediate business management or environmental problems operate (Shook, Priem & McGee 2003:379). These contexts include broader national issues such as the lamentable statistics about small business failures in South Africa; the high rate of unemployment; the contributions which government-backed institutions and organisations could have made to assist the failed businesses with various forms of financial and non-financial support, as well as the potential positive contributions which the general public and large businesses could have made by networking in

various ways with the failed businesses. Among other things, providing the necessary training programmes to the owners/managers of SMMEs to enable them to become successful entrepreneurs is one of the themes in this study (Section 6.7.2.2). A relational perspective involving the owners of the failed businesses and their micro and macro environments thus constitutes the conceptual framework underlying this research (Shook *et al* 2003:379; Fleetwood & Ackroyd 2004:146). This type of conceptualisation has been important in influencing the objectives and the theoretical and methodological frameworks of this research. This conceptualisation is based on the critical realist idea that people are constrained and enabled by their circumstances in terms of the structures or mechanisms in which they are located.

## **1.2 BACKGROUND AND ORIENTATION**

Across the globe people in country after country are choosing economic terms anchored by highly productive small businesses (Hill, Nancarrow & Wright 2002:361).

To demonstrate the significance of the small business sector around the world, the following sections emphasise the importance of small businesses in the growth of different economies in terms of employment creation in developed and developing countries including South Africa.

### **1.2.1 United States of America**

In the United States of America, the role of small businesses as an engine of economic growth has attracted considerable public attention since the 1980s (Wu & Young 2002:3). Small businesses account for approximately two-thirds of all the United States' newly created jobs (Rutherford, McMullen & Oswald 2001:64).

Most notably, small businesses in the United States of America have been vital to the flourishing success of the computer, biotechnology and other high-technology industries. With an estimated 95 % of all American businesses classified as small, more attention has been given to this business sector in both the popular press

and academic literature. In South Africa SMMEs form 97.5 % of all businesses (Nieman, Hough & Nieuwenhuizen 2003:3).

The entrepreneurial sector not only plays a major role in the economic growth of the United States of America, but also plays a dominant role in emerging and transition economies throughout the world. De Tienne, Shepherd & De Castro (2008:530) assert that, in the United States, whether small firms are created to fill the niche generated by larger firms or created to exploit cutting-edge technology, they provide 60 % to 80 % of new jobs, represent 99.7 % of all employers and account for 41 % of jobs in the high-technology sector.

### **1.2.2 Japan**

In Japan, studies by Honjo (2000:558) indicate a similar situation where SMMEs are looked upon to stimulate economic growth and competition in the industries of the country. During the 1999 (and 2008/2009) global business meltdown, the government of Japan looked to SMMEs to run the national economy (Futagami & Helms, 2009:72).

### **1.2.3 Britain**

Westhead *et al* (2005:109) among others have noted that SMMEs constitute an important driver of national growth in Britain.

### **1.2.4 Denmark**

In Denmark, it is commonplace to think of SMMEs as one of the key drivers of economic growth and increasing prosperity as they outperform the large, older firms (Eriksson & Kuhn 2006:1021).

### **1.2.5 Hungary**

The contribution of SMMEs to Hungarian GDP increased from 7 % in 1988 to 60 % in 1995 (Lyles, Saxton & Watson 2004:351). This is an important indicator of the dynamism of this sector.

### 1.2.6 Sweden

Research in Sweden, conducted by Persson (2004:423) on the survival and growth of new establishments, indicates that the creation of jobs by SMMEs is a major solution to the unemployment problem of the country.

### 1.2.7 Africa

According to Tushabomwe-Kazooba (2006:27) and Kiggundu (2002:254), in developing African countries, small businesses reduce poverty: for example, in Uganda small businesses are known to alleviate poverty. In Nigeria small businesses are generally regarded as engines for economic growth, job creation and poverty reduction (Mambula 2002:58; Okpara & Wynn 2007:24; Okpara & Kabongo 2009:7). Okpara & Wynn note that small businesses have the means to accelerate economic growth and industrialisation, and they are the backbone of the Nigerian economy.

Mfaume & Leonard (2004:1) note:

Small business entrepreneurship has been seen as a hub in generating income for the majority of urban dwellers with no formal paid employment in Tanzania.

These authors note (p.2) that since 1989, the Tanzanian government has implemented various reforms to improve business success and increase economic growth and prosperity.

The creation of small firms in Côte d'Ivoire is important in establishing a solid industrial base as well as economic growth (Goedhuys & Sleuwaegen, 2000:122).

According to Temtime & Pansiri (2004:18) in Botswana small businesses are favoured for creating job opportunities, more so than large firms, making them a primary source of employment creation.

### 1.2.8 South Africa

In South Africa, also, there are a number of contributions to the economy from small businesses. According to van Eeden, Viviers & Venter (2003:13), the SMME sector is the driving force in economic growth and job creation (Levin 1998:5; Sunter 2000:23). Nieman (2006a:12) concurs with the foregoing assertions by stating: “Small, Medium and Micro-Enterprises (SMMEs) are responsible for many innovations and for job creation in South Africa.”

After the political transformation of 1994, the South African government took a number of steps that sought to bring SMMEs to the mainstream of the national economy via the promulgation of the National Small Business Act, Act 102 of 1996 of the Republic of South Africa (RSA) (RSA 1996). The steps included the formation of a number of institutions which were given the mandate to provide financial and non-financial support services to SMMEs. As a result of the various measures, SMMEs in 1998 contributed about 42 % of South Africa’s gross domestic product (Levin 1998:79; South African Yearbook 2000:256). According to the Department of Trade and Industry (**dti**), in SMMEs create two out of every three jobs in South Africa (**dti** 2004:63; Seda 2007:44). SMMEs have therefore become a key driver of growth in South Africa. Advantages of using SMMEs as a key engine of local growth include:

- The contribution of SMMEs to GDP is between 36 % and 42 % (Juul 2002:vii; van Eeden *et al* 2003:1; Nieman 2006a:13);
- The sector is relatively simple to establish and manage;
- The sector has enormous potential to use local human and other resources;
- The sector can be used to generate foreign direct investment;
- The sector can be used to address the problem of poverty;
- The sector would be easy to establish in disadvantaged parts of South Africa;
- The sector employs the bulk of the population of South Africa;
- The sector is intimately linked to the culture and history of the relatively disadvantaged sector of South Africa, for example, in the promotion of handicrafts in the former “homeland” regions.

In view of the above substantial contributions that SMMEs can and are making to the economy of South Africa, it is imperative that the necessary support is given to this sector to maximise its contribution to the development of the country as a whole.

SMMEs are, however, beset by a number of problems such as business failure. Business failure is universally recognised as a complex, multi-dimensional and multi-disciplinary phenomenon, known to be complementary to the phenomenon of success. As evidence in support of the extent and magnitude of the failure problem in South Africa, the then Minister of Trade and Industry, Alec Erwin (Chamber Digest 2001:4) asserts that, despite efforts by the government to establish a support structure for the small business sector via the White Paper for the Development and Promotion of Small Business in South Africa (RSA 1995:24), to date these efforts have met with little success. It is estimated that the failure rate of SMMEs in South Africa is between 70 % and 80 % (Table 1.3). Consequently, millions of rands are being lost to the economy because of avoidable mistakes and problems.

Concurring with the foregoing on the failure of South African small businesses, Nieman *et al* (2003:260) argue:

The odds against the entrepreneur achieving success seem to be enormous. The 33 % success rate or less for small businesses is indeed alarming.

Other researchers who have expressed similar concerns about the failures of SMMEs include Mead & Liedholm (1998:61) and Rogerson (2000:687).

### **1.3 SMALL BUSINESS FAILURE THEORIES**

The many causes of business failures in developed countries, as extracted from various extant journal articles, are classified into three general themes in Chapter 2: 1) “Resources and opportunities” as a perspective for explaining small business failure, 2) Business management expertise classified metaphorically into “liabilities” and “venture life cycle” as a perspective for explaining small business

failure, and 3) “Multiple origins/causes of failure” as a perspective for explaining small business failure.

The theories about resources and opportunities as a small business failure perspective in Chapter 2 reveal two categories: resource-based theory and resource-dependence theory. The resource-based theory asserts that the survival of small businesses depends on the resource and opportunity combinations to create sustainable competitive advantage, culminating in superiority over competition (Barney 1991:99; Peng 2001:803; Runyan, Huddleston & Swinney 2007:392). The resource-dependence theory asserts that without adequate availability of resources and/or opportunities, small businesses face high prospects of failure (Ahmad & Seet 2008:1074). The theory of the multiple sources as a perspective of small business failure asserts that the failure of small businesses emanates mainly from a confluence of causes in the management inadequacies of the entrepreneurs, organisational inefficiencies and environmental uncertainties (Barker III 2005:44). The small business’ management expertise as a perspective of small business failure indicates that small businesses face prospects of failure as a result of causes of failure described in terms of the following metaphors:

- Liability of failure described as liability of newness, adolescence, and obsolescence metaphors; and
- Venture life-cycle metaphor (Bruton & Rubanik 2002:553; Wickham 2001:355, 2006:408).

The forementioned three themes were supplemented with failure theories from the critical realist perspective which is becoming a popular paradigm for research on SMMEs (Fleetwood & Ackroyd 2004:146).

From the reviewed literature, the research objectives were re-formulated to relate to the realities of the research area.

#### **1.4 IMPORTANCE OF THE RESEARCH**

Worldwide, entrepreneurship is seen as one of the most important solutions to unemployment, poverty and low economic growth (Harris, Grub III & Herbert

2005:223). The creation of new ventures and the growth of existing businesses are vital contributing factors to any economy (Botha, Nieman & van Vuuren 2007:163). Robertson *et al* (2003:308), who echo Morris & Brennan (2000:1), capture the importance of research into SMME failures when they state:

Small businesses are the lifeblood of our economy-boosting productivity, creating employment and prosperity and revitalising our communities. Our aim as a government has been to change attitudes to enterprise and tackle the difficulties that we know entrepreneurs can face in starting and growing their businesses.

Extending on the above quote, Levin (1998:1), Sunter (2000:23), van Eeden *et al* (2003:13) and van Scheers & Radipere (2007:85) also state that the SMME sector is the one global driving force in economic growth and job creation.

Despite the above, small business failure rates in the research area of the Gauteng, Limpopo and Mpumalanga provinces of the Republic of South Africa and Gaborone in Botswana remain at high levels (averaging 70 % to 80 %) within seven years from start-up (Table 1.3). These high failure rates are a concern when compared to the much lower failure rate of 4 % to 8 % in Australia (Craig *et al* 2007:9).

The root causes of the high SMME failure rate in the research area are not fully understood (Cardon, Stevens & Potter 2009:4). It is common knowledge that without an understanding of the root causes of small business failures any efforts towards policy intervention will be thwarted. It is said that one cannot change any social situation if one does not possess adequate information on the factors behind the problems at hand. Birley (1996:1) supports this thinking by asserting: “empirical research is always needed to tell us the truth about our world”.

South Africa is faced with a great challenge of reducing its unemployment rate (in 2007) of 25.50 % (“strict” figure, and 38.30 % “expanded” figure) (Roodt 2008:211). SMMEs have enormous potential to solve unemployment problems. van Scheers & Radipere (2007:85), for example, note:

In South Africa the problem is that too many small businesses are collapsing and lead to more unemployment, poverty and crime.

Given the important role played by the SMME sector in driving job creation in South Africa (that is, 80 % of new job opportunities are created by small businesses), the sustained high failure rate among small businesses, therefore, cannot be allowed to continue indefinitely (Temtime & Pansiri 2004:18; van Scheers & Radipere 2007:85). According to Lyles *et al* (2004:351) survival of small and new ventures is a critical issue in transitional economies that rely on the health of the private sector for economic development. The *raison d'être* for this research, therefore, is to understand the underlying causality of the failure of SMMEs in the studied areas for the purpose of forewarning would-be and serial entrepreneurs, thereby reducing the likelihood of failure.

According to Danermark *et al* (2006:58):

It is the task of science to try, as far as possible, to reach beyond the purely empirical assertion of a certain phenomenon, to a description of what it was in the object that made it possible. We cannot be satisfied with just knowing that A is generally followed by B; a scientific explanation should also describe how this happens, what the process looks like where A produces B – if there is any real causal relationship at all between the events observed. Here we must pose transfactual questions; we must look beyond the factual event by postulating and identifying the generative mechanisms which made the event possible. [“Mechanism” being understood as “how” and “why” something happens.]

The present research is largely informed by this statement. Thus, considerable weight in this work is given to the theories on SMME failure mechanisms. In this research, theories and realities, therefore, interact considerably in explaining failure.

On the need for understanding the small business failure phenomenon, Deakins & Freel (1998:151) and Temtime & Pansiri (2004:19) opine that new venture failure rates are very high, thus the causes of entrepreneurial failure need to be understood. Expanding on this idea, Stokes & Blackburn (2002:17) emphasise the need for obtaining detailed knowledge about the factors accounting for SMME failures. They argue that little is known about the failure of small businesses. In particular, there is insufficient research into the causes of business failures which means there is insufficient knowledge about those failures to enable stakeholders to reduce them.

The research was in part prompted by the ideas expressed above. The importance of producing explanatory models of SMME failures cannot, therefore, be over-emphasised.

#### **1.4.1 Advantages of explanatory research**

According to social researchers such as Neuman & Krueger (2003:44), the advantages of explanatory research are:

- It promotes knowledge of the causes of the failures;
- It helps to remove doubts about the causes of the failures;
- It helps to build confidence in the business environment once the causes of the failures are known;
- It helps to develop theories or causal models on the causes of the failures, and
- Ultimately helps to formulate and implement policies and plans for sustaining the businesses (research becomes policy relevant).

This research derives its objectives from the above. Essentially, it seeks to understand the key factors that have contributed to the failure of SMMEs in the research area. The importance of relating the research objectives to the above statements on explanatory research is captured in the work of Laitinen (1992:324) and Fleetwood & Ackroyd (2004:169), who state that small business failures can be understood either by analysing the causes of failure or by observing their symptoms. The intention of the studies on the causes of failure is to yield knowledge about the most important causes that can systematically be applied to avoid failures. Sheppard (1994:795) and Sarasvathy (2001:243) also observe that, because an organisation's existence is a prerequisite for its accomplishments, one would expect that researchers would be intensely interested in those factors which could lessen the likelihood of organisational decline and failure. One would expect that a topic involving so much wealth and dealing with the critical issue of organisational life and death would be of great importance to researchers.

Wickham (2001:132, 2006:205) concurs:

Statistics of business failure are widely reported and they are usually quite frightening. Yet 'failure' is not a simple notion.

Consequently, Wickham (2001, 2006) posits that reasons for failure need to be investigated to be understood in order to ameliorate the situation. To emphasise further the importance of this research, Tables 1.2, 1.3 and 1.4 provide key comparative statistics about SMME failures from France, Netherlands, United Kingdom, Finland and South Africa. The data highlight how widespread the phenomenon of the high number of small business failures is.

**Table 1.2: Failure and survival rates of SMMEs in Europe in the 1990s**

Period	France		Netherlands		United Kingdom		Finland	
	Survival %	Failure %	Survival %	Failure %	Survival %	Failure %	Survival %	Failure %
>1 year	75	25	82	18	88	12	79	21
>3 years	65	35	67	33	62	38	69	31
>5 years	51	49	60	40	48	52	51	49

**Source:** Adapted from Chandra *et al* (2001:18).

**Table 1.3: Small business failure rates in South Africa and Botswana**

Country / Province	Year	Percentage failure (%)	Source
South Africa	2009	50 to 90 %	Pretorius (2009:1) derived from secondary data
South Africa	2008	80 to 90 %	Pretorius (2008:408) derived from secondary data
Eastern Cape	2003	70 to 80 % within five years	van Eeden <i>et al</i> (2003:13) derived empirically
Gauteng	2008	80 % within a few years	Mohanlall (2008:26) derived from secondary data
	2007	90 % within ten years	van Scheers & Radipere (2007:86) derived empirically
	2003	30 to 80 % within the first two years	Nieman <i>et al</i> (2003:260) derived from secondary data
	2001	75 to 80 % within five years	Netswera (2001:32) derived from secondary data
	1994	70 to 80 % within five years	Moolman (1998:35) derived from secondary data
Free State	2004	70 to 80 % within three years	Baard & van den Berg (2004:1) derived empirically
Botswana	2004	80 % generally, with 70 % of start-up firms failing within 18 months	Temtime & Pansiri (2004:18) derived empirically
<b>Source:</b> Own compilation based on literature reviewed.			

**Table 1.4: Percentage of small business failure by age**

Failure description	0 to 2 Years (%)	0 to 3 Years (%)	0 to 5 Years (%)	0 to 10 Years (%)
	→			
Bankruptcy	36.9	57.0	72.1	95.0
To prevent further losses	35.7	54.9	75.6	95.0
Failed to “make a go of it”	37.0	55.9	75.3	94.2
Discontinuance of ownership	32.9	52.4	75.2	94.8
Discontinuance of business	27.2	44.9	65.9	91.9
<b>Source:</b> Adapted from Ojala (2002:11).				

Tables 1.2 and 1.4 set the scene for addressing a number of theoretical issues which should be of concern to researchers. The first concerns the question of why the failure rates appear to be age dependent. For example, there is a theory which states that the highest failure rate occurs during the growth stage and continues as the venture matures (Henderson 1999:281; Wiklund, Baker & Shepherd 2008:1). This theory is, however, contradicted by three distinct views. The first view, held by Cressy (2006:104) and Agarwal & Audretsch (2001:37), asserts that failure in SMMEs is highest at the venture founding phase and not with age. However, the second theory held by Birley (1996:34) states that size and age are not sufficient predictors of failure. A third theory (De Tienne 2010:203) notes that, despite the high number of business failures, entrepreneurial exit might be a necessary part of the entrepreneurial process. There are a number of such age-related theories which are further explored in Chapter 2.

#### **1.4.2 Consequences of small business failures**

Generally, for all causes, there are associated effects or consequences. This reality is equally applicable in the failure of SMMEs. Understanding effects from events assists researchers to understand the mechanism of failure itself. General

effects of failure are emphasised by Dimitras, Zanakis & Zopoundis (1996:487) who state:

Clearly, failure affects a firm's entire existence and it has high cost to the firm, the collaborative (firms and organisations), the society and the country's economy.

These effects are analysed in terms of financial consequences, job losses and societal stigma and are dealt with below.

#### **1.4.2.1 FINANCIAL CONSEQUENCES**

The financial consequences of business failure can be quite devastating (Shepherd, Wiklund & Haynie 2009b:142), as discussed in this section. Peacock (2000:1) stresses that a high incidence of failure is a serious waste of resources and there are not only economic (Cook 2001:19), but also human, costs associated with failure. In South Africa, the then Minister of Trade and Industry, Alec Erwin (Chamber Digest 2001:4) reported on the financial consequences of failed small business ventures (Table 1.5).

**Table 1.5: Capital employed assisting South African small businesses before failure**

Year	Number of failed SMMEs	Capital employed*
1997	14 356	R128 908 234
1998	26 656	R234 876 123
1999	35 985	R345 902 126
2000	40 251	R432 567 854
Total	117 248	R1 142 254 337
*\$1 = R7 Source: Erwin (Chamber Digest 2001:4).		

Table 1.5 reports huge sums of unrecovered money mismanaged by owners of small businesses that impact negatively on both the state and civil society (Cook 2001:17).

#### **1.4.2.2 EMPLOYMENT LOSS CONSEQUENCES**

The failure effects in terms of employment losses are also important. First, the effect of employees losing jobs as a result of small business venture failure is confirmed by Argenti (1976:3), Van Witteloostuijn (1998:501) and Temtime & Pansiri (2004:18) who concur that organisational decline is a serious matter for the employment sector.

Developed countries are also affected by losses of jobs due to small business failures. Peacock (2000:1) notes:

The government policy makers in western countries have been spurred on by what they see as the job generation potential of small firms. Therefore, they have a concern for small firm failure.

Table 1.6 presents the unemployment situation in South Africa. If one notes that SMMEs have the potential to address the country's unemployment situation, then one can understand why their failure should be taken as important input into entrepreneurial success (Sarasvathy 2004:520), both at micro- (individual) and macro- (the economy) levels of analysis.

#### **1.4.2.3 PSYCHOLOGICAL EFFECTS OF BUSINESS FAILURES**

Society can develop a "psychology of failure" stigma as a result of business failure (Luthans, Stajkovic & Ibrayeva 2000:95; Wiesenfeld, Wurthmann & Hambrick 2008:231). McGrath (1999:13), van Gelder *et al* (2007:388) and Shepherd (2009:85), for example, assert that social norms can regard "losing" as shameful. SMME failure is an issue which should concern all South Africans because such deaths or failures imply that a major portion of the population becomes unemployed, impacting on the country's social and political stability. Such failures can have major psychological implications and could adversely affect the mindsets and belief systems of those concerned (Shepherd, Covin & Kuratko 2009a:590).

Concerning the psychological effects of business failures, Cressy (2006:104) and Temtime & Pansiri (2004:19) assert that business failures are persistent and pervasive unwelcome economic and social events. As far back as 1977, Di Pietro & Sawhney assert that knowledge of the causes of business failures is a prerequisite to the formulation and implementation of effective policy:

Very little work has been done in the area of identifying the reasons for business failures: Why do businesses fail? (Di Pietro & Sawhney 1977:4).

**Table 1.6: South African overall unemployment rate by province**

Province	Strict definition*			Expanded definition**		
	2005 %	2006 %	2007 %	2005 %	2006 %	2007 %
Eastern Cape	27.1	22.1	25.5	43.6	36.9	42.9
Free State	30.6	28.3	26.4	39.1	38.7	37.5
Gauteng	22.7	23.3	22.6	34.1	34.3	32.3
KwaZulu-Natal	31.7	29.9	29.2	45.5	44.0	42.0
Limpopo	32.4	35.6	32.4	57.3	59.0	53.5
Mpumalanga	27.4	27.4	26.3	42.1	39.4	38.6
North-West	28.8	31.8	32.0	45.6	45.6	54.3
Northern Cape	29.4	23.5	26.5	41.4	36.3	36.7
Western Cape	17.6	15.9	17.2	24.9	23.0	23.9
<b>South Africa</b>	<b>26.5</b>	<b>25.6</b>	<b>25.5</b>	<b>40.5</b>	<b>39.0</b>	<b>38.3</b>
<p>*<i>Strict definition</i>, defines unemployment as economically active but unemployed for last seven days prior to interview, want to work, actively looking for employment or self-employment four weeks prior to interview.</p> <p>**<i>Expanded definition</i>, includes the strict definition, the 'discouraged' to look for work as unemployed.</p>						
<p><b>Source:</b> Roodt (2008:211).</p>						

Bukula (1995:11) expresses a similar concern about the impacts of small business failure issues in South Africa by reminding would-be owners of small businesses to think of the high failure rate (then at 60 %) of new businesses within the first five years. Surely, this should trouble venture owners? Some might argue that the threat of failure is good for one because it focuses one's mind. It forces one to carry out tough pre-start-up preparations that will reduce the chances of failure of a small business.

Lussier (1996:80) also argues that of major concern to any would-be entrepreneur is their chance of success for the proposed business if forewarned that business failures are high.

Everett & Watson (1998:372) and Temtime & Pansiri 2004:18) opine that although failures cannot be completely avoided in a free-enterprise system, the failure rate could be reduced if some of its causes are recognised and preventive action is taken.

From the above, certain pertinent issues emerge:

- The success of small businesses in South Africa cannot be taken for granted.
- There is the need to find locally based information when analysing SMME failures instead of depending solely on theoretical ideas from developed countries.
- The perceptions of the owners of the small businesses interviewed towards business management principles, therefore, need to be taken into account to understand the causes of failure of the businesses concerned.
- In addition, the important roles played by other stakeholders in the small business development process of South Africa must constitute an important component in developing explanatory models for the failure phenomenon of the small businesses being researched (Fleetwood & Ackroyd 2004:117).

From these issues, the problem statements of this research are stated below.

## 1.5 PROBLEM STATEMENT

The thrust of this research is based on the idea that social research needs to be organised periodically to understand the causes of events. Without proper understanding of the processes behind empirical events, the world could become a place of confusion and uncertainty (Bruno & Leidecker 1988:53; Levin 1998:5; van Eeden *et al* 2003:13). Establishing ongoing dialogue between social realities and practically adequate knowledge of such realities is therefore crucial in all spheres of social life (Sunter 2000:23; Wickham 2001:132, 2006:205; Timmons & Spinelli 2003:52, 2009:106; Balcaen & Ooghe 2006:63; Nieman 2006a:12). Knowing the causes of the failures of small businesses in South Africa is therefore crucial for their sustainability. Lyles *et al* (2004:351) emphasise that the survival of small and new ventures is a critical issue in transitional economies that rely on the health of the private sector for economic development.

The Southern African Development Community region consists of many examples of emerging economies. There is, therefore, a challenge that needs to be addressed in terms of the small businesses in this region, and specifically, in South Africa and Botswana. This revolves around the overarching question of what appropriate research approach could be used to obtain practicable and relevant information to understand the causes of small business failures.

On the basis of the above, the following research questions therefore emerge:

1. What explanations are available in the literature about developed countries as being the causes of SMME failures and what lessons could be learnt from such explanations? How relevant are such explanations in the understanding of the failure factors in developing countries and particularly for this research? (Chapters 2 and 3)
2. What causes of failure do owners of locally based failed businesses studied in this research report as having caused their businesses to fail, and how different are these causes from the existing literature? (Chapter 3)
3. Can a model for a better understanding of the causes of business failures be created? (Chapter 5)

4. What are the implications of the information emanating from this research? (Chapter 6)

Answering the above questions should assist to understand the implications of the actual causes influencing the shutdown or failure of SMMEs in South Africa.

## 1.6 OBJECTIVES AND PROPOSITIONS OF THE RESEARCH

On the basis of the above research questions, the objectives of the research are to:

- undertake a literature review of the small business failure theories as a backdrop to finding explanatory theories of failure which relate to broader socio-economic conditions of the problem being researched (Chapters 2 and 3);
- obtain empirical data from the respondents whose businesses have failed about the actual causes of the failure of their small businesses (Chapter 4);
- use the data obtained to produce an explanatory or causal model of the SMME failures in the research area (Chapter 5); and
- make recommendations based on the findings of the research (Chapter 6).

The research proposition are:

- P<sub>1</sub>** Monitoring and control contributes to failure in small businesses.
- P<sub>2</sub>** Experience and planning in finance and marketing contributes to failure in small businesses.
- P<sub>3</sub>** Income constraints contribute to failure in small businesses.
- P<sub>4</sub>** Cash control contributes to failure in small business.

As elaborated on in Chapter 3, the critical realist research approach is appropriate to address the above research questions and objectives. The key concepts used in the research are therefore largely critical realist based.

## 1.7 DEFINITION OF KEY CONCEPTS

### ***BUSINESS MANAGEMENT PRINCIPLES OR KEY SUCCESS FACTORS***

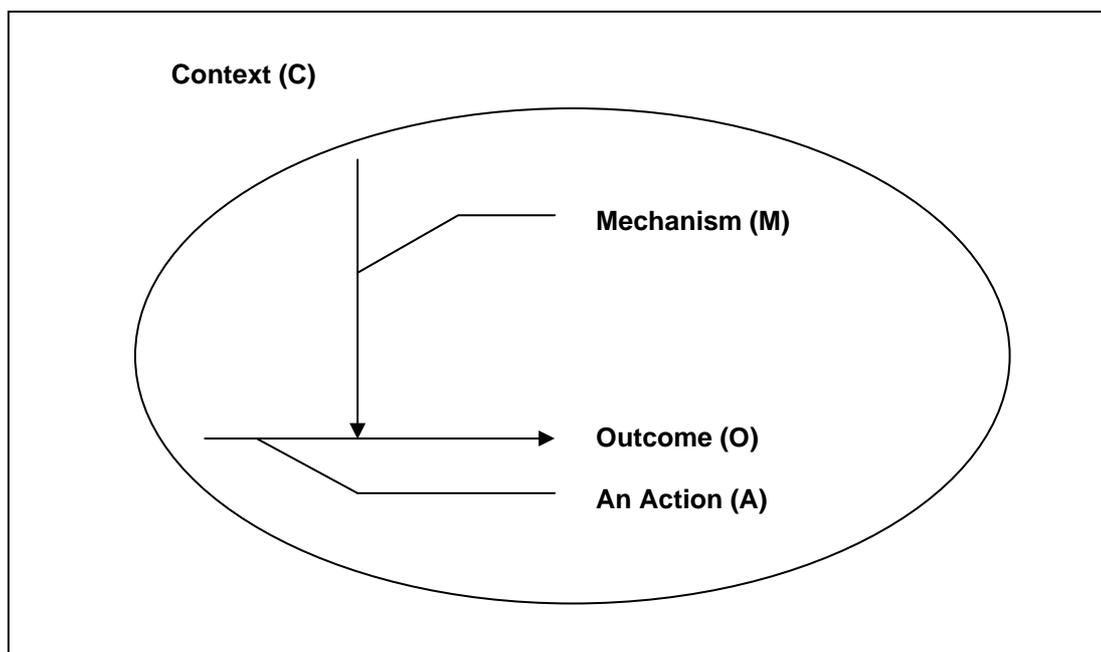
“Business management principles” or “key success factors” are the set of conditions/rules that need to be satisfied to enable businesses to survive and grow with time (Beaver & Jennings 2005:9; Wickham 2006:205).

### ***BUSINESS FAILURE DEFINITION ADOPTED FOR THIS RESEARCH***

The definition of “business failure” as adopted for this research means: *Any small business in which the owner has lost control or the business is no longer commercially viable, resulting in the small business’ physical structure/assets voluntarily or involuntarily closing down or being disposed of, and the small business ceasing to operate or transact.*

### ***CAUSAL MODELS***

An action (A) is “causal” if its outcome (O) is produced by a mechanism (M) operative in a given context (C) (Fleetwood & Ackroyd 2004:152; Pawson & Tilley 2000:58). This is depicted in Figure 1.2.



**Source:** Fleetwood & Ackroyd (2004:152) and Pawson & Tilley (2000:58).

## **Figure 1.2: Elements of causal modelling**

“Causality” in realist research is explained in terms of the powers of internally related objects. Causes are seen to be mechanisms which possess the power to produce certain effects (Fleetwood & Ackroyd 2004:152; Pawson & Tilley 2000:58; Danermark *et al* 2006:205).

Such systems exist only in open systems and therefore controlled experiments, predictions and decisive tests of theory are impossible with such structures. The fact that the mechanisms exist in open systems is one reason their nature can be changed by agents operating at the actual level in critical realist approach (Danermark *et al* 2006:206).

### ***CAUSE***

To ask “What has ‘caused’ something?” is to ask “What makes it ‘happen’?”, “What produces, generates, creates or determines it?” or, more weakly, “What ‘enables’ or ‘leads’ to it?” (Mouton 1994:79; Lewis 2000:264; Danermark *et al* 2006:54).

### ***DEVELOPING CAUSAL MODELS IN REALIST RESEARCH***

This involves moving beyond positivist statistical descriptions to the conceptualisation of groups of factors as mechanisms. The criteria for developing causal models involve time and asymmetry, empirical associations, non-spuriousness, the identification of a mechanism to explain causality and an indication of the context of the model (Danermark *et al* 2006:54).

### ***HAZARD RATE***

The “hazard rate” can be understood as the “proxy” or “placeholder” for causes associated with failure between venture birth and venture death (Preisendorfer & Voss 1990:127; Laitinen & Kankaanpää 1999:72; Anderson & Tushman 2001:696; Abouzeedan & Busler 2004:159).

## ***HERMENEUTICS***

The art and science of interpreting texts with a view to establishing mutual understanding between people, that is, “hermeneutics” is an interpretive method of deriving understanding from narrative. For example, interviewed owners of failed small businesses cite the causes of business failures which are conveyed to the readers/examiners by the researcher without losing the context of what the owners said (McKenzie & Sud 2008:128).

## ***MECHANISMS***

“Mechanisms” explain “Why?” and “How?” reactions in processes take place. A mechanism is that which can cause something in the world to happen and, in this respect, mechanisms can be of many different kinds (Danermark *et al* 2006:55).

## ***OPPORTUNITY***

Several definitions of “opportunity” apply to this research:

- An “opportunity” is a situation in which a person can create a new means-ends framework for recombining resources that the entrepreneur believes will yield a profit (Shane 2003:46).
- An “opportunity” is defined as a perceived situation where a good and/or a service can be introduced which the entrepreneur believes will yield a profit (Alsos & Kaikkonen 2004:7).
- An “opportunity” is a potentially profitable business refined from an idea or a range of ideas (Rwigema 2005d:159).

## ***REALIST STRATIFICATION MODEL***

There are three components of social reality in the critical realist method linking the empirical layer (surface appearances) to processes taking place in the actual and real levels. The model states that beneath the empirically observable features are mechanisms conceivable in ontological terms at the lower or real level base (Danermark *et al* 2006:61).

## ***RESOURCES***

There are differing views of “resources”, for example:

- “Resources” are the things that a business uses to pursue its ends. They are the inputs that the business converts to create the outputs it delivers to its customers. They are the substance out of which the business is made (Wickham 2006:91).
- “Resources” are the fuel needed to start and operate a business, just as petrol or diesel is the fuel for vehicles (Nieman *et al* 2003:111).

### ***RESOURCE BUNDLES***

Organisations are seen as “bundles” of resources, which are defined as all tangible and intangible assets that are tied to the firm in a relatively permanent fashion (Bergmann Lichtenstein & Brush 2001:37).

### ***RESOURCE AND OPPORTUNITY HALF-LIFE***

The duration of resources and opportunity bundles before disintegration and disentanglement around each stage over the venture life cycle is different for every business and the “half-life” can be of either short or prolonged duration (Eckhardt & Shane 2003:340).

### ***SMALL BUSINESS VENTURE OR DOMAIN***

The term “small business” is used interchangeably with “SMME” (dti 2004:35; Lyles *et al* 2004:352). This refers to a venture that can be classified as “small” in terms of the National Small Business Act, Act 102 of 1996 (RSA 1996). A small business generally has fewer than 50 employees and less than R2.5 m turnover per annum. A “small business” is also defined as an independent profit-oriented business unit that is personally managed by the owner of the business and has a small influence or market share in the business world (van Scheers & Radipere 2007:86).

### ***THEORY IN CRITICAL REALISM***

Theory in critical realism examines conceptualisations which make claims about the nature of real objects, particularly their structures and powers (located at the real level) and how they generate outcomes at the empirical level. Realist theory is based on the idea that objects can be changed to relate to the changing needs of people (Fleetwood & Ackroyd 2004:30; Danermark *et al* 2006:4).

## ***MECHANISMS AT THE REAL LEVEL OF THE REALIST APPROACH***

The development of substantive theories is performed at this level to indicate how processes and properties operate and appear in given contexts. When necessary relations are abstracted here and researchers can make strong theoretical claims about them (Fleetwood & Ackroyd 2004:152; Danermark *et al* 2006:59).

### ***VENTURE DECLINE***

The “decline” of a venture is defined by some researchers as the process of decreasing performance over a prolonged period. “Performance” is measured in terms of profitability. There are four possible outcomes of the decline process: immediate exit, turnaround success, flight from losses, and chronic failure (Van Witteloostuijn 1998:503).

Engelbrecht (2005:463) takes the position:

Where a business has experienced a successive decline in real earnings for a period of not less than two years, that business may be said to have experienced a decline in its fortunes.

Engelbrecht (2005:463) concludes that the nub of the working definition of “venture decline” is that there should have been consecutive periods during which earnings diminished.

## **1.8 LIMITATIONS OF THE RESEARCH**

The following limitations are applicable to this research:

- In applying the retrospective or *ex post facto* method, it is usually not necessary to impose a control over the research subjects. This research complied with this principle (Martella, Nelson & Martella 1999:180).
- The retrospective analysis involved face-to-face interviews with owner-managers over issues that are historical. Some of the respondents may have experienced memory lapses when providing the necessary information.

- Some owner-managers refused to be reminded of their misfortunes and downfalls as failure has a societal stigma attached to it. Such respondents may have held back some of the information about the failure of their businesses.
- As financial information or records about small business ventures are often not readily made public, calculating the financial predictions was fraught with difficulties. Also, some of the records to tell the historical story were not available; consequently, the researcher relied on the owners to tell the truth about “How?” and “Why?” their businesses finally closed down.

The above problems were partially addressed by allowing those prepared to be interviewed to be reassured by the interviewer. The research subjects were able to direct the researcher to particular individuals, who, in turn, identified others. In this way, the “snowball” sampling methodology assisted in conducting face-to-face interviews.

## **1.9 STRUCTURE OF THE THESIS**

### ***CHAPTER 1: INTRODUCTION AND PROBLEM ORIENTATION***

This chapter delineates the problem statement, justification for the research questions and objectives. The chapter also clarifies the definitions necessary for understanding the terminologies used in the research.

### ***CHAPTER 2: LITERATURE REVIEW: SMALL BUSINESS FAILURE THEORIES***

This chapter is devoted to a literature review of the failure of SMMEs from developed and developing countries.

### ***CHAPTER 3: CONCEPTUAL FRAMEWORK FOR THE RESEARCH***

This chapter provides an outline of the conceptual framework for this research in the context of the realities facing the owners of the failed businesses.

## ***CHAPTER 4: RESEARCH METHODOLOGY***

In this chapter, the retrospective or *ex post facto* methodology adopted for the research objectives is expounded. The propositions to be validated by the fieldwork are also presented here. These are then used to justify the research instrument and to validate the research methods. Finally, there is a discussion on how the data were collected and analysed to generate the causal models on the business failures through the use of qualitative and quantitative research techniques.

## ***CHAPTER 5: FINDINGS AND ANALYSIS***

This chapter outlines the empirical findings from the field study as collected through the research instrument. The findings are reported largely in two broad categories – descriptive statistics, followed by the critical realist explanatory causal analysis.

## ***CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS***

In this chapter, the conclusions to the research are presented and recommendations made.

### **1.10 RESEARCH ASSUMPTIONS**

Research assumptions are unobservable or non-testable declarations about the study that are accepted as being valid within a discipline at a particular juncture (Mouton 2002:57; Neuman 2006:52; Nieman 2006b:19; Hofstee 2009:88, McKinney 2009:20). The distinctive feature of these assumptions is that, in science, they operate as postulates or presuppositions. This means that they are not part of the testable propositions and hypotheses of the research. They actually precede such propositions. The assumptions for the research involved the conceptual framework and the interviewing methodology.

The assumptions regarding the conceptual framework were that, generally, the owners of successful small businesses – when compared to the owners of failed small businesses – succeed or stay in business because they adhere to the “rules” and expectations of classical management theory (Hogarth-Scott, Watson &

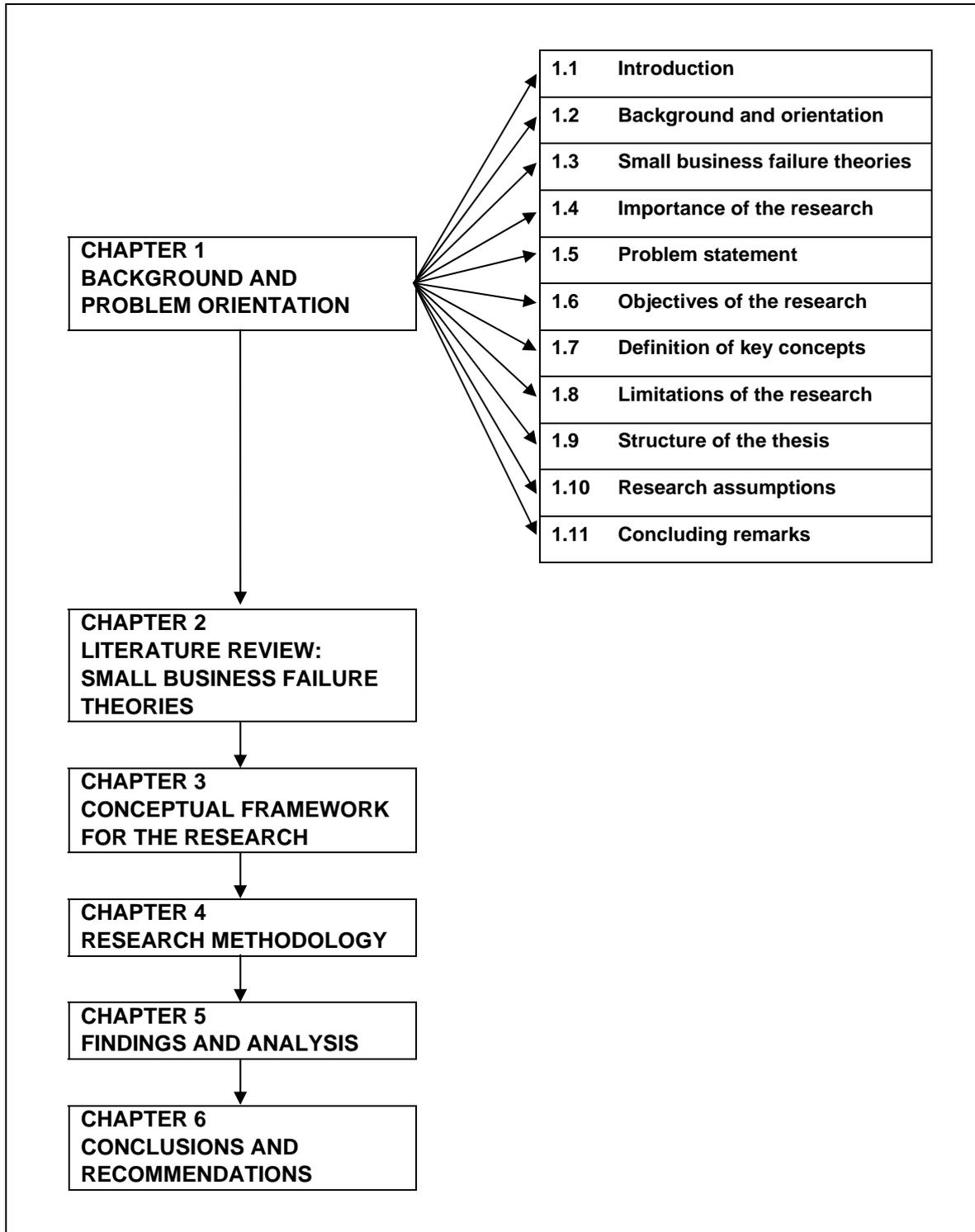
Wilson 1996:6; Mazzarol 2000:2; Beaver & Jennings 2005:9; Mbonyane 2006:26; Neuman 2006:52; Nieman 2006b:19; Hofstee 2009:88).

The interviewing methodology assumptions are that (a) owners of failed small businesses understand why their ventures failed; (b) respondents would truthfully answer questions posed to them as opposed to providing what they believed to be the correct answer; (c) respondents would understand the questions, and (d) that respondents were not qualified at hermeneutically translating their failure experiences and actions (McKinney 2009:20).

### **1.11 CONCLUDING REMARKS**

The purpose of Chapter 1 was to introduce the reader to the background, problem statement, research questions, objectives and the methods used to address them. The chapter orientated the reader to the importance of understanding the causes of small business failures in the context of their important roles within the economy of South Africa. The next chapter provides a broad theoretical overview of small business failures.

**Retrospective analysis of failure causes in South African small businesses**



**Figure 1.3: Organisation of the research and layout of the thesis**

**CHAPTER 2**  
**LITERATURE REVIEW: SMALL BUSINESS FAILURE THEORIES**

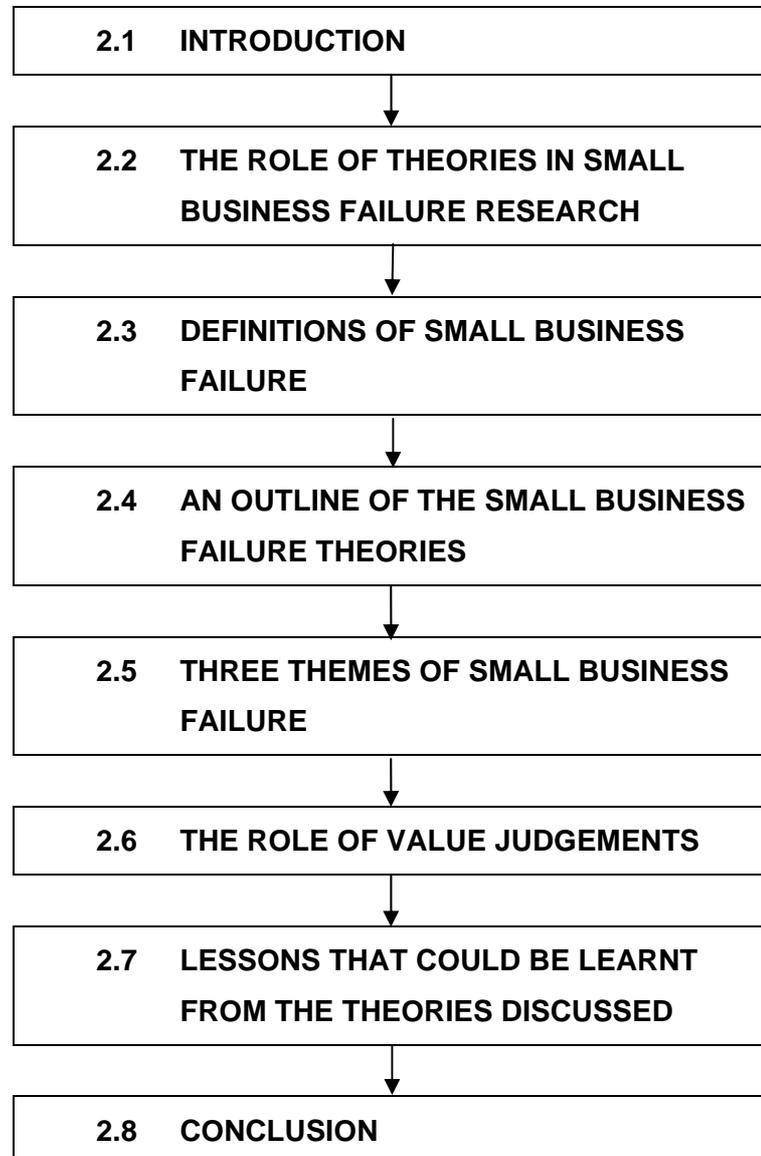


Figure 2.1: Layout of Chapter 2

## CHAPTER 2

### LITERATURE REVIEW: SMALL BUSINESS FAILURE THEORIES

#### 2.1 INTRODUCTION

The objective of this chapter is to highlight causes of failure in SMMEs cited by literature as explaining the SMME failure phenomena needed to inform the methodology (Chapter 4). The review examines the different perspectives (causal descriptions) under which small business failures have been discussed. The chapter ends with a critical evaluation of conventional small business failure theories as well as lessons that could be learnt from the existing theories for researchers interested in undertaking similar studies in the South African context.

The Literature Review has led to some important conclusions. First, the theories indicate that the business success or failure processes are related to certain business management principles or theories to which business owners need to adhere in order to stay in business (Beaver & Jennings 2005:9). These principles may be described as the key success factors for business survival, implying that once they are non-existent the business will have to close (Figure 3.3). The business management process thus revolves around the nature of objects and their causal powers (Fleetwood & Ackroyd 2004:11; Danermark *et al* 2006:54) and as in Figure 3.3.

Second, the review also brings out the fact that the business failure factors need to be understood in terms of how the principles are interpreted by the business owner as per the value judgement in Section 2.7 (Danermark *et al* 2006:200; McKenzie & Sud 2008:123).

Third, there is also the fact that a discussion of the business failures would not be complete without taking into account the broader socio-economic environment in which the businesses operate (Shook *et al* 2003:379). For explanatory theories to

be relevant, the local context needs to be taken into account (Wickham 2006:209). The discussion thus ends with an indication of how the above issues need to be taken into consideration in the processes of data collection and analysis to relate the explanatory factors underlying the business failures to local conditions. This chapter thus seeks to answer the first two research questions in Chapter 1 which are: “What explanations are available in the literature about developed countries as being the causes of SMME failures and what lessons could be learnt from such explanations? How relevant are such explanations in the understanding of the failure factors in developing countries and particularly for this research?” and “What causes of failure do owners of locally based failed businesses studied in this research report as having caused their businesses to fail, and how different are these causes from the existing literature?”.

The literature review on the causes of failure of SMMEs begins with the discussion of the importance of business management principles and resources as outlined by various researchers and how non-adherence to them – or the lack of them – can lead to business failures. This is followed by an examination of the international literature on business failures aimed at providing an idea of the nature of those theories. As causes of small business failure reported by the literature are many and varied (Gitman 2009:784), there is a need to classify these causes into categories and themes. An important element of this literature review relates to an attempt made by the author of the present research to classify the numerous failure theories reported into causes of small business failure themes (Longenecker, Simonetti & Sharkey 1999:503; Carter & van Auken 2006:493). These causes have been classified into three broad themes to enhance understanding. This classification principle is again applied in Chapter 5 where factor analysis is used to obtain the four failure factors from the geographical research area.

The theoretical discussions begin by defining the basic concepts used in this research as a backdrop to the substantive issues that are elaborated on later. To set the scene, it begins with definitions of research theories and their roles generally in research studies.

## 2.2 THE ROLE OF THEORIES IN SMALL BUSINESS FAILURE RESEARCH

Aldrich & Martinez (2001:42) stress the significance of theories in explaining phenomena by stating that theories as interpretive lenses serve to profoundly influence our capacity to understand phenomena. Taking this matter further, Hair *et al* (2006:710) point out that a “theory” is a systematic set of relationships providing a consistent and comprehensive explanation of phenomena. Cooper & Schindler (2001:53, 2008:193) contend that, in practice, a “theory” is a researcher’s attempt to specify the entire set of dependence relationships explaining a particular set of outcomes. For this research, the outcome is the failure of small businesses. According to Cooper & Schindler (2001:53, 2008:193), the analysis of the causes of failure should enhance the understanding of the failure phenomenon. These authors succinctly assert that the sets of interrelated concepts, definitions, and propositions that are advanced to explain and predict phenomena are called “theories”.

According to Kerlinger & Lee (2000:11), “theories” explain phenomena through a combination of definitions, propositions and interrelatedness between variables. These researchers note that theories can be derived from one or more of the following sources: (1) prior empirical research; (2) past experiences and observations of actual behaviour, attitudes, or other phenomena; and (3) other theories that provide a perspective for analysis. They opine:

The basic aim of science is theory. Perhaps less cryptically, the basic aim of science is to explain natural phenomena. Such explanations are called ‘theories’ (Kerlinger & Lee 2000:11).

Many researchers (Mouton 2002:198; Zikmund 2003:24; Kerlinger & Lee 2000:11; de Vos 2006a:36; Danermark *et al* 2006:115; Cooper & Schindler 2008:51) have attempted to define what a theory in general terms is, but the definition that is cited extensively is Kerlinger & Lee’s (2000:11) which states:

A theory is a set of interrelated constructs (concepts), definitions, and propositions that present a systematic view of phenomena by specifying relations among variables, with the purpose of explaining and predicting the phenomena.

Expanding on the above definition, Kerlinger & Lee (2000:11) continue:

(1) a theory is a set of propositions consisting of defined and interrelated constructs (concepts), (2) a theory sets out the interrelations among a set of variables (constructs), and in so doing, presents a systematic view of the phenomena described by the variables, and (3) a theory explains phenomena; it does so by specifying which variables are related to which variables and how they are related, thus enabling the researcher to predict from certain variables to certain other variables.

In line with the above definition, de Vos (2006a:36) also points out that a theory is an attempt to explain and/or predict a particular phenomenon. In this case, it is the phenomenon of small business failure that this research seeks to explain – through the analysis of the causes of the relevant failure variables – which variables are related to which in causing the resultant event known as “failure”.

The role of theories in research follows next.

According to Silverman (2001:10), theories are the impetus for any research. This research is informed among others by the ideas from a few researchers (Zikmund 2003:43; Hair *et al* 2006:711) who opine that prediction and understanding or explanation are the two purposes of theory. In line with the foregoing assertions, Sayer (2000:45) confirms that the role of theory is to order, explain and to predict. Indeed, when conducting research one cannot proceed without identifying some theories and concepts which provide frameworks for the research for prediction and explanation of data collection, analysis and for testing hypotheses. Among others, theories function to give rigour to the research as Dollinger (1999:25) and Cooper & Schindler (2001:51) point out that a good theory tells the user how things and events are related – which are likely to be external causes and independent, and which are likely to be internal results and controllable. A good theory also tells us the probable direction of causality.

This research analyses retrospectively the causes of failure in South African small businesses. Explanatory theories are used to provide an account of the causes of the events or situations concerned. In this research, the theories discuss the identified factors which are believed by the various researchers cited to have caused the businesses to fail. The shortfall or gap from extant literature is that it does not subject these factors of failure to causality testing.

To make sense of this, there is a need also to study descriptive theories which predict what certain objects are capable of doing by virtue of their nature (Sayer 2000:15). In contrast, realist explanatory theories seek to explain causality in terms of what mechanisms can do in view of their inherent qualities or constitution.

One important assumption as stated in Section 1.10 is related to the role that business management rules or principles play in understanding business failures. The principles need to be followed to ensure business survival. The researchers discussed in the review below argue from a common standpoint by stressing the importance of business owners following some common rules of the business game: “Comply with the rules or fail” is the central theme in the literature review (Mardjono 2005:272). In addition, David (2003:185) stresses as a rule that a lack of strategic management knowledge is a serious obstacle for many small business owners. Figure 3.3 illustrates business management concepts. Attention is now turned to the definitions of small business failure.

### **2.3 DEFINITIONS OF SMALL BUSINESS FAILURE**

To understand the small business failure phenomenon it is essential to define the small business failure concept.

Phenomena such as entrepreneurial failure and levels of entrepreneurial activity cannot be aggregated and generalised across contexts, even across “rural” or “urban” areas, because there may be key differences between regions (Vaillant & Lafuente 2007:313; Arinaitwe 2008:167; Cardon *et al* 2009:1). Consequently, definitions of “small businesses” are split into those for “developed” (or western) countries and “developing” countries, including South Africa.

The sections that follow discuss definitions of small business failure from the perspectives of developed countries as well as African (developing) countries (including South Africa).

### **2.3.1 Definitions of small business failure in developed countries**

To understand the phenomenon of failure of SMMEs, it is necessary to present definitions from research on developed countries first. Table 2.1 presents a summary of different interpretations of the concept of “business failure”, indicating that there is no single agreed-upon definition of “business success” or “business failure” (Rogoff, Lee & Suh 2004:365; Gitman 2009:784).

From Table 2.1, it emerges that the concept of “failure” has been defined from a number of perspectives, all of which ultimately point to the inability of the venture to satisfy certain set goals. The inability to satisfy the goals in variably translates into the position occupied by the firm along a continuum characterised by success at one pole and failure at the other.

Table 2.1 indicates that the opposing forces could be in terms of tensions between assets against liabilities, revenues against costs, output against input, demand against supply and hope against despair. The definitions illustrate that where the expenses tend to exceed the incomes, the business concerned could face the possibility of bankruptcy, leading to eventual closure of the business. The closing down of the business thus denotes the end of the venture, having struggled to survive over a certain time period. The failure definitions in Table 2.1 are thus based on the concept of tensions between opposing forces.

**Table 2.1: Developed countries' definitions of "small business failure"**

Failure definition	Category/key definition construct	Source
Firms earning a return on investment which is less than the opportunities cost of capital	Economic failure	Friedland & Morris (1976:7)
Bankruptcy is an obvious form of failure; the courts treat technical insolvency and bankruptcy in the same way. They are both considered to indicate the financial failure of a firm	Economic failure	Gitman (2009:785)
Failure: Failing business organisations are those that become insolvent unless appropriate management actions are taken to effect a turn-around in financial performance	Pending insolvency. Requirement for alternative management action	Richardson, Nwankwo & Richardson (1994:9)
Small business failure: the inability to satisfy principal stakeholders' aspirations	Subjective failure	Jennings & Beaver (1995:192)
Failure: Firms involved in court procedures or voluntary actions which result in losses to creditors, excluding discontinued ventures	Losses to creditors	Lussier (1996:79)
A company is unsuccessful if it fails to meet the objectives set for it by its stakeholders, or if it produces outputs which are considered undesirable by those associated with it	Subjective failure	Thompson (1996:227)
Failure is defined as bankruptcy	Bankruptcy	Zacharakis, Meyer & De Castro (1999:5)
Failure refers to deaths of entire firms and industry exits by multiple business companies	Closing or exiting the industry	Henderson (1999:291)

Failure definition	Category/key definition construct	Source
Discontinuation (cessation of operations) of business for any reason or bankruptcy or failing to “make a go of it”	End of operations	Watson & Everett (1993:35)
An initiative fails when it is terminated as a consequence of actual or anticipated performance below a threshold (fallen short of its goals)	Termination because performance is below critical threshold	McGrath (1999:14)
Business failure involves an involuntary change in both the ownership and management of the business owing to poor performance	Poor performance	Shepherd (2003:319)
Business failure is defined as a situation in which firms cannot meet their liabilities and hence cannot conduct economic activities any more	Cannot meet liabilities	Honjo (2000:559)
Failure is “not having made a profit for the previous three years”	Losing money	Lussier & Pfeifer (2001:232)
<p>Closing firms could have been financially successful, but closed for other reasons: sale of the firm or personal decision by the owner to accept employment with another firm, to retire, or the like. Not the same as failure defined by the following five categories:</p> <ul style="list-style-type: none"> <li>• ceasing to exist (discontinuance for any reason);</li> <li>• closing or a change in ownership;</li> <li>• filing for bankruptcy;</li> <li>• closing to limit losses; and</li> <li>• failing to reach financial goals</li> </ul>	Business closure	Headd (2003:52)

Failure definition	Category/key definition construct	Source
When fall in revenue and/or rise in expenses are of such magnitude that the firm becomes insolvent and is unable to attract new debt or equity funding, consequently, it cannot continue to operate under the current ownership and management	Insolvency and involuntary change in ownership and management	Shepherd (2003:318)
Bankruptcy is the ultimate reason for exiting the economy and happens when firms lack sufficient capital to cover their obligations. Firms that are insolvent to the point of legal proceedings have clearly failed to meet the market's performance threshold of fulfilling their financial obligations	Exiting the economy or not meeting the "performance threshold" of the market	Thornhill & Amit (2003a:497)
Failure is the involuntary decline in or termination of an independent owner-managed business organisation of limited significance within the industry, employing less than 100 employees, where the owner-manager's omnipresence creates a highly personalised management style	Owner's personalised management style	McCartan-Quinn & Carson (2003:207)
Success and failure are identifiable as "end states"	End state	Ritchie & Richardson (2004:236)
Business failure can be defined as the condition when the value of a company's liabilities exceeds the value of the company's available assets	Liabilities of assets	Koksal & Arditi (2004:2)
Decline and deteriorating financial performance measured by bankruptcy and dramatic fall in market value	Decline and deterioration of financial performance	Probst & Raisch (2005:90)

Failure definition	Category/key definition construct	Source
Business failure is when a venture has not survived the “market test”. The “market test” is one that compares revenues and costs: if revenue does not sufficiently exceed costs to make continuing the venture attractive, then it has failed	Revenue greater than costs	Coelho & McClure (2005:15)
Organisation failure is the end result of a decline	Failure follows decline	Sheppard & Chowdhury (2005:241)
Failure, in organisations and elsewhere, is deviation from expected and desired results	Deviation from goals	Cannon & Edmondson (2005:300)
Failure occurs when a firm’s value falls below the opportunity cost of staying in business	Performance decline	Cressy (2006:108)
The failure (or death) of a business can result in one or more “modes” or outcomes – dissolution, liquidation, bankruptcy, or even unplanned acquisition. Any one of these outcomes is equated to firm failure	Insolvency	Salazar (2006:1)
True failure really occurs only when a company ceases trading	Cessation of trading	Medway & Byrom (2006:518)
When a firm becomes insolvent	Insolvency	Seshadri (2007:68)
Business failure occurs when a decline in revenue and/or increase in expenses is of such magnitude that the firm becomes insolvent, and is unable to attract new debt or equity funding. Consequently, the business cannot continue to operate under the current ownership and management	Insolvency	Shepherd <i>et al</i> (2009b:134)
<b>Source:</b> Own compilation extracted from literature review.		

### **2.3.2 Definitions of small business failure in developing countries**

According to Pretorius (2008:408) the concept of “business failure” “often appears ill-defined and messy for research purposes”. There is still inadequate clarity on the phenomenon of small business failure. Pretorius (2008:408) supports the view of researchers such as Steyn Bruwer & Hamman (2006:8). Below are three different approaches in which “failure” is defined by South African researchers (Table 2.2) as an indication as to how they understand it from a local perspective. In reviewing the definitions one notices the influence of both developed and developing countries on South African definitions. The observation supports views from Ladzani & van Vuuren (2002:155) who confirm South Africa’s late entry into entrepreneurship as possibly impacting on the performance and failure of South African SMMEs. Despite Ladzani & van Vuuren’s observations in 2002 there remains a dearth of journal articles, publications and accessible information to inform appropriate interventions to reduce the high failure rate of small businesses.

#### ***2.3.2.1 FAILURE DEFINED AS GENERIC FAILURE***

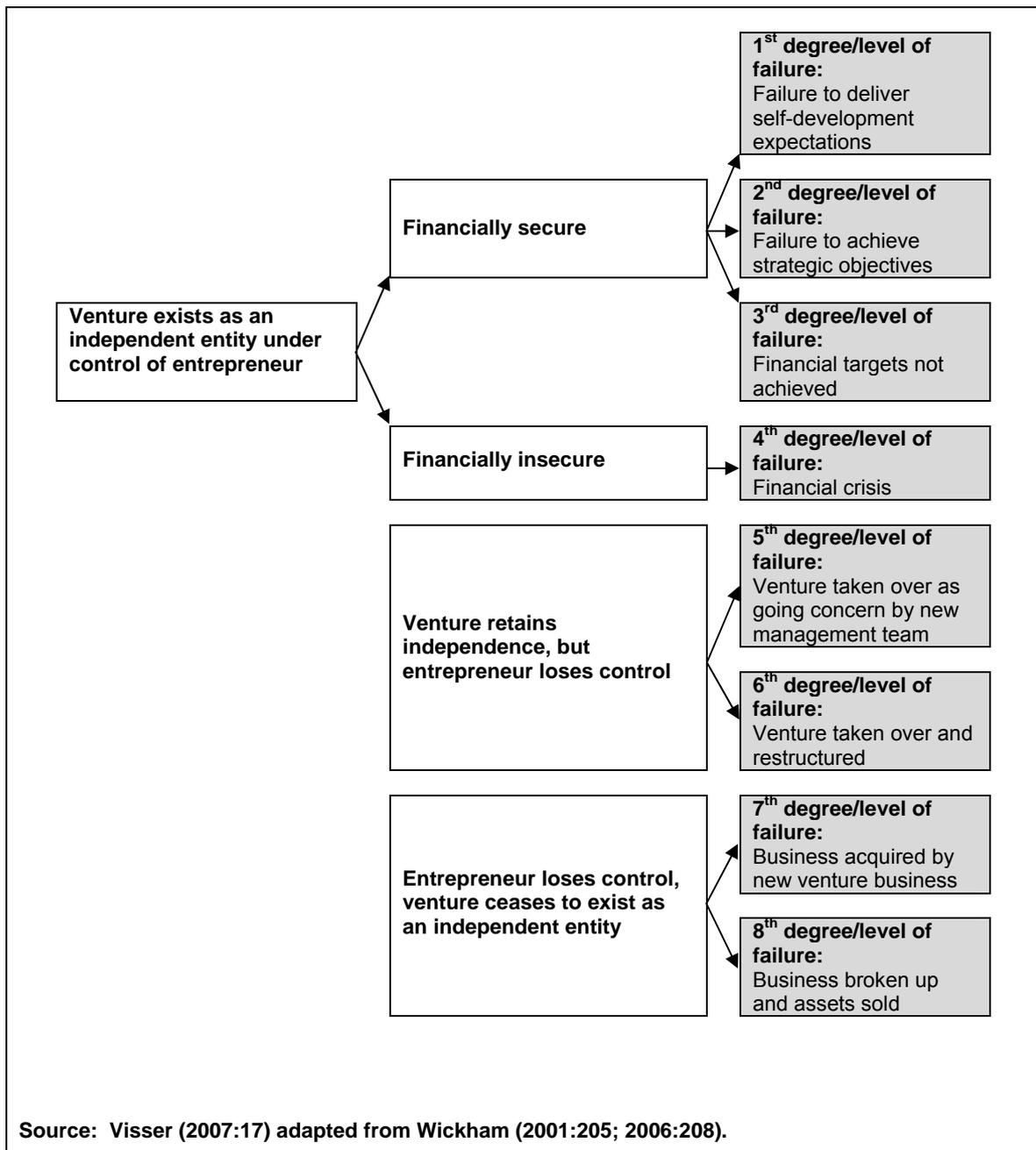
Definitions of failure can also be approached from a generic point of view. Many researchers have different perspectives on failure (Table 2.2), especially in the South African context there are those who hold the generic view or perspective, whilst others have the view of levels or degrees of failure (Figure 2.2). These levels or degrees of failure, are discussed in the next section.

#### ***2.3.2.2 FAILURE DEFINED AS EIGHT LEVELS OR DEGREES OF FAILURE***

Visser (2007:17) illustrates eight levels of failure similar to the levels suggested by Wickham (2001:205; 2006:208) (Figure 2.2).

**Table 2.2: South African definitions of “small business failure”**

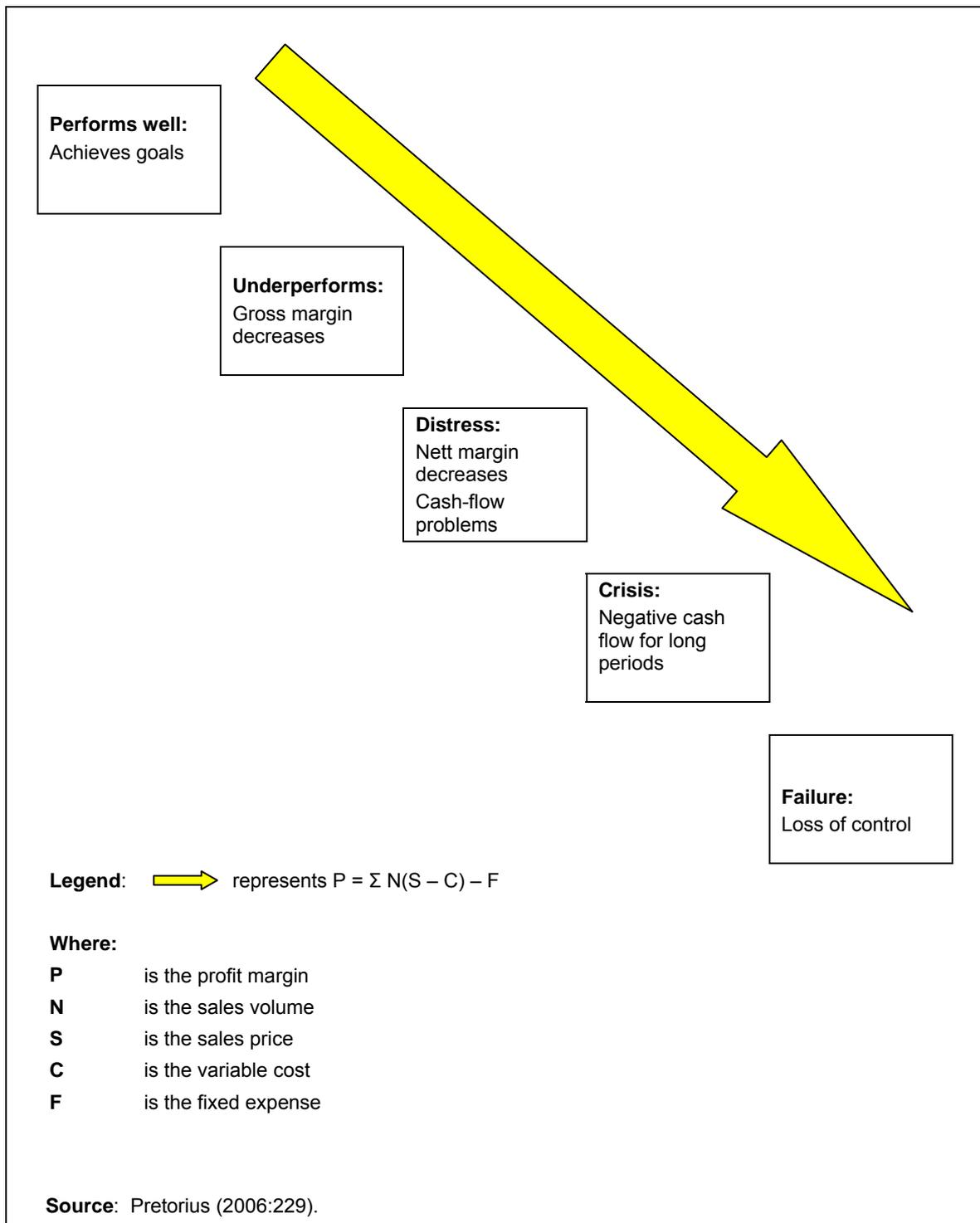
Failure definition	Category/key definition construct	Source
Failure can be defined in different ways, but most people automatically think of absolute failure as evidenced by bankruptcy	Bankruptcy	McLeary (1995:288)
An SMME failure can be seen as a venture that one must get rid of (whether by selling or liquidation) at a loss in order to prevent further losses. This definition includes bankrupt ventures and those that realise they are on the road to failure, but does not include those which are sold at a profit	Performance below expectation leading to bankruptcy	Moolman (1998:34)
Failure can be the inability of a business to meet its financial obligations or the discontinuation of a business – that is, the entrepreneur no longer has the managerial capacity or the desire to continue operating, and the small business is not attractive enough to attract a purchaser to continue the operations	Inability of a business to meet its financial obligations	Engelbrecht (2005:464)
Failure is those businesses that cease to trade because the economic model is not sound	Economic failure	Pretorius (2006:221)
Venture failure is seen as the opposite of success	Success	Pretorius (2006:226)
Failure happens when expectations are not met. Outcomes are less than expectations	Shareholders' expectations or objectives	Visser (2007:16)
<b>Source:</b> Own compilation extracted from literature review.		



**Figure 2.2: Degrees/levels of business failure**

### 2.3.2.3 *FAILURE DEFINED AS LEVELS OF ECONOMIC FAILURE*

South African small business failure is also defined in terms of economic levels of failure (Figure 2.3).



**Figure 2.3: Failure associated with different stages of the failure slide**

From Figures 2.2 and 2.3 it is clear that there is no consensus reached within disciplines as to “what” “small business failure” is, and “how” and “why” it occurs.

The above three discernibly different definitions serve to confirm that a lack of a uniform definition of failure persists (Dobbs & Hamilton 2007:296). The high failure rates appearing in Table 3.1 are largely influenced by the differing failure definitions (Southard & Swenseth 2003:578). This situation can result in different failure rate statistics.

This should be of concern since using different failure rates can imply using different corrective actions thereby preventing any efforts at standardisation. This problem has been highlighted by Ucbasaran, Westhead & Wright (2001:69) who opine:

There is no universally accepted definition of the point in time when an organisation can be said to have closed (or failed).

Of concern is that under such circumstances, different researchers exhibit little deference to each other's work, thereby causing major conceptual disagreements. This situation can hinder the advance of knowledge, because it creates parts without wholes, and disciplines without cores (p.57). This concern is raised to highlight that, if failure can be defined in more than one way, the causes of failure can also be manifold which is not helpful for the business owners and researchers trying to address business problems or deviations from the business management principles or rules.

For as long as there is no consensus on the definition of failure, researchers will continue to find it difficult to account for the causes of a phenomenon they themselves cannot fully define. The absence of a uniform definition of failure (Ucbasaran *et al* 2001:69) has added a further complex dimension to understanding research into SMME failures. For example, understanding the causes of failure using resources and opportunities has, to date, received scant attention from researchers of the failure phenomenon.

Business failure definitions have been expressed in terms of the following (among a rather long list): organisation mortality, organisational death, organisational exit, business bankruptcy, decline, business downsizing, underperformance, business downturn. These various interpretations give a picture of a continuum from which various researchers make choices.

### **2.3.3 Definition of failure adopted for this research**

In line with the owners of small businesses who were interviewed ultimately in this research, “business failure” is defined as: *Any small business in which the owner has lost control or the business is no longer commercially viable, resulting in the small business’ physical structure/assets voluntarily or involuntarily closing down or being disposed of, and the small business ceasing to operate or transact.*

## **2.4 AN OUTLINE OF SMALL BUSINESS FAILURE THEORIES**

### **2.4.1 Introduction**

This section is dedicated to an in-depth discussion of the theories on small business failure which have been identified by the author for this research. In undertaking a comprehensive business failure theoretical review, classifications are important (Steyn Bruwer & Hamman 2006:7; Pretorius 2008:408). The theoretical assumptions as defined in Section 1.10 refer here to frameworks of the causes of failure, in which the failure by owners of businesses to adhere to certain basic business management principles culminates in the decline and eventual failure of the businesses concerned. For example, the mismanagement of a small business is presented as a cause that triggers a venture’s decline and eventual failure (Amit & Schoemaker 1993:33; Arditi, Koksal & Kale 2000:120; Mellahi & Wilkinson 2004:21). But, how can the failure concept in small business be viewed? The next section on hazard rate crystallises the concept of failure in small businesses.

### **2.4.2 The “hazard rate” failure theory**

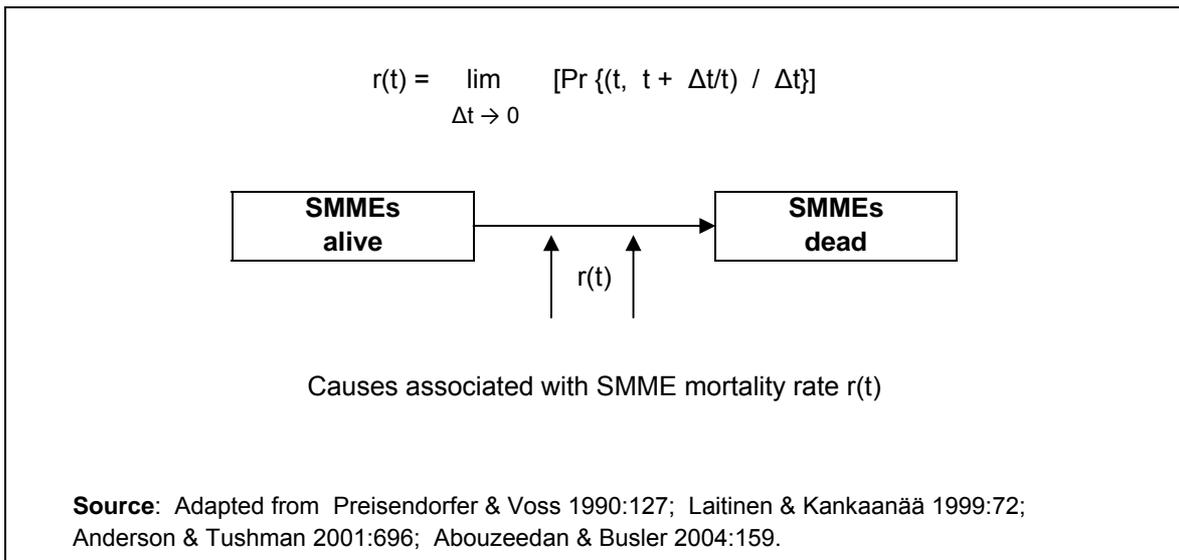
Before an in-depth review of small business failure is conducted, attention is first given to the conceptualisation of “hazard rate” in the small business failure process. This concept is being introduced to set the stage for a deeper review of small business failure theories. According to Abouzeedan & Busler (2004:159), the hazard rate is used to isolate causes responsible for the fate of small businesses.

Furthermore, according to Segarra & Callejón (2002:9) the determinants of the life duration of small businesses can be explored by making use of the hazard function. The hazard function is a model for understanding the causes of small business failure that determine the lifespan of small businesses and new firms. The exploration of the causes of the high failure rate (averaging 70 % to 80 %) follows a conceptual framework known as the “hazard rate” (death) or failure rate (Tveterås & Eide 2000:65; Santarelli & Lotti 2005:187; López-García & Puente 2006:21). The framework models the causes of business failure by pinpointing possible fatal points over the venture’s or business’ lifespan.

Cox (1972:187) initiated the concept of “hazard rate”. Also known as the “Cox regression”, the hazard rate is designed to sequentially pinpoint the events responsible for failure over the venture life cycle (age). The hazard rate model is known for the partial exploration of the causes of failure over the venture age, that is, the factors contributing to the business’ failure. It explores repeatedly until all the covariates (independent explanatory variables) responsible for failure have been exhausted by continually asking such questions as “Why a particular business exits the state while others in the same risk set do not?” (Mouton 1994:79; Tunali & Pritchett 1997:2).

Cox developed the “hazard rate” concept further and, in 1975, introduced the partial likelihood analysis that enables researchers to detect the covariate (explanatory) variables or independent variables responsible for the observed pattern of venture exits. The independent variables are supposed to explain the dependent variable – in this case, the dependent variable is the failure phenomenon (Cox 1975:652).

In this framework, the concept of “hazard rate” is used as a proxy for the causes of small business failure. The proxy represents the factors that are associated with failure between birth and death over the venture lifespan. This placeholder for causes of failure of small business is illustrated in Figure 2.4.



**Figure 2.4: The hazard-rate failure framework**

Figure 2.4 illustrates that at time  $t(0)$  all units (firms/SMMEs) are presented as being “alive”. As time ( $t$ ) progresses, some units “die”, in other words, they change their state from “SMMEs alive” to “SMMEs dead”. This constitutes  $r(t)$ , known as the mortality rate. In this model,  $r(t)$  is described as the factors associated with the small business failure. The model allows for a multivariate analysis of the factors (independent variables/explanatory variables or covariates) affecting  $r(t)$ . In this framework, everything in entrepreneurship is supposed to begin with the venture start-up and end when venture ceases to function (Abouzeedan & Busler 2004:159).

As illustrated in Figure 2.4, the hazard rate process of failure is viewed as involving the process in which the SMMEs are first seen as being “alive” before a set of causal factors,  $r(t)$ , changes the SMMEs’ direction towards failure which predisposes SMMEs to failure. So,  $r(t)$  is described as a set of causal factors. In this model understanding  $r(t)$  is equivalent to understanding the mechanism of the failure phenomenon. The mechanism of failure is necessary for understanding how the failure process/phenomenon unfolds. Identifying the constituents of  $r(t)$  is thus equivalent to finding the causes leading to the failure of SMMEs. As the hazard rate illustrates above, all small businesses are supposedly “born” and are then expected to “die” at some later stage in their lifespans.

This is indeed a gloomy deterministic picture to paint for anyone desiring to venture into the small business sector. A shortcoming of the hazard rate is that it does not answer “why” some small businesses fail whilst others succeed (Mouton 1994:79; Aldrich & Martinez 2001:41; Van Gelderen, Thurik & Bosma 2005:365). Specifically, it does not explain the  $r(t)$  responsible for small business failure. Attention is now turned to the three explanatory theories.

## 2.5 THREE THEMES OF SMALL BUSINESS FAILURE

As discussed in Chapter 1, causes of small business failure are many and varied, often complicating how business owner-managers as well as researchers understand the small business failure phenomenon, necessitating prioritisation and categorisation of the causes of failure if discussions are to be meaningful.

In this section, the failure theories are presented in terms of various classifications which have been made by researchers such as Timmons (1999:536) and Nieman *et al* (2003:98) who posit four classifications: strategic management; poor planning and financial systems; practices and controls, and environmental issues. In contrast, Longenecker *et al* (1999:503), Zikmund (2003:43), de Vos (2006b:442) and Pretorius (2008:411) suggest only three classifications. The many causes that have been used by extant researchers are grouped in this research into three classifications or themes:

- Resources and opportunities as a perspective of failure;
- Metaphors as a perspective of failure (for example, the venture life cycle and liabilities of failure);
- Multiple origins/causes as a perspective of failure (entrepreneur, organisation, environment).

These themes are presented in Figure 2.5 and elaborated on in this chapter. The discussion that follows after Figure 2.5 indicates the important role of the model on this study. The model could be regarded as the summary outline of the literature reviewed in this study. Those aspect of this model which are relevant and applied in this study are elaborated in Chapters 5 and 6.

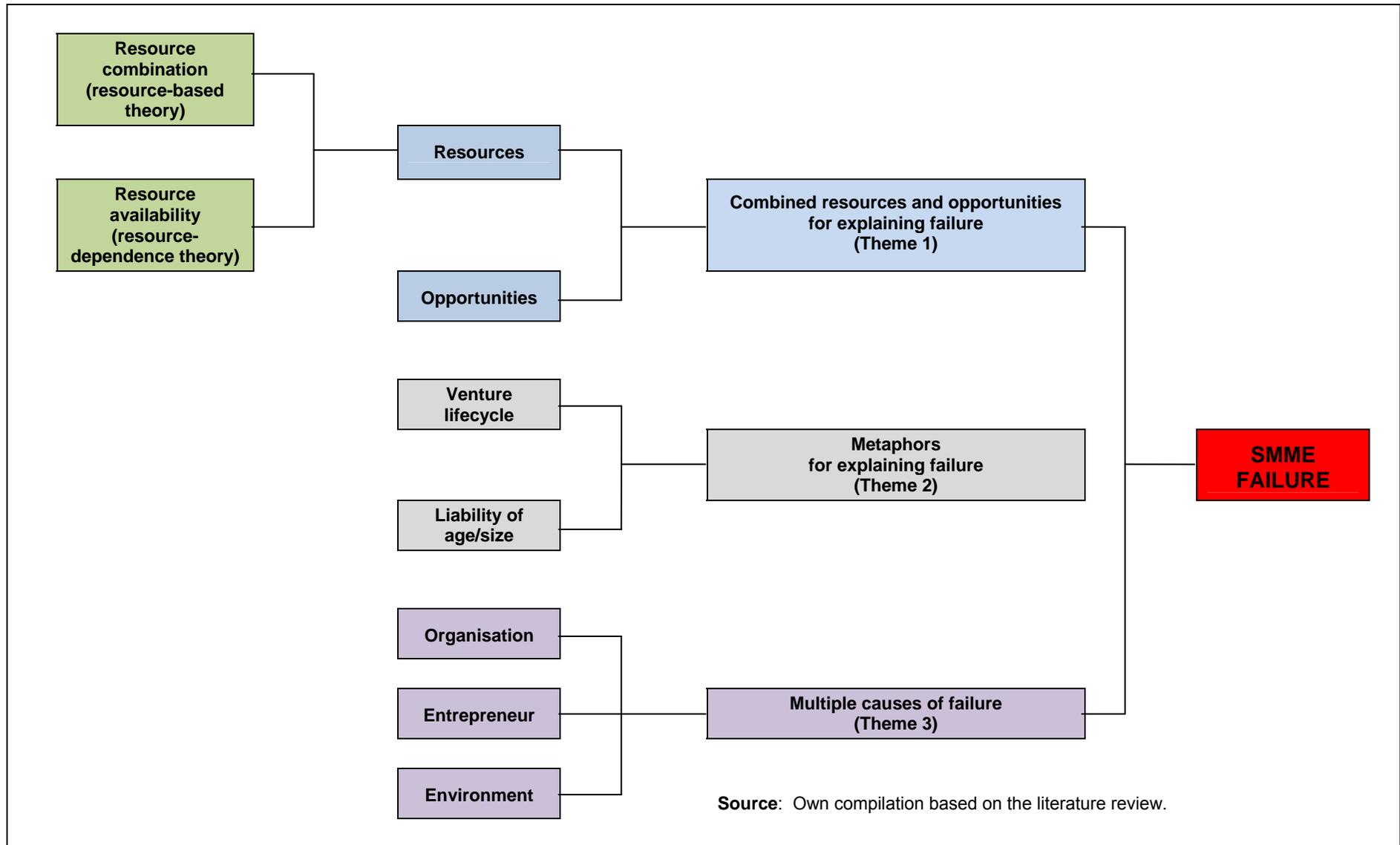


Figure 2.5: Proposed tree diagram of small business failure themes

### **2.5.1 Theme 1: “Resources and opportunities” as a perspective for explaining small business failure**

In Figure 2.5, the first of the three themes on small business failure is the theory of “resources and opportunities” as a perspective for explaining small business failure. This theme is divided into three sub-themes which are: resource availability; combination of resources, and combination of resources and opportunities. These three sub-themes are discussed later.

According to Hisrich & Peters (2002:9), the creation of a venture involves a process in which:

The entrepreneur organises and operates a venture for personal gain. He pays current prices for the materials consumed in the business, for the use of the land, for the personal services he employs, and for the capital he requires. He contributes his own initiative, skill, and ingenuity in planning, organising, and administering the venture. He also assumes the chance of loss and gain consequent to unforeseen and uncontrollable circumstances. The net residue of the annual receipts of the venture after all costs have been paid, he retains for himself.

A similar idea has been propounded by Nieman *et al* (2003:9):

An entrepreneur is a person who sees an opportunity in the market, gathers resources, and creates and grows a business venture to meet these needs. He or she bears the risk of the venture and is rewarded with profit if it succeeds.

The above business process models indicate that as soon as the entrepreneur has galvanised and mobilised all of the “building blocks”, if the venture is to succeed in continually delivering positive performance, the building blocks should remain fused together, just like cement holding bricks together. Other researchers (Watson 2003:262; Timmons & Spinelli 2007:51; 2009:106) in entrepreneurship or small business management identify with this idea by stating that entrepreneurship or small business management and development involves mainly fusion (likened to a contact sport) of the building blocks (mainly entrepreneur, resources, and opportunity), and that the outcomes are understood to be profits/rents or revenues necessary for refinancing continuing business operations. The three building

blocks are further narrowed into two main building blocks. In particular, Pretorius, Millard & Kruger (2005:56) opine the two main dimensions responsible and critically important for entrepreneurship are “resources” and “opportunities”. By implication, for continued successful small business or entrepreneurship, the mass that must remain fused together is narrowed down to resources and opportunities.

In this research it is recognised that, once the venture has been formed, often unexplored questions are: “What effect (long term or short term) does the separation of resources from opportunities have on the continued existence of a venture?” “What triggers this separation?” “Once the separation has occurred, can a venture remain in existence?”.

Two resource theories that explain the influence of resources on the survival or failure of a business organisation are: the resource-dependence theory and the resource-based theory. The resource-dependence theory is discussed first. Before discussing the issue of shortage of resources known as the resource-dependence theory, it is necessary to define “resource types”. Definitions of resources follow next.

Armstrong & Shimizu (2007:960) have observed that resources are generally defined as: all assets, capabilities, organisational processes, firm attributes, information, and knowledge controlled by a firm.

### **2.5.1.1 THE ROLE OF RESOURCES IN SMALL BUSINESS FAILURE**

In this section on the role of resources in small business failure, types of resources are discussed first.

#### **2.5.1.1.1 Types of resources**

The resource typologies (Greene & Brown 2001:161; Dollinger 1999:32) that are recognised in entrepreneurship management and development are:

- **Physical resources** (plant and equipment, and inventories)
- **Reputational/intangible resources** (reputation, brand recognition, and goodwill)
- **Organisational resources** (quality control systems, corporate culture, and relationships)

- Financial resources (cash flow, debt capacity, and new equity availability)
- Intellectual and human (scientist, production supervisors, and sales personnel)
- Technological capabilities/resources (high-quality production, and low-cost plants).

#### **2.5.1.1.2 *Small business failure: resource-dependence theory***

Sheppard (1995:28) spearheaded the resource-dependence theory. The theory's basic assumption is that organisations survive by acquiring and maintaining resources from their environments (Sheppard 1995:28; Wiseman & Bromiley 1996:530; Thornhill & Amit 2003a:497; Nieman 2006b:23). Mudambi & Treichel (2005:545), van Gelder *et al* (2007:393), Rogerson (2007:61) and Fernandez (2008:113) highlight resource-dependence theory by stating that the majority of organisations dissolved due to resource insufficiency. Barker III & Mone (1998:1229), Cardozo & Borchert (2003:1), Castrogiovanni, Combs and Justis (2006:29), Bercovitz & Mitchell (2007:61), Ahmad & Seet (2008:1074) and Townsend, Busenitz & Arthurs (2010:193) assert that a lack of resources is among the factors that shape small business fatality rates. Consequently, it is anticipated that firms will fail if they experience depletion of resources. In particular, Greene & Brown (2001:162); Wiseman & Bromiley (1996:530) and Aldrich & Martinez (2001:45) confirm that the transformation of an idea into an organisation requires that entrepreneurs acquire resources; the success or failure of a new venture is thus affected by its resource profile.

In an earlier contention, Mosakowski (1993:825) and Galunic & Rodan (1998:1193) supported the foregoing when they asserted that some unexpected occurrence in a firm's rapidly changing environment may render obsolete previously viable valuable resources. Harris *et al* (2005:226) and Thwala & Mvubu (2009:361) confirm this position. Brush *et al* (1997:318) also note that additional resources are necessary to move any venture to the next venture stage, especially during the "growth stage". A lack of additional resources, they maintain, influences venture failure due to an accelerated rate of growth which is generally known as "overtrading". The European Federation of Accountants (FEE 2004:14) supports

this contention. The resources needed for growth are then supposedly put under pressure as the venture's growth outstrips the resources that are available to support such growth.

Furthermore, as discussed by Rwigema (2005b:61) (and in Chapter 1) and Chandler & Hanks (1998:353), just acquiring and maintaining resources and opportunities is not adequate as the firm cannot develop over time without acquiring and developing additional organisational resources. Contributing to this idea, as already stated, Fernandez (2008:113) asserts that the majority of organisations dissolve due to resource insufficiency. According to Mosakowski (1993:825) and Mellahi & Wilkinson (2004:21), once the resources utilised to retain the corresponding opportunity have been acquired, the changing environment can accelerate depletion of these resources, resulting in a shortage of slack resources from a lack of resource replenishment and augmentation.

According to Sheppard (1995:32), organisational slack tends to dry up if small business poor management practices continue. Sheppard notes that when business reserves of slack resources are depleted, the firm's munificence or supportive environment (known as "coalitions" or networking) ceases. Consequently, he maintains that failure occurs when the organisation does not have sufficient resources to maintain support from critical coalitions, as in cases where firms can no longer convince suppliers that they will eventually pay. This view is supported by de Klerk & Kroon (2008:25) and Johannisson & Mønsted (1997:109). Sheppard further asserts (p.32) that firm failures can result from high indebtedness at start-up which signals the absence of resources and the presence of high debt.

Complementing the foregoing authors, Kraatz & Zajac (2001:635) note that resource endowment protects organisations from death as organisations possessing greater stocks of historically valuable resources have the capability to grow and neutralise external turbulent environments.

Table 2.3 represents a summary of evidence to illustrate that a lack of availability of resources contributes to the failure of small businesses.

**Table 2.3: Causes of businesses that have failed as a result of absence of resources and opportunities**

Evidence	Source
The key to organisational survival is the ability to acquire and maintain resources and opportunities	Sheppard (1995:28)
Absence of resources and opportunities is the underlying cause of venture failure	Sheppard (1995:28) Carter, Williams & Reynolds (1997:128) Greene & Brown (2001:163) Baldwin <i>et al</i> (1997:26) Brush <i>et al</i> (1997:315) Chandler & Hanks (1998:353) Galunic & Rodan (1998:1193) Bergmann Lichtenstein & Brush (2001:38) Brush <i>et al</i> (2001:64)
Without an opportunity, or absence of the key resources, the entrepreneurial process is likely to result in failure	Kodithuwakku & Rosa (2002:434)
Organisations survive by acquiring and maintaining resources from their environments	Sheppard (1995:28) Thornhill & Amit (2003a:497)
Some unexpected occurrence in a firm's rapidly changing environment may destroy previously viable valuable resources	Galunic & Rodan (1998:1193)
Additional resources are necessary to move a venture to the next venture stage, especially during the "growth stage": a lack of additional resources influences venture failure due to the accelerated rate of growth known as "overtrading". The resources needed for growth are under pressure as growth is faster than the resources that are available to support growth	Brush <i>et al</i> (1997:318) FEE (2004:14)
The firm cannot develop over time without acquiring and developing additional organisational resources	Bergmann Lichtenstein & Brush (2001:38)
The conclusions indicate that the majority of the organisations dissolved due to resource insufficiency	Fernandez (2008:113)
Organisations face a period of zero mortality risk immediately following their founding because they can live off their stock of initial resources. The greater the initial resources of a firm, the longer the period of "adolescence" and the lower the peak death rate. The death rate reaches a peak soon after the period of adolescence is over and continues to decline thereafter	Thornhill & Amit (2003a:497)
Firms can be viewed as composites of various resources	Bruton & Rubanik (2002:553)
Without an opportunity there is no entrepreneurship	Alsos & Kaikkonen (2004:1)
No success can happen unless an opportunity is present	Rwigema (2005b:61)
<b>Source:</b> Own compilation based on the literature review.	

### **2.5.1.1.3 Small business failure: resource combinations**

According to Wu (2006:451) and Sheppard (1995:33), “if a firm cannot obtain the proper mix of resources, it will eventually fail”. The resource-based theory was spearheaded by the work of Wernerfelt (1984:184) and Barney (1991:99). The theory was developed and chosen among other resource-based alternatives, such as “neo-classical microeconomics” and “evolutionary economics”, as a means of explaining that the lack of a sustainable combination of salient resources contributes to venture failure. These resource-based theories are applied for studying rents/profits generated by the ability to develop new capabilities, while evolutionary resource-based theories are used for studying the process by which these new capabilities are developed (Barney 2001:649). Since its diffusion into strategic management, the resource-based theory has been used as a framework for explaining the conditions under which a firm may gain a sustained competitive advantage, resulting in consistently outperforming other firms.

The foregoing models explain why some firms perform better than others based on the nature of the resources they combine optimally and control. According to Barney (1991:99), Peng (2001:803) and Runyan *et al* (2007:392), the key to competitive advantage is for small businesses to be able to sustain the advantages gained from superior resource combinations and deployment. Consequently, small businesses fail when they cannot (and do not) make the best use of resources.

According to Brush *et al* (2001:64), each resource choice has an important implication for business survival and growth. These choices are expected to show negative consequences if the wrong resources are acquired, if they do not fit the opportunity, or waste other productive resources. In particular, two salient resources whose absence is reported to contribute to failure of SMMEs are financial resources (Greene & Brown 2001:163) and human resources (Cooper, Gimeno-Gascon & Woo 1994:371). Thus, according to the resource-based theory, firms can gain sustainable competitive advantage over their competitors if they can obtain a resource supply that is unique when compared with their competitors.

Ventures that are unable to protect their resource base face high prospects of failure.

Improper configuration of salient resources debilitates a firm in the face of its competition. The firm's final downward spiral occurs when opportunities have been whittled away by competition (Rwigema 2005a:42). In this way, they may end up with diminished market demand. No market demand may imply that no revenue is received. Hence, firm overheads may remain relatively high due to underutilised assets. Slack resources may be in excess in relation to eroded opportunities. Consequently, there may no longer be any reason for their existence. These theories assert that companies exist for customers. Thus, no customers will imply no business (Drucker 2007:95). In summary, the absence of resources and unsuspected shortage of revenue for continued financing may lead to inefficiencies terminating in venture failure.

According to Thornhill & Amit (2003b:2), the resource-based theory of the firm depicts firms as heterogeneous bundles of idiosyncratic, hard-to-imitate (inimitable) resources and capabilities. For example, the lower the resources and the lower the opportunities, the more predisposed is the venture to failure. Bruton & Rubanik (2002:553) concur with the foregoing by asserting that firms can be viewed as composites of various resources (Figure 2.6). In stable economies, these authors note, young firms are said not to perform well. The underlying reason for such a liability of newness is the limited resources available to young firms (p.553).

Different levels in the combined resources with entrepreneurial opportunities also affect the fate of businesses (Smith, Matthews & Schenkel 2009:38) (Figure 2.6).

The next section addresses the role of opportunities combined or in isolation in the process of small business failure.

#### **2.5.1.2 THE ROLE OF OPPORTUNITIES IN SMALL BUSINESS FAILURE**

Wickham (2001:77) and Rwigema (2005d:159) define an "opportunity" as the gap left in a market by those who currently serve it. It represents the potential to serve customers better than they are being served at present.

In discussing the role of opportunities in small business failure, types of opportunities are discussed first.

### **2.5.1.2.1 Types of opportunities**

According to Eckhardt & Shane (2003:340) and Smith *et al* (2009:39) opportunities manifest themselves in a variety of ways. The aforementioned researchers categorise “opportunities” into:

- The locus of the changes that generate the opportunity;
- The source of the opportunities themselves;
- The initiator of the change (p340).

Eckhardt & Shane (2003:340) maintain that, in addition to opportunities resulting from the changes in products or services, they can also result from changes in the value chain. According to them, the loci of these changes resulting different opportunities are:

- Those emanating from creation of new products, or services,
- Those that stem from discovery of new geographical markets,
- Those that emerge from discovery of new raw materials,
- Those that emerge from new methods of production, and
- Those that are generated from new ways of organising (p340).

Eckhardt & Shane (2003:341) assert that once a profit-yielding opportunity has been obtained, it is important to understand how to retain it which involves understanding its type and its source of origin. They note that opportunities vary depending on their sources. Three types of opportunity by source from their origin are:

1. Information asymmetry versus exogenous shocks – “changes in technology, regulation and other factors generate new information about how resources might be used differently” (p341). This process allows the first set of economic actors to exploit the profitable opportunity less expensively than followers;
2. Demand-and-supply opportunities – profitable opportunities can also be classified on the basis as to “whether the changes that generate them exist on the demand- or supply-side” (p.343); and

3. Productivity-enhancing versus rent-seeking opportunities – opportunities can be categorised according to their profitable productivity-enhancing or rent-seeking properties (p.344).

Opportunities are also classified by Eckhardt & Shane (2003:341) according to their change-initiator dimension in which different types of entities initiate the changes (for example, changes initiated by government, universities, industrial changes) that result in different types of profitable entrepreneurial opportunities. How then do opportunities explain small business failure?

#### **2.5.1.2.2. *Small business failure: absence of opportunities***

Following from the above arguments on the different types of opportunities, Alsos & Kaikkonen (2004:1) assert: “without an opportunity there is no entrepreneurship”. Their contention supports Shane & Venkataraman (2000:220). This should be understood in the light of the entrepreneurial process as defined by Hisrich & Peters (2002:9) where resources are seen as essential for the retention of an opportunity, whilst an opportunity is responsible for dictating the size of corresponding resources. The foregoing is thus understood as implying that every firm exists to exploit an opportunity/demand (Drucker 2007:95). Without an opportunity, the researchers reviewed maintain that there can be no business success.

The theories in this area of business failure therefore state that profitable opportunities constitute the main reason for the existence of every business (small or large). Opportunities yield the revenues and the profits required for venture refinancing and for moving the small business towards the next development stages (Hoy 2008:152).

In support of the themes enunciated above, Rwigema (2005b:61) emphasises the significance of opportunities in driving the venture forward by asserting that no success can happen unless an opportunity is present. Extending on this idea, Hisrich & Peters (2002:9) also concede that the reason an entrepreneur mobilises resources is to grab an opportunity and that if, at any time during the lifespan of the venture, an opportunity is detached from the venture or ceases to exist, then they contend that one cannot have the business any more. The same researchers

maintain that opportunities are market driven and, by their nature, yield the profits or revenues needed to refinance business ventures. Rwigema (2005b:61) has indicated that once an opportunity is whittled away by competition, the venture can face low demand. This assertion is corroborated by Drucker (2007:95).

### **2.5.1.3 THE ROLE OF COMBINED RESOURCES AND OPPORTUNITIES IN SMALL BUSINESS FAILURE: ABSENCE OF RESOURCES AND OPPORTUNITIES**

As stated earlier (Section 2.6.1.1.2), according to Sheppard (1995:28), the key to organisational survival is the ability to acquire and maintain resources and opportunities. The absence of resources and opportunities as the underlying cause of venture failure in the entrepreneurial process is well documented (Sheppard 1995:28; Carter *et al* 1997:128; Greene & Brown 2001:163; Baldwin *et al* 1997:26; Brush *et al* 1997:315, 2001:64; Chandler & Hanks 1998:353; Galunic & Rodan 1998:1193; Bergmann Lichtenstein & Brush 2001:38).

Kodithuwakku & Rosa (2002:434) emphasise that,

Without an opportunity, or absence of the key resources, the entrepreneurial process/small business management is likely to result in failure.

The same researchers (p.434) also assert:

The entrepreneurial process is opportunity-driven, creative, resource-efficient and driven by a lead entrepreneur or entrepreneurial team.

From the foregoing, it is clear that opportunities are related directly by the researchers to resources – that is, the larger the opportunity, the greater the required resources. The reverse also holds that the quality and quantum of resources determine the degree of opportunity realisation (Rwigema 2005a:25). The resources and opportunities “recombinations”, understood to be the fusion or mix between resources and opportunities, are continually in a state of flux. Mathematically the foregoing assertions can be represented as:

**Resources < = > Opportunities**

Rwigema (2005a:25) and Kodithuwakku & Rosa (2002:434), in this area of failure of SMMEs, state that the availability of resources implies the existence of opportunities, whilst the existence of opportunities implies a need for resources. In a way, it is clear that resources are key for capturing and sustaining opportunities, whilst opportunities are key for sustaining resources (Michael & Combs 2008:73). By implication, there is a two-way feedback loop and mechanism operating as a process whereby resources need opportunities, whilst opportunities need resources. For a business to remain a going concern, they argue that resources must always be available to capture and retain the opportunity and simultaneously an opportunity must always exist for yielding profits to refinance and keep the venture afloat. Daubie & Meskens (2001:1) contribute to this argument by stating that the starting point of the process of failure is an insufficiency of revenue and poor profitability. Thus, for a venture to exist, they express the idea that the resources and opportunities must be inseparable. Van Witteloostuijn (1998:503), for example, opines that immediate exit occurs when profitability falls below zero, and the firm decides (or is coerced) to exit. By implication, their framework implies that no resources will imply no opportunity exploitation and, vice versa, no opportunity implies no need for resources.

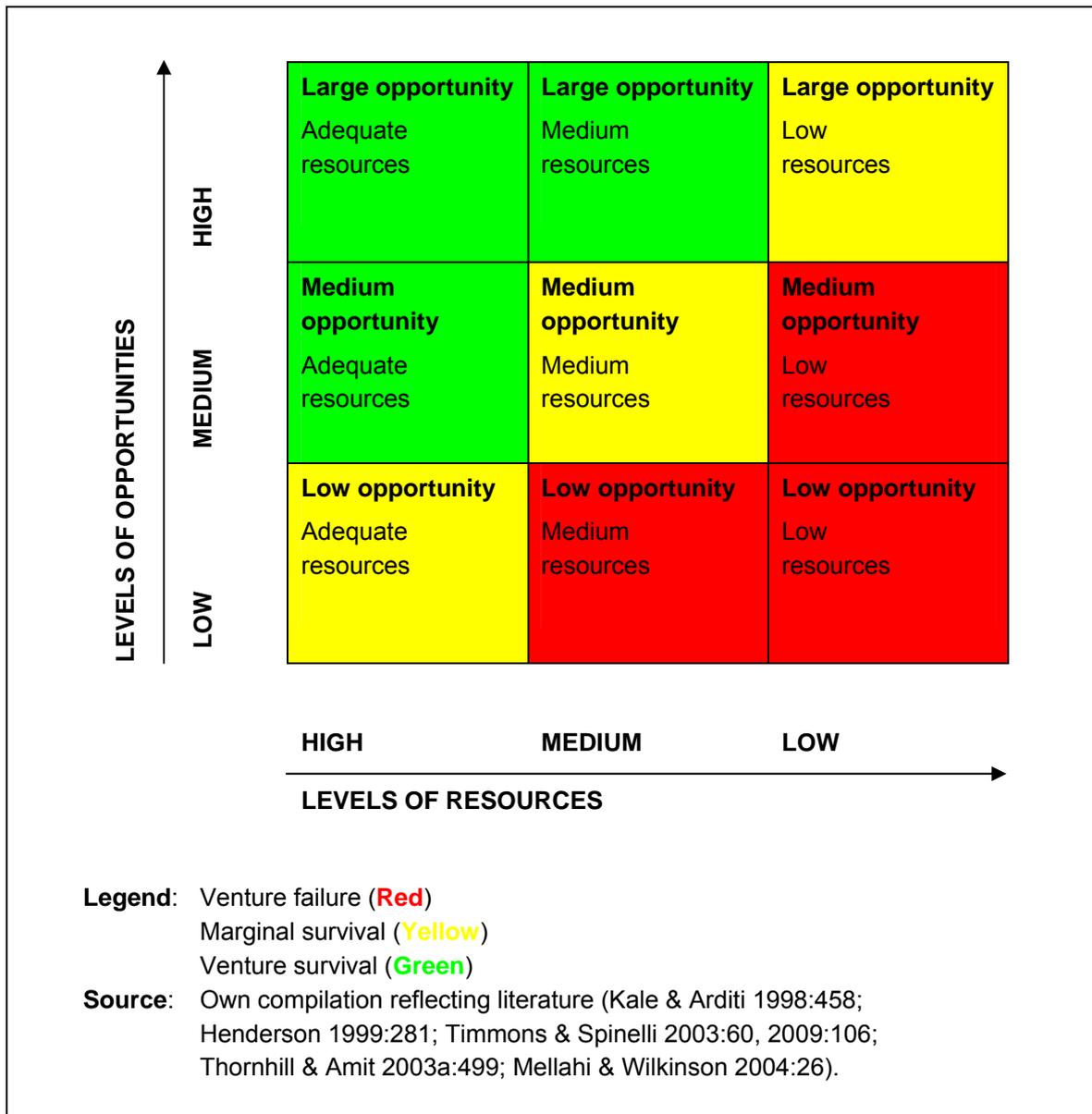
Gleaning from past researchers' understanding of the failure phenomenon, a deeper understanding of causes of small business failure could have been achieved by considering different combinations in levels of resources with opportunities. These combinations are illustrated in Figure 2.6.

In Figure 2.6, the resource and opportunity combinations concept has been used to explain that at each point during the venture life stages, there are combinations between resources and opportunities which define whether a venture remains in existence or ceases (Timmons & Spinelli 2003:56; 2009:555). Thus, the lethal combination (marked in red in Figure 2.6) between the absence of resources and absence of opportunities emanates from the unexpected revenue (opportunity) loss as well as reduced resource slack. As previously asserted, when the resource slack dries up, a situation can ensue in which the opportunity can no longer remain attached to the small business. The absence of both resources and opportunities are explained as being responsible for triggering the failure process (Sharma &

Mahajan 1980:84; Flynn & Forman 2001:42; Kodithuwakku & Rosa 2002:431; Ooghe & De Prijcker 2008:226). The small business is then expected to face a situation of no sales demand. Such a situation, Drucker (2007:95) stresses (Section 2.6.1.1.3), is unfortunate in that every business exists to create a customer in exchange for revenues.

How long the resources and opportunities stay glued together is known as the opportunity “half-life”, explained as the time the small business lasts before failure or separation between resources and opportunity occurs.

Figure 2.6 illustrates the half-life concept by considering the combinations between resources and opportunity bundles before disintegration and disentanglement around each stage over the venture lifespan. The half-life can be of a short duration or prolonged duration (Eckhardt & Shane 2003:340). The half-life theory also states that different combinations in resources and opportunities at any time over the venture lifespan represent a different firm type. These types of combinations (Figure 2.6) may range from a failed firm (marked in red), a marginally surviving firm (marked in yellow) or a completely surviving (successful company) (marked in green). It all depends on the level of combinations of the different resources and opportunities.



**Figure 2.6: Proposed opportunity-resource propensity small business failure model**

Figure 2.6 is based on the premise that the aim of every business is firstly to ensure its continued existence which can lead to success with time. This view appears also in Figure 3.3. Rogerson (2000:687) holds a different view to the foregoing as he believes that most small businesses tend to grow at a rate of only 1 %. This is evidence of stagnation in growth trends. When small businesses have stagnated, their propensity to fail is often expected to be high. To answer

what causes the inefficiencies within small businesses, this section focuses on the resources and opportunities combinations resulting in the small business' failure.

Figure 2.6 also illustrates that the propensity for failure is contingent upon the levels of combination of resources and opportunities (resource bundles) (Amit & Shoemaker 1993:33; Thornhill & Amit 2003a:498) (Section 2.6.1.1.3). The model indicates as a suggestion that, to reduce high failure rates, small businesses should strive to combine their resources and opportunities optimally such that in Figure 2.6 they move from the right bottom corner of low-low (in red) to combining resources and opportunities ending with a high-high configuration (in green) in the top left corner.

Considering both the resource-dependence discussions and resourced-based theories, the question that should be answered is: "Why some small businesses fail whilst others succeed, given similar external environmental conditions?". The answer, it seems, lies in the fact that the failure of small businesses is contingent upon the combinations of resources and opportunities in Figure 2.6. The lower the resources and opportunities at each and every stage in the life cycle of the venture, the more predisposed to failure is the venture. All of the configurations in the resources and opportunities result from the owners' skills in acquiring and deploying resources and opportunities (Eckhardt & Shane 2003:334). Several researchers (for example, Brush *et al* 1997:315, 2001:64) concur that the origin of failure in small business lies in the improper configuration between salient or critical resources and their corresponding opportunities as in Figure 2.6. The configurations between salient resources and the opportunities against time should be from right to left and from bottom to top (Figure 2.6).

The combinations are governed by the continuum in resources and opportunities. The X-axis constitutes the resources continuum, which stretches from ample resources at venture creation to depleted or scarce resources just before venture failure. The Y-axis constitutes the opportunities continuum which stretches from large or growing opportunities at venture creation to low opportunities just before failure. Thornhill & Amit (2003a:497) as well as Brush *et al* (1997:315) concur that the extent of firms failing would be reduced if resources and opportunities are in favour of optimal intensity, that is high-to-medium and high-to-high (green to

green). They have studied these outcomes in firms only at early stages (new firms) and later stages (older firms). There is, therefore, a need to consider the entire range of resource and opportunity configurations over the entire venture life cycle (Figure 2.6).

Finally, Figure 2.6 can therefore be understood to represent the status of resources and opportunities which serves as a failure propensity model in small businesses by revealing the different combinations resulting in different exposure to failure. Understanding the various propensities for failure could promote small businesses from marginally surviving to complete survival and growth.

In Figure 2.6, the different combinations in resources and opportunities can be likened to the venture life-cycle model. The combinations in resources and opportunities models propensity for survival, whilst the venture life cycle has to do with small business management style and capability skills at each and every stage. Small businesses at birth or immediately thereafter face numerous fatal problems mainly due to inadequacies in resources – specifically, financial and human capital (Kale & Arditi 1998:499; Henderson 1999:281; Timmons & Spinelli 2003:60, 2009:252; Thornhill & Amit 2003a:499). Financial capital as well as human capital are the main resources seen as critical to launch the small business (Greene & Brown 2001:163; Brush *et al* 2001:64). The choices may even have negative consequences if the wrong resources are acquired, if they do not fit the opportunity, or if they waste other resources. In order to stay in business (in green in Figure 2.6), small businesses are expected to strive for high-high from low-low combinations (in red in Figure 2.6) of resources and opportunities. The merit of Figure 2.6 lies in the fact that it analyses the levels of resources and opportunities in small businesses before failure.

The gaps in the resource and opportunities theories are discussed below.

#### **2.5.1.4 CRITICALLY EVALUATING THE USE OF RESOURCES AND OPPORTUNITIES IN UNDERSTANDING THE FAILURE PHENOMENON**

The manner in which resources and opportunities become available – and also how they combine – serves as an excellent indicator to alert business owners as

to how resourceful the business is. This can lead to superiority over the competition as a result of optimum resource deployment. Unfortunately, the resource-based theory can only remain a resourced-based view and not a resourced-based theory like many researchers contend (Priem & Butler, 2001:36). This means that, without being a theory of competitive advantage, the resourced-based view therefore has no explanatory and predictive powers generally associated with theories – for example, it has no power of both explaining and predicting causes of failure of small businesses. The resource-based view does not meet the empirical content criterion required of theoretical systems (Priem & Butler, 2001:36). As a result of the foregoing assertions, the business owner needs to take cognisance of the fact that the fate of the small business is in the hands of the owner (Danermark *et al* 2006:200).

A major flaw of the deterministic view of the resource and opportunity perspective of failure is its set of regularities (repetitive data trends) that order and predict predisposition to failure (due to non-adherence to business management principles). This one-shoe-fits-all deterministic description falls short of causal explanations. To reduce the high failure rate of small businesses, it is critical to understand that causal analysis is more important than descriptive analysis.

Ultimately, at the crossroads of low resources and opportunities, or through incorrect combinations, there lies the value judgement or choice of the owner to opt to survive or close down. In summary, the fate of the small business lies with the owner (Eckhardt & Shane 2003:334).

### **2.5.2 Theme 2: “Metaphors” as a perspective for explaining small business failure**

In Figure 2.5, the analogy between business “failure” and “mortality” is a useful metaphorical device, but it should not be misconstrued. So, as one continues to analogise between a business’ failure and its death, it needs to be seen as a metaphor and should not be taken literally (Bruton & Rubanik 2002:553).

In Figure 2.5, the second of the three themes identified to explain the causes of small business failure is in the form of analogies of failure described as metaphors

of the “liabilities of age/size” and “venture life cycle”. These metaphors are a further manifestation of the absence of resources and opportunities according to the first theme. According to Bruton & Rubanik (2002:553), one can understand different aspects of complex organisations by using metaphors. Two types of metaphors that are generally used for understanding the failures or successes of business organisations are the “liabilities of age/size” and “venture life cycle”.

The life-cycle stages clearly depict the different management styles in controlling the levels of resources and opportunities. To describe the influence of the owners’ mismanagement on the failure of small businesses, metaphors are sometimes used to create imageries of small business failure in accordance with the absence of resources and opportunities at each and every point along the venture life cycle. Different researchers have used metaphors to crystallise various ideas about the nature of the organisations. These metaphors are discussed in the next section, starting with the venture life cycle, followed by the liabilities of failure.

#### **2.5.2.1      *EXPLAINING SMALL BUSINESS FAILURE IN TERMS OF VENTURE LIFE-CYCLE METAPHORS***

According to Wickham (2001:355, 2006:408), the notion of “life cycle” suggests that the organisation undergoes a pattern of growth and development much like a living organism. “Life” for an organisation is consists of a series of different stages: it is born, grows, matures and eventually ages and dies. This pattern is supposed to be pre-programmed/predictive and the changes that take place are both unavoidable and irrevocable (deterministic).

From a practical sense or view, the notion of “life-cycle” metaphor portrays venture failure in terms of the inability to manage resources for optimal retention of the opportunity, develop, mobilise and re-configure the resources needed for growth over the venture life cycle. Wickham (2001:355, 2006:408) further classifies the metaphors depicting organisational changes into several types: windows of opportunity, life cycle, evolution, and the dialectic (success-failure continuum) which is also supported by Pretorius (2006:226). As businesses exist only when resources and opportunity remain fused as alluded to in the previous sections, the fusion or a lack thereof may reveal the different issues involved at each phase that may overwhelm the venture such as venture strategic positioning, operational,

sales/marketing, human and capital resources. It seems, therefore, that the venture life cycle can reveal the potential imbalances or obstacles between resources and opportunities, creating a situation of depleted resources followed by the loss of the opportunity.

In support of the previous arguments on metaphors, Wickham (2001:356, 2006:409) also contends that, as a metaphor, the life-cycle evolution reminds the venture owner that he/she is operating in a competitive environment, that he/she must compete for scarce resources and that the venture must be efficient. Wickham (2001:356, 2006:409) notes that small businesses experience obstacles that dominate each and every phase over the venture life cycle. Understanding the venture life-cycle metaphor is tantamount to investigating how owners of SMMEs negotiate such hurdles in their decision making at crisis points in their life cycle to achieve their firms' growth and development (Moy & Luk 2003:201).

Churchill & Lewis (1983) pioneered and proposed six phases of venture growth: conception/existence; survival; profitability/stabilisation; profitability/growth; take-off, and maturity. Since then the venture life-cycle phases have evolved to four: inception, growth, maturity and decline.

According to Timmons & Spinelli (2003:561, 2007:535, 2009:555), there are five stages in the life of every growing firm: wonder, blunder, thunder, plunder and asunder. At each and every stage of the venture life cycle, before the next stage or phase there is always a possibility of failure. For example, a lack of successful and proper management during the "wonder" and "blunder" stages predisposes the small business to failure, due to a lack of management of capital and sales with demand.

Timmons & Spinelli (2003:561, 2007:535, 2009:555) opine that during the next growth stage, "thunder", if growth issues such as sales and marketing leading to overtrading are not properly controlled, the penalty is the danger of collapsing. During the "asunder" stage, a lack of adequate innovation in the presence of competition leaves the venture vulnerable to failure as resources or slack are insufficient to hold resources and opportunity together. Competition exploits this

management weakness by introducing innovative product offerings, thereby whittling away the opportunity originally held by the venture.

Other researchers (Dodd 2002:527; Coelho & McClure 2005:17) treat the concept of “venture life cycle” metaphorically with “human life and death”. They maintain that there is no need for panic if small businesses experience high failure rates as small businesses are naturally born to die. Accordingly, every human born is destined to die (Dodd 2002:527). But, if humans had their way, “individuals would typically wish to postpone death indefinitely, yet it is the inevitable end for all living organisms” (Coelho & McClure 2005:17). Similarly, all ventures created are at some age believed to be destined to fail. This is a typical deterministic model. As iconic large companies like Coca-Cola and McDonald’s, for example, have been in business for over 100 years, this research does not support the age dependency liability theories that small businesses are necessarily born and some day to die.

According to Kuratko & Hodgetts (2001:495), at each of the phases, the entrepreneur is faced with different performance problems. The set of problems to be negotiated by the owner resembles hurdle points over a hurdle race. The initial stages are known for management and product introduction issues. Issues of a strategic nature, including prospects for survival, dominate this stage. Growth management dominates the second stages. Too rapid growth is often followed by overtrading issues and additional resources are needed to sustain growth (FEE 2004:14). Management and systems problems dominate these stages (Table 2.4). Similar issues to the second stages dominate the maturity stages. The last and declining stages are overwhelmed with intense competition as well as new product innovations. Issues of survival are also paramount. These researchers (2001:495) confirm that firms that fail to innovate at this phase normally die. In summary, the owner-manager is then expected to be faced with various management issues over the venture life cycle.

There is an alternative way of looking at the above venture life cycle in terms of resources and opportunities over the entire small business’ lifespan (Brush *et al* 1997:318; Kodithuwakku & Rosa 2002:434). The foregoing authors have named this alternative life cycle the “resource and opportunity life cycle”.

**Table 2.4: Table of management issues over a venture's life cycle**

Life stage and management issues	Source
<p><b>Start-up stage</b></p> <p>Entrepreneurial weaknesses</p> <p>Marketing and financial</p> <p>Survival</p>	<p>Rwigema (2005a:47)</p> <p>Kuratko &amp; Hodgetts (2001:495)</p> <p>Nieman <i>et al</i> (2003:241)</p>
<p><b>Growth stage</b></p> <p>Rapid growth issue</p> <p>Competition and market forces</p> <p>Lack of maintenance of profitability and acquiring resources</p>	<p>Rwigema (2005a:47)</p> <p>Kuratko &amp; Hodgetts (2001:495)</p> <p>Nieman <i>et al</i> (2003:241)</p>
<p><b>Maturity stage</b></p> <p>Managerial weaknesses</p> <p>Competition issues</p> <p>Lack of innovation issues</p> <p>Inadequate profits</p>	<p>Rwigema (2005a:47)</p> <p>Kuratko &amp; Hodgetts (2001:495)</p> <p><i>Nieman et al</i> (2003:241)</p>
<p><b>Decline stage</b></p> <p>Entrepreneurial weaknesses</p> <p>Firms' failure to innovate and subsequent demise</p>	<p>Rwigema (2005a:47)</p> <p>Kuratko &amp; Hodgetts (2001:495)</p>
<p><b>Source:</b> Own compilation based on literature review.</p>	

According to this model, resources are deemed necessary to propel the venture to the next venture stage (Brush *et al* 1997:318). This can happen only if the venture is profitable (Koksal & Arditi 2004:9), and is continually earning revenues resulting from the opportunity for refinancing the venture at each of the venture stages. Ventures are expected to perform above their thresholds. It is also theorised that ventures that experience unexpected loss of revenue exit the marketplace.

The rationale for the discussion of the venture life-cycle concept in this research is to highlight that, at each stage in the life cycle, there is a set of management skills needed to keep the venture afloat. The reason for survival or failure emanates from the absence of resources and opportunities at each of these stages (resource and opportunity bundles that change along the venture life cycle). For example, once a business owner has graduated from a new venture start-up, he/she has learnt from past experience (Minniti & Bygrave 2001:9) and therefore is ready to steer the venture towards the next phase of growth, maturity and decline, or, having innovated, continues along the continuum of venture success and prosperity. Given this, the model indicates that failure can therefore result from the interactions of several environmental factors and demands along the growth paths over the venture life cycle, such as customers, suppliers, competitors and intermediaries from the market domain. In the theory, failure results at any of the venture life-cycle stages from, for example, mismanaged strategy leading to limited resources and lack of innovativeness. Each of the growth phases is presented as having variables that can potentially cause venture failure.

**Table 2.5: The life cycle of a venture with its corresponding liability phase**

Life-cycle stage	Liability phase	Management issues	Source
Start-up life-cycle stage	Newness	Marketing and financial issues Inadequate product demand Venture undercapitalisation issues Survival issues	Kuratko & Hodgetts (2001:496) Timmons & Spinelli (2003:563, 2009:555) Nieman <i>et al</i> (2003:241)
Growth life-cycle stage	Adolescence	Business management and strategic issues Overtrading issues Financial acquiring additional resources for growth Efficiency issues	Kuratko & Hodgetts (2001:496) Timmons & Spinelli (2003:564, 2009:555) FEE (2004:14) Nieman <i>et al</i> (2003:241)
Maturity, stabilisation and decline life-cycle stage	Obsolescence/Ageing	Competition issues Lack of innovation and creativity issues Cash-shortage issues	Kuratko & Hodgetts (2001:496) Timmons & Spinelli (2003:564, 2009:555) Nieman <i>et al</i> (2003:241)
<b>Source:</b> Own compilation based on literature review.			

Table 2.5 shows the life cycle of a venture with its corresponding liability phase and indicates that it is important to treat the process of business growth as phases/stages with time lines or ages understood as business management styles or as metaphors of a life cycle. Each phase of the life cycle, as Engelbrecht (2005:444) points out (Table 2.5), has the following characteristics:

- Managerial style;
- Organisational structure;
- Extent of formal systems;
- Major strategic goals; and
- The owner's involvement in his/her business.

For the sake of clarity, it is appropriate to consider these major characteristics at each phase of the venture life cycle. This is discussed next.

At venture start up, with the liability of newness (Table 2.5), marketing and financial constraints are paramount in causing venture failure because financial resources are needed to start and propel the venture to the next stage, which is liability of growth and adolescence (Brush *et al* 1997:315). van Eeden *et al* (2003:14) found from their survey of South African ventures that inexperience in the field of business (especially lack of technological knowledge) and inadequate managerial skills are the most prominent reasons for failure, especially in the start-up phase.

Engelbrecht (2005:445) concurs with the foregoing by stating that where start-up funds cannot be stretched to cover start-up losses, it is the entrepreneur's responsibility to terminate the venture. If the venture suffers from initial high indebtedness and faces too little revenue, it is predicted that the business will be unable to attract further financial capital due to its lack of legitimacy (Kuratko & Hodgetts 2001:363). At venture growth phase, McPherson (1995:3) and Kuratko & Hodgetts (2001:363) maintain that, once the business has been successfully established and begins to suffer from inability to handle growth, this leads to deterioration and eventual failure of the business. McPherson and Kuratko & Hodgetts concur that inefficient ventures will then decline and exit, while efficient firms survive and grow.

Pretorius (2006:235) supports these assertions that competition and other market forces can call for strategic changes in the small business management process. He notes that too fast growth with insufficient resources is predicted to result in the phenomenon of the “overtrading effect” (p.235). Rwigema (2005a:38) supports this idea by asserting that the act of conducting business consumes cash. Pretorius and Rwigema independently contend further that a growing business consumes more cash and, without additional revenue, the venture can collapse with dire consequences.

During the “stabilisation stage/phase” or “mature stage”, with its liability of obsolescence, the market conditions and the entrepreneur’s efforts drive the venture’s stability, competition begins to intensify, requiring tremendous amounts of innovation for the next venture stage. Failure to respond adequately is then expected to lead to systems trouble (Pretorius 2006:234).

At the stage of “venture innovation and decline”, accompanied by its obsolescence phase, the need to innovate is paramount. Without it, the venture is expected to be forced to exit the marketplace as a result of intense competition. As previously stated, Kuratko & Hodgetts (2001:496) confirm that firms that fail to innovate will die. They support this idea by stating that, without innovation, opportunity is whittled away by competition even when resources are in abundance. They conclude that strategically management becomes weakened and the competitive landscape overwhelms the ability of the owners of businesses to survive.

In summary, the venture life cycle discussed is based on the idea that businesses follow some predetermined stages, culminating in their ultimate closures because the forces working in favour of failure are presented as being stronger than those working in favour of survival. This idea of opposing forces or power conflicts in the life of small businesses has been elaborated by researchers such as Wickham (2001:356) who contend that the business management process occurs within the framework of a dialectic of opposing causal powers.

### **2.5.2.2 EXPLAINING SMALL BUSINESS FAILURE IN TERMS OF LIABILITY METAPHORS**

Small business failure is now discussed in terms of the liability metaphors of age and size (Figure 2.5).

#### **2.5.2.2.1 Liability of age and size as a factor of small business failure**

Liability metaphors are used as analogies to clarify the understanding of the small business failure phenomenon.

#### **2.5.2.2.2 Liability of age of small business as a factor of small business failure**

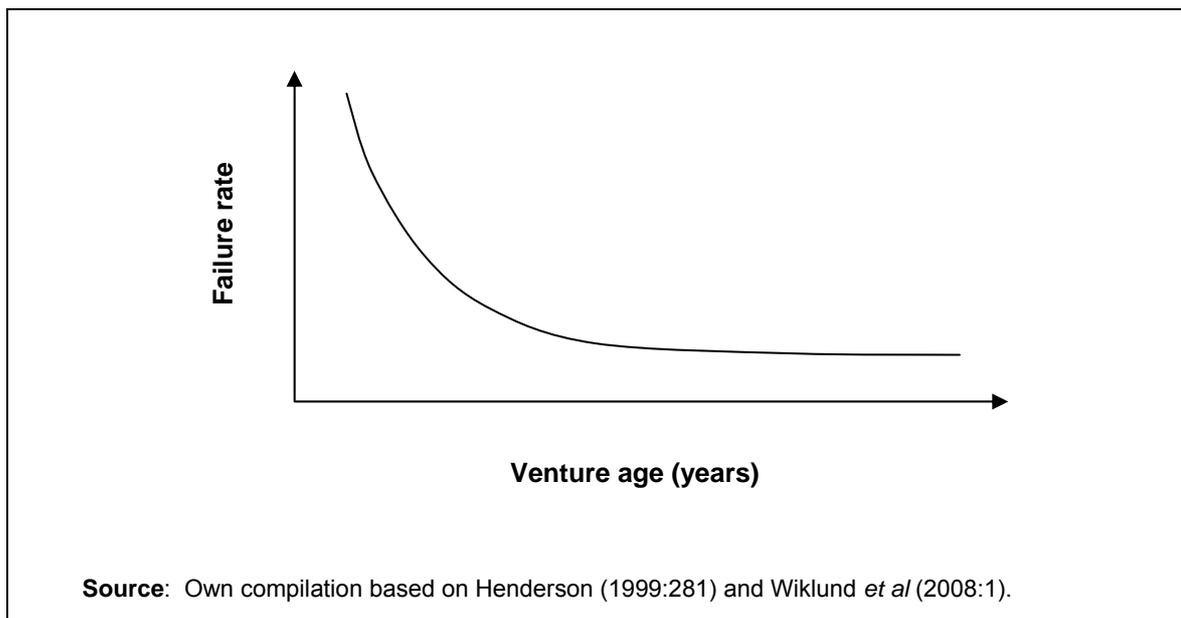
Stokes & Blackburn (2002:19) and Cressy (2006:113) contend that the age-dependency failure rates are highest in the early years after venture start-up, and decline as the business ages. They contend that younger firms tend to close at a higher rate than older ones. This metaphorical phenomenon is well documented as “the liability of newness”. Ventures that are *de novo* (new) have less experience in marketing, finance, managing, control, and leadership. Initial financial resources are thus depleted through time due to a lack of experience and expertise. Consequently, financiers are unenthusiastic about lending large sums of money for business development and start-up to newly established ventures as their expertise in running businesses is at this stage generally questionable. Statistically, according to Stokes & Blackburn (2002:19), a one percentage point change in age leads to a 13 % change in the probability of survival.

The liability of newness has often been connected with firm failure. The term today is typically associated with a broader meaning that more accurately implies the inability of a new firm to prosper. Thus, both resource theory and the literature on the liability of newness recognise that resources are critical to firm growth (Bruton & Rubanik 2002:557).

According to Henderson (1999:281) and Wiklund *et al* (2008:1), age dependence as a liability of newness predicts that failure rates decline with age as roles and routines are mastered, and links with external constituents established. This

implies that a “survival of the fittest” situation in small business selection processes favours the relatively older, more experienced organisations.

Figure 2.7 portrays Henderson’s (1999:281) framework indicating that failure rates decrease monotonically with age. The model shows that there is a negative relationship between old age of the small business and the failure rate: the older the business, the lower the likelihood that it will fail.



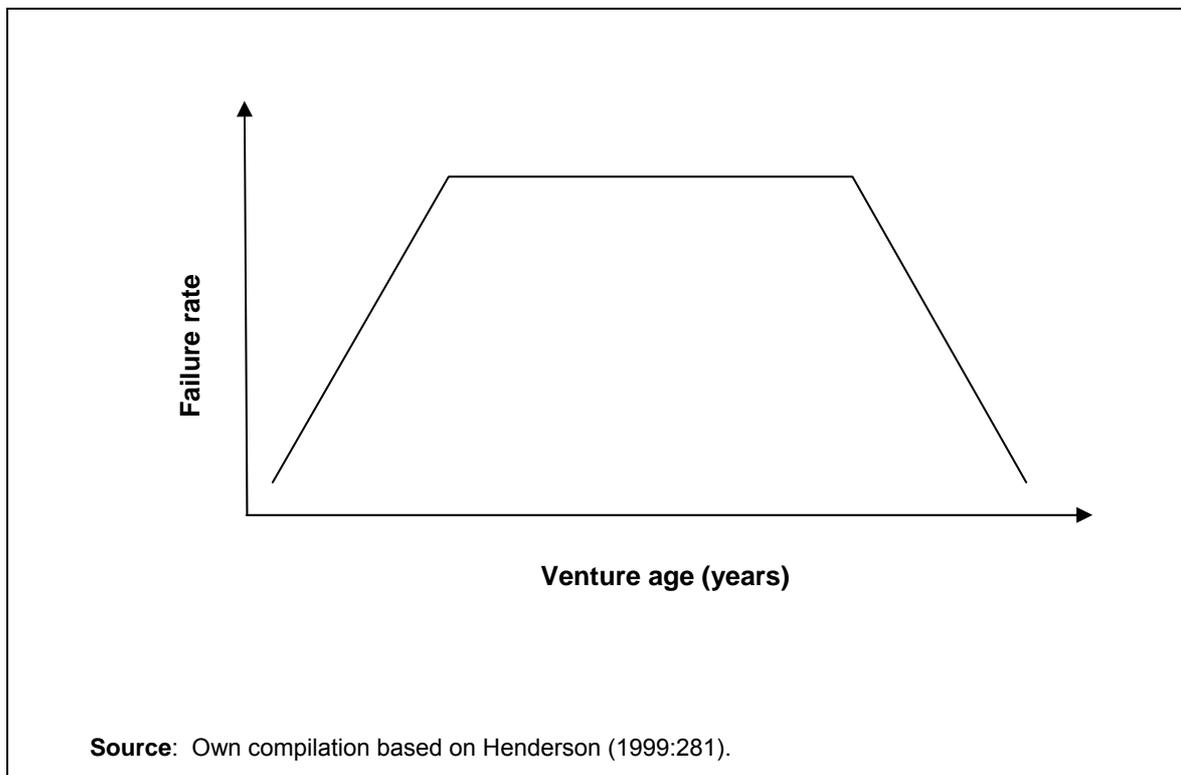
**Figure 2.7: Proposed failure rate versus liability of newness in years**

The problems and crises faced by new and small venture owner-managers before conception and development of the venture are well documented (Timmons & Spinelli 2003:60, 2009:106). The issue of the liability of newness of small businesses is largely about the scarcity of resources and a lack of innovativeness to introduce new products/offerings. Due to a venture’s newness this theory states that an illegitimacy situation arises from a lack of experience in which financiers have little or no faith in the new venture or the capability of the owner-manager to manage the affairs of the small business. Hence financiers may not be willing to extend credit or lend large amounts of capital to new, inexperienced businesses. This problem of undercapitalisation is predicted as spreading to the next venture growth stage of the business resulting in low profits, illiquidity and low revenues,

which can culminate in ultimate venture bankruptcy (Koksal & Arditi 2004:9; Ooghe & De Prijcker 2008:226).

### **2.5.2.2.3 Liability of adolescence as a factor of small business failure**

According to Henderson (1999:281), the liability of adolescence metaphor predicts that failure rates rise with age until the initial buffering resource endowments are depleted, and then decline with further increase in age. These ideas suggest that organisations can survive for a time with little risk of failure because they can draw on the initial stock of assets they typically acquire at founding (capital and loans). Thus, the failure rates are predicted to have an inverted, U-shaped relationship with age. The theory is portrayed diagrammatically in Figure 2.8.



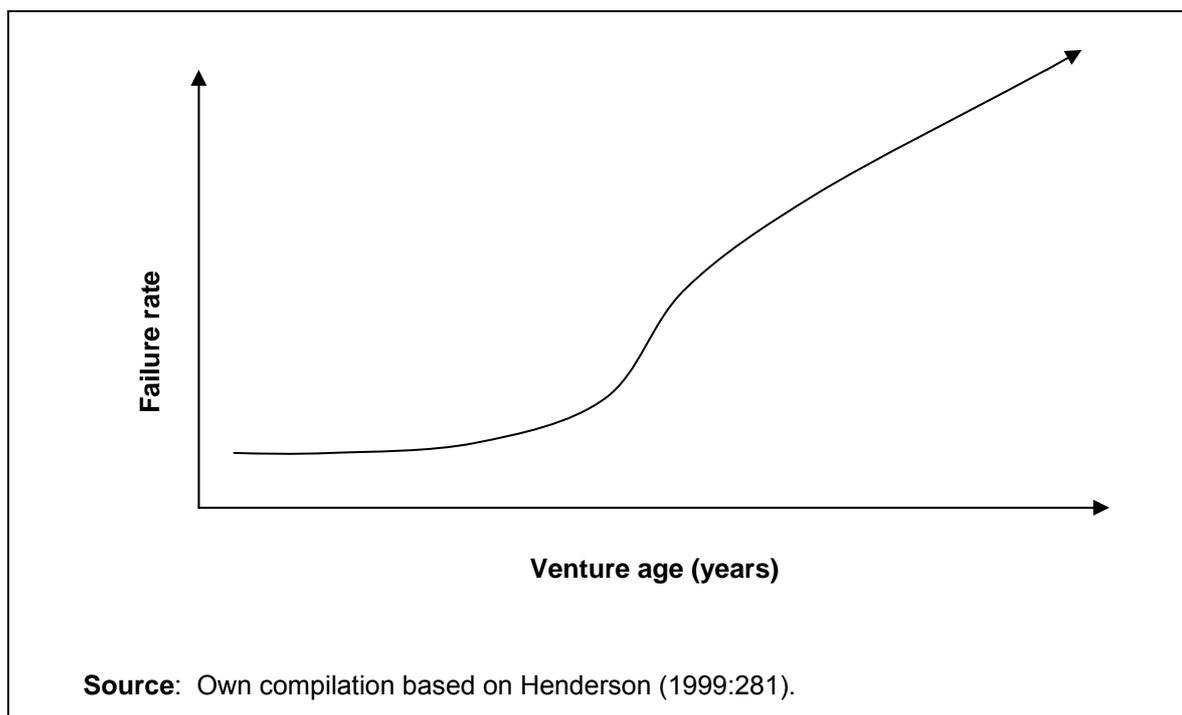
**Figure 2.8: Proposed failure rate versus liability of adolescence in years**

Figure 2.8 supports Bruderl & Schussler (1990:23), Fichman & Levithal (1991:15) and Cressy (2006:130) who opine that the liability of adolescence claims that the risk of failure increases for a certain period at the beginning of the life of an

organisation, reaches a peak, and declines thereafter. The liability of adolescence metaphor predicts a non-monotonic, inverted U-shaped pattern of failure unlike the monotonic failure pattern displayed by the liability of newness (Figure 2.7).

#### **2.5.2.2.4 Liability of obsolescence as a factor of small business failure**

The liability of obsolescence metaphor predicts that failure rates increase with age as the small business' original fit with the external environment erodes (Sheldon 1994:533; Henderson 1999:281; Sorensen & Stuart 2000:87; Scherrer 2003:52). This metaphor implies that firms are highly inertial (internally) and tend to become increasingly misaligned with their environments. The liability of senescence or obsolescence concept is associated with internal small business environmental friction, mismanagement, poor monitoring processes and a general picture of failure. Consequently, failure rates are expected to increase with age. This model is portrayed diagrammatically in Figure 2.9.



**Figure 2.9: Proposed failure rate versus liability of obsolescence in years**

Figure 2.9 indicates that the liability of ageing revolves around organisational inertia which hinders positive growth (Ranger-Moore 1997:907; Anderson & Tushman 2001:675). Furthermore, according to these authors, when organisations have aged, their response rate frequently slows down because of being sluggish in undertaking business decisions. Older organisations often lack capacity to introduce new products and new product offerings through innovation and hence cannot rejuvenate themselves. This happens because of slack and depleted resources often called by its misnomer, “hardened arteries” or “ossification”. Such small businesses are notorious for maintaining the status quo, some kind of a “boiled frog” syndrome (Richardson *et al* 1994:9; Anderson & Tushman 2001:675), embedded in slow reactions to environmental demands and changes.

#### ***2.6.2.2.5 Liability of smallness as a factor of small business failure***

According to Kale & Ardit (1998:459), size dependence as a liability of smallness metaphor predicts that failure rates are inversely proportional to business size which buffers large organisations from threats to survival. They contend that there is a relationship between the size of a small business venture and its potential for survival or failure. The model states that smaller the size of the venture, the more vulnerable it is believed to be. Accordingly, small ventures are deemed ignorant, incapable and not fit to compete in the business world. These researchers note that (p.459) venture capitalists, financiers and creditors often regard small ventures as vulnerable to failure.

Due to their smallness, such ventures have difficulty in attracting resources such as financial capital and human capital (in the form of qualified personnel) when compared to large firms as employees perceive them as not having growth prospects or career development opportunities. The influence of the venture size on failure is well documented. Smaller firms are more likely to close than larger ones. According to Stokes & Blackburn (2002:19) and Davidson & Dutia (1991:61), small firms have lower current and quick financial ratios than larger firms and therefore appear to be financially less liquid than larger firms. Smaller firms also often have lower profit margins than larger firms.

The theories on the failure of small businesses also assert that small firms are more likely to be indebted than larger firms (Kuratko & Hodgetts 2001:445), and will use more short-term debt than larger firms do. This indicates that small firms are predicted to have less access to the long-term capital markets often associated with lower interest rates, and hence must rely on expensive short-term debt.

This situation is expected to overwhelm small firm liquidity and debt measurements. Consequently, consistently undercapitalised firms are predisposed to failure as a result of a lack of adequate liquidity. This contention is supported by Tybout (2000:12) who notes that financiers favour large firms.

Furthermore, researchers in this area of business failure argue that due to the “liability of smallness” firms start off with inadequate human capital. At birth, the attrition is expected to be higher because of high venture density and competition is rife. In the eyes of financiers, small firms are not creditworthy enough. After birth, management incompetence and lack of experience will fuel inefficiencies. As the firm grows larger its chances of survival begin to increase. Statistically, according to Stokes & Blackburn (2002:19), a one percentage point change in firm size leads to a 7 % change in the probability of survival. The concept of smallness is thus an important variable which has been used in the literature to discuss small business failure.

A summary of foregoing liabilities follows in Table 2.6.

**Table 2.6: Explaining SMME failure in terms of management problems and other external factors**

Phase	Management issues	Source
<b>Age Dependence</b>		
Liability of newness	Marketing and financial issues Inadequate product demand and venture undercapitalisation issues Survival issues Inadequate resources and incapability issues	Kuratko & Hodgetts (2001:496) Timmons & Spinelli (2003:563, 2009:555) Nieman <i>et al</i> (2003:241)
Liability of adolescence	Business management and strategic issues Overtrading issues Financial issues Acquiring additional resources for growth Efficiency issues Inherited initial resources cushioning effect	Kuratko & Hodgetts (2001:496) Timmons & Spinelli (2003:564, 2009:555) FEE (2004:14) Nieman <i>et al</i> (2003:241)
Liability of obsolescence/ageing	Competition issues/lack of innovation and creativity issues Cash shortage issues External environmental misfit issues	Kuratko & Hodgetts (2001:496) Timmons & Spinelli (2003:564, 2009:555) Nieman <i>et al</i> (2003:241)
Liability of senescence	As for obsolescence above, but more applicable to internal environment	Ranger-Moore (1997:907)
<b>Size Dependence</b>		
Liability of smallness	Lack of experience and know-how results in lack of credibility in the eyes of financiers which leads to insufficient resources	Kale & Arditi (1998:459)

According to Barker III (2005:44), Pretorius (2006:234) and Brigham & Gapenski (2008:1015), most business failures occur because a number of factors combine to make the business unsustainable. These causes reinforce each other to influence failure in small businesses and are discussed as theme three (Section 2.5.3).

### **2.5.2.3 CRITICALLY EVALUATING THE USE OF METAPHORS IN UNDERSTANDING SMALL BUSINESS FAILURE**

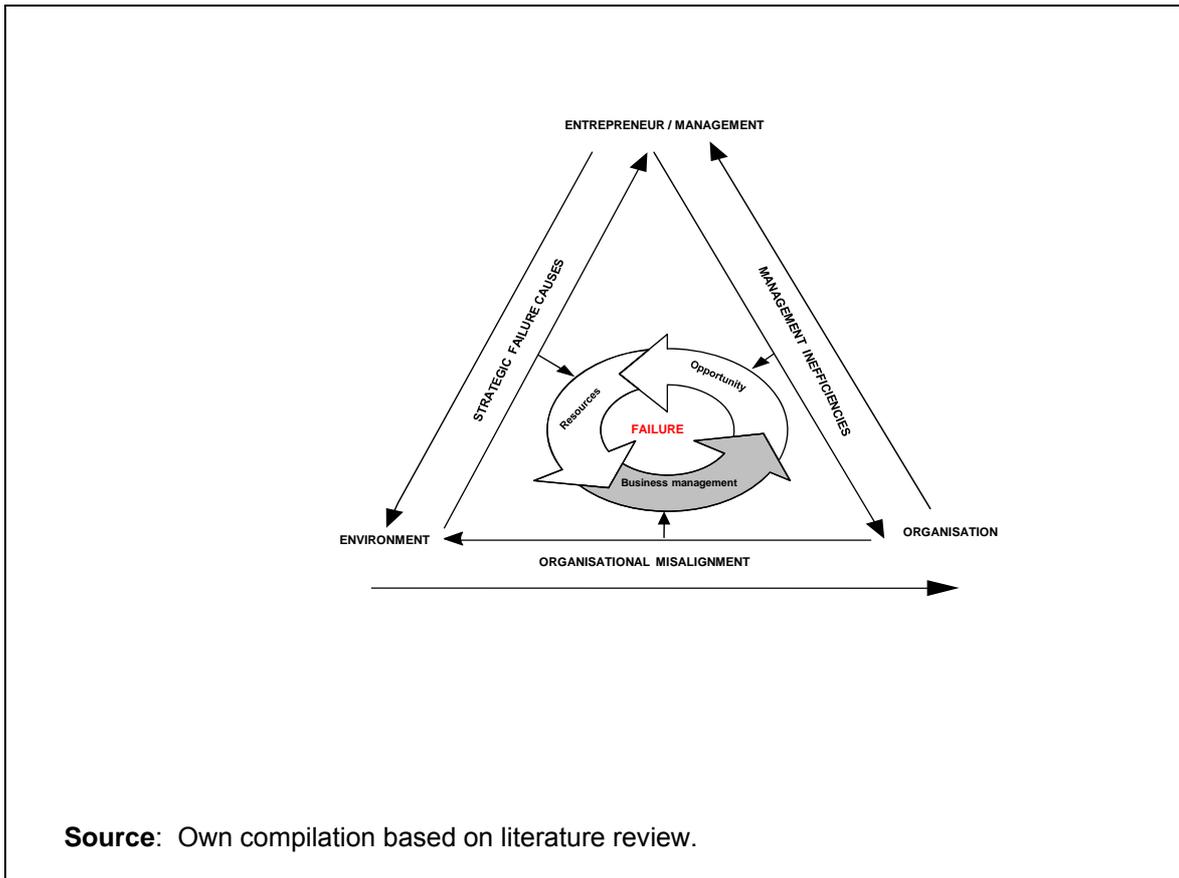
As the metaphors explain failure by analogy which conveys meaning from one thing to another, the danger is that the owners of small businesses may take them literally without questioning their meanings. Danermark *et al* (2006:123) alert the reader to risk in the use of metaphors by noting:

The risk is through the associations and ‘*aha* experiences’ they create, they may also tempt people to go too far in utilising them.

The problem is that it is hardly possible to modify a metaphor. In scientific research one must be able to modify or develop concepts. It is fundamental for a scientific attitude to be open to revision in the light of new experiences and findings, but metaphors do not accommodate changes.

### **2.5.3 Theme 3: “Multiple origins/causes of failure” as a perspective for explaining small business failure**

In Figure 2.5, the third theme on small business failure in this research represents problems such as small business management problems, internal organisational environment issues and external business environment problems as Barker III (2005:44) and Stanger (2010:9) confirm. Figure 2.10 illustrates these issues.



**Figure 2.10: The proposed interrelatedness of the multiple origins of causes of failure**

Figure 2.10 is a model which is based on the assumption that in the finality small businesses that suffer from inefficiencies will exit the marketplace. The inefficiencies in failed small businesses are understood to emanate from the confluence of the three entrepreneurial process elements (entrepreneur, environment, and organisation) whose interactions result in the inefficiencies between resources and opportunities that ultimately lead to the failure of the small business (Razi, Tarn & Siddiqui 2004:228; Shepherd *et al* 2009b:134). The multiple origins of failure, according to Arditi *et al* (2000:121), in a way can be perceived as preceding the resource and opportunity propensity model. Figure 2.10 posits that to understand the failure phenomenon it is imperative to identify its building blocks or elements and their reactions or interrelatedness.

In Figure 2.10, the first element, the **entrepreneur**, begins the venture by assembling and mobilising the financial resources with the aim of creating a

customer (Hormozi 2004:279). Drucker (2007:95) states that the purpose for every business is to create a customer. In the event of a lack of acquiring slack resources either through lack of credibility from financiers, or even through a lack of revenue for refinancing or lack of demand from customers, the venture is predicted to become vulnerable. In an ailing venture the resource and opportunity levels are found to be inadequate (Figure 2.10).

The **first element**, the *entrepreneur*, is the fulcrum around which every business initiative revolves. He/she needs to acquire and manage resources well for the resources and opportunity to remain glued together indefinitely. As noted in Section 2.6.1, Hisrich & Peters (2002:9) define the main functions of the entrepreneur as organising and operating a business for profit.

A lack of business management skills and/or entrepreneurial skills is predicted to hinder this process of acquiring and maintaining resources and result in inefficiencies and lost opportunity or demand (Yanchus *et al* 2003). Inefficiency in slack resources influences the subsequent loss of the opportunity in the presence of overwhelming competition. Concurring with these views on the contribution to small business failure by reduced levels of resources, Bruton & Rubanik (2002:554) also assert that the principal cause of high-technology firm failure is a lack of financial resources.

### **2.5.3.1 THE ENTREPRENEUR'S BUSINESS MANAGEMENT CAPABILITIES AS A FACTOR OF SMALL BUSINESS FAILURE**

Cressy (1996:1253) and the European Federation of Accountants (FEE 2004:7) note that both financial and human capital “explain” survival but, once a convincing human capital structure for the firm is specified, the econometric “marginal product” of financial capital is zero. Human capital is the “true” determinant of survival (Cronje, du Toit & Motlatla 2000:98; Van Praag 2003:1, Cronje *et al* 2006:120) and the correlation between financial capital and survival is spurious.

Attention is first turned to the entrepreneur's business management capabilities. This perspective argues that if the owner-manager lacks the necessary skills or versatility, the business is likely to be doomed (Wright 1995:48; van Aardt, van Aardt & Bezuidenhout 2000:250; Appiah-Adu, Fyall & Singh 2001:18;

Westhead & Storey 2001:14; Yanchus *et al* 2003:2; Cardon & Potter 2003:2; Shepherd & De Tienne 2005:91; Fuller-Love 2006:175; Okpara & Kabongo 2009:7). Taking the idea further, Sullivan (2005:162), van Emmerik, Baugh & Euwema (2005:310) and Seshadri (2007:71) contend that contributions to SMME failure emanating purely from the entrepreneur incapacibilities element are: incompetence, rigidity (freezing and inaction due to overwhelming external environmental turbulence) and intemperance (unbalanced management).

In support of these views, Shakespeare (1996:94) quotes an interviewee who said: “When all is said and done, as the business owner *you* are responsible for any failures.” The voluntarist perspective in organisation studies and organisational psychology literature suggests that managers’ actions due to misperceptions, lack of vision, threat rigidity, strategic persistence, and the lack of will and ability to respond effectively and make necessary adjustments to reverse the downward spiral of decline triggered by external factors, are the fundamental causes of internal organisational failure (Mellahi, Jackson & Sparks 2002:17; Mellahi & Wilkinson 2004:21; Rasheed 2005:239). As the business continues to grow, the key variables of an entrepreneur’s weakness that have been used to explain business failure have been expressed in terms of a lack of turnaround strategies as a management function or activity. According to Mellahi *et al* (2002:17), an entrepreneur’s weaknesses find expression in inadequacies in dealing with the internal decisions needed to be taken to address the external threats to the business. This idea has been supported by Seshadri (2007:55) who refers to this concept in terms of the entrepreneur-organisation goal dissonance.

Kodithuwakku & Rosa (2002:431) have analysed the entrepreneur faults from another perspective. They emphasise that the manner in which resources (human capital included) combine with opportunities and remain fused to each other ultimately determines whether a small business will continue to exist or not. For example, they argue that the failure of an entrepreneur to combine resources and opportunities successfully could lead to the failure of a small business. This idea has been supported in empirical research on small businesses in Japan where Honjo (2000:573) demonstrates how poor management of capital resources contributes to small business failure in that country.

In conclusion, the importance of the entrepreneur's management style has been stressed as a key component in the small business success or failure process. The human element is so vital in entrepreneurship that it is inconceivable that it could be precluded from any discussions on failure. As Mellahi *et al* (2002:17) and Abouzeedan & Busler (2004:158) note, corporations are managed by humans, and humans never forget to manage organisations to suit themselves. Thus corporate calamities are man-made calamities. From this perspective, it is clear that the activities of the owners of small businesses are inseparable from the successes or failures of the ventures they are supposed to manage.

The metaphor of failure versus age liability still reflects on the owner, this time on his/her management style at each and every part of the venture's lifespan. Sub-optimal synergy between the organisation and its environment is predicted ultimately to result in misalignment. The misalignment between the organisation and its environment once more calls for the attention of the owner. The lack of alignment between the internal environment and the external environment has been noted as being the root of small business failure (Mellahi & Wilkinson 2004:1). From this perspective, it is the internal weaknesses of the owner when addressing the external environmental uncertainties due to a lack of demand and environmental uncertainties that are presented as threatening the survival of the small business.

In the **second element**, which is the **organisation** itself, failure of the small business is presented as emanating from inefficiencies within the organisation accumulated throughout the venture's lifespan.

### **2.5.3.2 ORGANISATIONAL ISSUES AS A FACTOR OF SMALL BUSINESS FAILURE**

If the entrepreneur is not competent enough to foresee the competitive activities, does not react, and is less innovative, the organisation may not be able to fend for itself as a result of the inability to cope under difficult circumstances. This culminates in the said inefficiencies. The size of the firm as a metaphor is also presented as a small business failure determining factor, analogised as metaphors of smallness.

This section discusses the theories on internally derived causes of small business failure, for example, failure from the systems within the organisation. These theories are discernibly different from those emanating solely from the owner management weaknesses theories or failures due to the human element discussed in the previous section.

The section that follows discusses this problem in the sequence: location factors, improper franchise prototype, barrier to entry, and Gibrat's Law of Proportional Effect (Sutton 1996:2; 1997:40).

#### ***2.5.3.2.1 Business location factors as influencing small business failure***

As a metaphor, the survival of a venture is related to the presence of an ideal business location (Stearns, Reynolds & Williams 1995:23). For example, it has been stated that the survival chances of ventures are related to factors such as population density. Densely populated areas create an adequate market size or threshold to support small businesses. In contrast, businesses located in sparsely populated areas are not likely to obtain the minimum population size required to support the small business (Rogerson 2000:687). Such businesses are pre-disposed to failure.

The location factor has also been analysed from a perspective where there is small business overcrowding leading to the phenomenon of "businesses without customers" (Rogerson 2000:687). Surviving in such an environment then becomes difficult.

#### ***2.5.3.2.2 Failure originating from improper franchise prototype system/structure***

Gerber (2001:91) and Shane (2001:156) assert that 80 % of failures are due to a lack of systems similar to the franchise prototype. Longenecker *et al* (1999:505) and Sheth & Sisodia (2005:22) also contend that a lack of internal operating mechanisms and structures influences the organisation's ability to compete, leading to failure due to a lack of systems alignment with the strategies.

### **2.5.3.2.3 Failure as a result of barriers to entry**

This theory asserts that certain industries are easy to enter, whilst others are not (Lévesque & Shepherd 2004:30). An incumbent company enters an industry if the post-entry profits are perceived higher. According to Geroski (1995:421), if profits, as measured by  $\pi^e$ , are less than the barrier of entry  $F$ , post-entry failure ensues whilst mortality rate increases. Consequently such industry entry becomes unattractive. The following entry model explains this:

$$E = \beta (\pi^e - F) + \mu$$

Where:

- E is entry into some industry at a particular time period
- $\pi^e$  is expected post-entry profits
- F is the costs of entry (including absolute cost or product differences between entrants and incumbents). F measures the level of profits at which entry is cut off
- $\beta$  is an unknown parameter which measures the speed of entry in response to profitable opportunities, and
- $\mu$  is the transitory constant accounting for variation in entry in relation to  $\pi^e$  and F.

### **2.5.3.2.4 Gibrat's Law of Proportional Effect (law of small business size)**

It is generally accepted that the smaller the size of an entity, the more predisposed it is to failure. However, according to Sutton (1996:2; 1997:40), Gibrat as early as 1931 noted that the size of the small business does not necessarily influence its failure – for as long as the small business can be innovative, it can grow and not be condemned to death by virtue of its small size. Gibrat's thinking was influenced among others by the generally accepted belief that small businesses are more innovative and nimble when compared to large firms. Gibrat's law was found not to hold when tested empirically (Bruton & Rubanik 2002:553), as small businesses that grew ahead of larger firms could not be confirmed empirically. This law contradicts the theories on size discussed in the previous sections.

The **third element**, which is about causes influenced by the **environment**, involves the perspective where there is environmental misalignment. If the less-skilled owner cannot introduce winning strategies to resolve the misalignment, the organisation is predicted to end up with strategic weaknesses due to high competition and reduced demand (Van Witteloostuijn 1998:501; Drucker 2007:95). Ultimately, a misaligned, inefficient small business is expected to end up weakened. Inefficient firms have the propensity to exit the marketplace (McPherson 1995:3; Kuratko & Hodgetts 2001:419).

### **2.5.3.3 ENVIRONMENTAL/MACRO PROBLEMS AS A FACTOR OF SMALL BUSINESS FAILURE**

The third sub-theme (Figure 2.5) under the multiple origins of failure, as discussed above, relates to environmental complexities. In this theme, small business failures are discussed at the macro level, where the causes of small business failure are supposed to stem from the goal dissonance between the venture and its environment (Turner 2005:2; Seshadri 2007:55). This means that the internal complexities are related to the small business failure in theoretical terms. This perspective maintains that the environment in which the business owner operates puts considerable constraints on the day-to-day decision-making processes.

#### **2.5.3.3.1 Environmental complexity problems influencing venture failure**

A “complex environment” is discussed in the literature as one with a series of complex product lines, for example: several product lines. The greater the number of product lines, the more complex the business is supposed to be thereby requiring more dexterity in management skills. Firms with numerous product lines are predicted to fail due to a lack of proper control of the environment. The owner of a new small venture is more often associated with inadequate management skills. In comparison with large corporations, the owner of the small business is typecast as one who lacks management depth to manage the multiple functions of his/her small business. This multiple task environment is described as having tremendous causal powers to close down businesses (Anderson & Tushman 2001:675).

### ***2.5.3.3.2 Environmental munificence influencing venture failure***

The concept of “environmental munificence” is another issue which falls under environmental factors. “Environmental munificence” is understood in the literature to cover a number of organisations such as government and non-government organisations. This perspective states that the lack of such supporting and enabling environments can adversely affect small businesses in their day-to-day operations. The elements which make up environmental munificence cover government legislation, licence laws, interest rates, financial support, infrastructure, information provision and networking, among others (Anderson & Tushman 2001:675).

### ***2.5.3.3.3 Environmental uncertainty problems influencing venture failure***

Environmental uncertainty is understood as a lack of certainty or assurance in the future of the business due to changing external environments. These uncertainties are often beyond the control of the small business owner and, therefore, represent major challenges for the survival of businesses. The Game-Theory (Crutzen & van Caillie 2007:1) is one technique that can be used to explore the uncertainty principle in business management. Some of the changing environments are associated with a lack in sales demand, and technological uncertainty which is unpredictable (Anderson & Tushman 2001:675). Such environmental uncertainties can result in high SMME mortality rates.

### ***2.5.3.4 CRITICALLY EVALUATING MULTIPLE ORIGINS OF CAUSES FOR UNDERSTANDING SMALL BUSINESS FAILURE***

As already noted, according to Barker III (2005:44)

Business decline often stems from multiple sources both outside and inside the organisation that coalesce at the same time and overwhelm the venture. Thus, decline can and usually does result from multiple sources making perceiving of its causes difficult.

The above quotation confirms the common business management theory that the causes of small business failure do not occur as discrete or isolated events, but in terms of multiple feedback loops. These feedback loops display tremendous cause-effect relations which tend to make their understanding complex. For a business owner, multiple causes of small business failure are not amenable to

easy corrective actions as they are not user friendly. Thus the need to classify the causes into groups to simplify understanding.

It is apparent that in a predictive manner, both lack of availability and optimal combinations of resources and opportunities will result in the predisposition of the venture to failure. The failure of a small business is thus not attributable to one or a few causes but to several causes that coalesce until the small business is finally overwhelmed – deterministic. That is, based on its size or age or the unfriendly environment, a small business is predicted to fail. But what about the coping mechanism endowed and bestowed on the small business owner?

On reflection, Figure 2.10 as a model on multiple origins of small business failure has the demerit of assuming a closed system in which the small business owner-manager is constrained to obey some laws in the corporate business management process without free will or value judgement. As discussed in the next section on value judgements, this model, although elegant, is not employed as the proposition for this research because of its rather deterministic stance.

Consequently, the critical realist model is used to demonstrate how interrelated variables tend to function as structures and mechanisms in the real level (in which owners operate) of the critical realist schema to generate business solutions. The discussions will show that theories make their strongest claims at the real level about the causal powers of sets of interlinked variables as testimony for agent (owner-manager) value judgement.

## **2.6 THE ROLE OF VALUE JUDGEMENTS**

The discussions on the theories on small business failure cannot end without specific mention of those models which could be described as falling typically under the perception-based business failure explanations rooted in critical realism (Chapter 1). Up to now, classic research on business failure has not considered the relative freedom that the owners of businesses have to take decisions to address certain challenges and opportunities based on their personal values. This is a central reality which cannot be discussed just in passing (van der Merwe & de Swardt 2008:450). Parsa *et al* (2005:313) furthermore emphasise that success

and failure of owners of small businesses rest more directly on their own decision making or value judgement. The position of Parsa *et al* is confirmed by Hayward, Shepherd & Griffin (2006:160), De Tienne, Shepherd & De Castro (2008:533), McKelvie, Haynie & Gustavsson(2009:5) and Ekanem (2010:126).

Numerous business management researchers have elaborated on the meanings or value judgement-located theories based on the critical realist research tradition (Fleetwood & Ackroyd 2004:56; Perry 2002:415; Headd 2003:51; Danermark *et al* 2006:200; Carter & van Auken 2006:493; Michael & Combs 2008:73). This perspective posits that in its many-faceted complexity, the business world must be seen by the researcher as a hermeneutically interpreted world of various business owners. The actions of business owners and the fates of their businesses can therefore, it is contended, be properly understood only if business researchers take account of the ways the entrepreneurs interpret the business management principles, challenges, opportunities, the macro environment and other problems. The foregoing researchers thus note that to understand the actions of the businesses owners, there is the need for researchers to allow the owners to give reasons for their concrete actions. This must involve the researcher establishing direct contact with those concerned and asking them to offer their own views as to what caused their businesses to fail. The researchers argue that the owners of businesses are thinking, feeling human beings and that the only way to understand the nature of their business performances is to interact directly with them and let them indicate the nature and outcomes of the power play between the success and failure forces. This position is confirmed by Danermark *et al* (2006:117).

The critical realist business research perspective indicates that the reasons given by the owners of failed businesses for their businesses' failure need to be classified into logical groups to enhance understanding of the multiplicity of causal factors involved and thereby achieve parsimony in explanations and descriptions as well as the feasibility of implementation of the corrective actions (business improvement) (Fleetwood & Ackroyd 2004:112). The perceptions of the owners of failed businesses towards their problems and challenges could then be seen as their ways of interpreting their business situations in different ways to produce different outcomes (McKenzie & Sud 2008:127). Understanding such perceptions,

it is posited, can provide important information for engaging the owners of businesses to find hidden problems, contradictions and resources about which they might be ignorant so that the necessary solutions can be found.

This perspective of the business failure process is an integral part of the failure explanatory theories in this research (Zacharakis *et al* 1999:3; McKenzie & Sud 2008:127). As elaborated below, in the critical realist method used in this research, the real level is represented by the business management principles and problems. The actual level is represented by the meanings which the business owners attach to the business management principles and problems (De Tienne, Shepherd & De Castro 2008:533). These two dimensions of the critical realist approach will constitute the central pillars in the modelled business failure explanation processes (Figure 3.3).

## **2.7 LESSONS THAT COULD BE LEARNT FROM THE THEORIES DISCUSSED**

This chapter has helped to draw attention to the major explanatory theories on the causes of small business failures. A number of pertinent issues, however, need to be drawn from the literature reviewed to serve as input in the chapters that follow.

One issue that stands out clearly from the literature review is that the researchers' publications paint a picture of the primary need for owners of businesses to be conversant with basic business management rules as well as to have access to basic resources without which their businesses cannot be guaranteed success (Beaver & Jennings 2005:9). An issue which does not, however, feature prominently in the literature reviewed concerns the idea of grounding explanatory theories in local realities. This element is crucial to ensure that research becomes relevant to those concerned. The critical realist approach has the merit of devoting much attention to the identification of the stakeholders who matter in the understanding of particular problems, that is, the supportive environment of the SMME.

As indicated above, one of the objectives of this research is to relate the findings to the broader development context of SMMEs in South Africa. This is one way of

making the research relevant to the South African situation. This is the basis of the concept of grounded theory in critical realist research (Mouton 2002:168). This research, therefore, devotes considerable attention to the South African stakeholders as well as to critical issues associated with failure of the businesses researched. These issues cover the importance of small businesses to the South African economy in terms of job creation (for example, the roles of other stakeholders in the operations of the owners' small businesses); the challenges facing the owners of small businesses in terms of competition from big businesses; the public's attitude towards small businesses, and the roles of institutions (such as Khula and Seda) in providing different forms of support and resources to small businesses. What is different in this research is thus the attention it seeks to pay to conceptualisation issues by locating the business failure problem in the context of other important actors whose operations can or do impact on the performance of the owners of small businesses in different ways. The critical realist concerns with such conceptualisation issues (by grounding research in local realities) is what sets this research apart from the conventional approaches.

Based on the above, the following are therefore paramount in this research:

- There are many inter-related factors that are used to explain the causes of small business failure (Barker III 2005:44).
- Obtaining the causes of business failure from the owners' perspectives provide valuable information for understanding and decision making on the part of other stakeholders (Thornhill & Amit 2003a:497).
- In view of the importance of SMMEs in the development of South Africa, theories on the failures of small businesses must not be separated from the wider socio-economic environments in which they operate.
- Classifying the many causes of the business failure theories into themes or factors help to simplify understanding the failure causes at work both for researchers and business owners (Longenecker *et al* 1999:503; Pretorius 2008:408). The critical realist research method can assist researchers to address the above issue by conceptualising the many failure causes as sets of integrated variables with particular

causal powers by virtue of their nature (Fleetwood & Ackroyd 2004:12; Danermark *et al* 2006:54).

- The fate of the businesses depends on the final outcomes of struggles between the business success and failure forces (Wickham 2001:132, 2006:193; Pretorius 2006:226).
- Explaining “How?” and “Why?” businesses fail necessitates the use of the causality principle in business research (Mouton 1994:79; Fleetwood & Ackroyd 2004:12). Quantitative research methodologies have not been successful in explaining “How?” and “Why?” businesses are failing (McKenzie & Sud 2008:124) as evidenced from consistently high failure rates, that is, deterministic views versus critical realist approaches.
- In the critical realist approach, the value judgements of the owners of the businesses can be analysed as interpretations which they can make of the mechanisms, structures or situations concerned to produce different outcomes (Neuman & Krueger 2003:44; Leca & Naccache 2006:627; McKenzie & Sud 2008:128).
- The value judgements and coping mechanisms/skills of the owners of the businesses and related stakeholders can be influenced in such a way as to enable them to apply the basic principles of business management to ensure the success of the businesses (Hogarth-Scott *et al* 1996:6; Neuman & Krueger 2003:44; Fleetwood & Ackroyd 2004:30; Shepherd *et al* 2009a:590).

## **2.8 CRITICAL EVALUATION OF PAST SMALL BUSINESS FAILURE RESEARCH EFFORTS**

The above points indicate that any models that predestine or predict small business failures based on a set of *a priori* assumptions (for example, of age or size) cannot be the appropriate explanatory theories for understanding the concrete situation regarding the businesses studied. Positivist (deterministic) or predictive explanations, for example, involve descriptions of events instead of a description of the structures and mechanisms which causally generate the observable phenomena (Danermark *et al* 2006:169). One needs to go beyond any apparently deterministic and closed positivist-based quantitative models of the X's and Y's and incorporate the role of meanings or value judgements in the X's. The

positivist models hold the position that social phenomena confront agents (business owners) as external objects that are beyond the control of those concerned (Mouton 1994:80; Fleetwood & Ackroyd 2004:14; Johnson & Christensen 2004:115). Instead of holding to such apparently closed-ended models, contemporary business researchers are arguing that social phenomena (such as business problems) are constructs built up from the perceptions, leadership styles of the owners of the businesses, and other members of the supportive environment, all of which can be changed to positively influence the future performance of businesses (Danermark *et al* 2006:200; Leca & Naccache 2006:627; Allio 2007:12). This is contrary to the positivist thinking that condemns to death or extinction small businesses because of, for example, age or size. This perspective reinforces the one-shoe-fits-all views (Section 2.6.1.4).

As alluded to in Chapter 1, explaining events and phenomena from the point of view of human perceptions is one feature of the critical realist approach (Clover & Darroch 2005:238). Researchers, such as Sheldon (1994:533) and Ekanem (2010:126), for example, have noted that an understanding of the causes of SMME failures from a value judgement perspective can help to provide important information which could be used to build confidence of the owners of small businesses through the formulation and implementation of the relevant education, policies and plans of action. In research seeking the understanding and analysis of the real causes of the failure phenomenon, one can thus draw on ideas based on the critical realist causality theories (Minniti & Bygrave 1999:41; Mellahi & Wilkinson 2004:21; Jeppesen 2005:1; Seshadri 2007:401). These include the use of the meanings the owners of businesses may hold on the failure causes, and how they could be influenced in a positive way to prevent more business failures (Sheldon 1994:533; Markman & Baron 2003:281; Danermark *et al* 2006:200).

The critical realist approach is thus an open-ended value-judgement-based research model which will constitute the framework to be used for data collection, analysis and recommendations in this research. As noted by Fleetwood & Ackroyd (2004:148), organisational and management studies are but two of a long line of areas of knowledge to which realist social science has contributed. One objective of this research is to make a contribution to the efforts being made by critical realist business management researchers specifically in the understanding of the causes of small business failure processes.

## 2.9 CONCLUSION

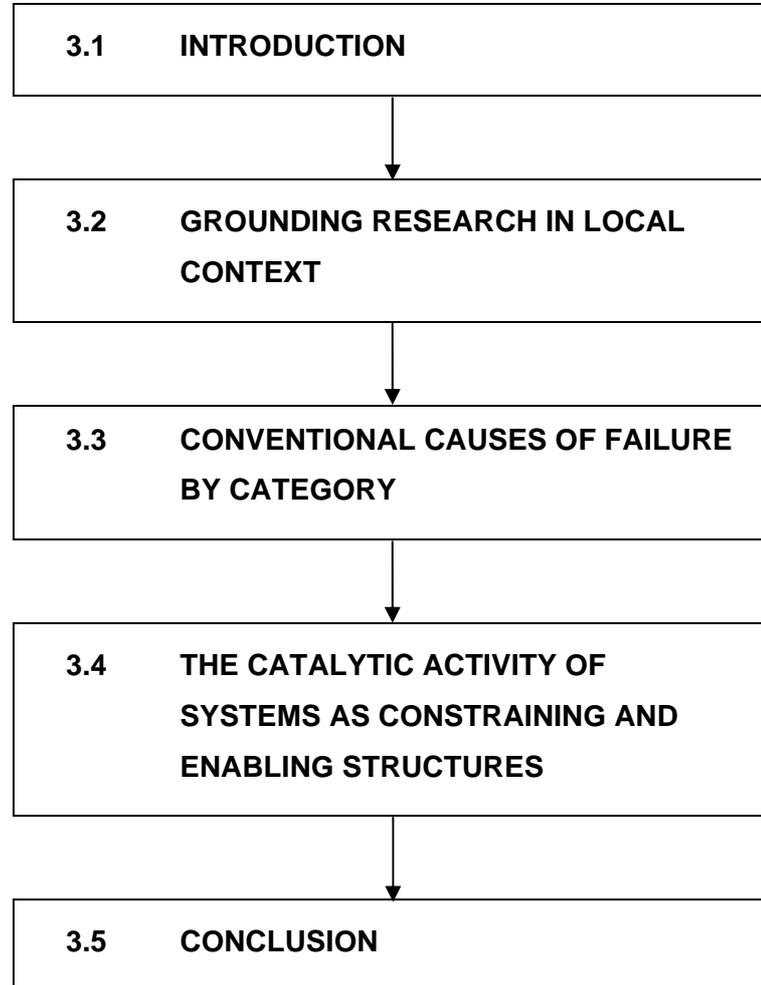
This chapter commenced by highlighting the need for the present research through an exposition of the basic business management principles that the owners of businesses need to follow. Attention was then turned to the small business failure theories as reported in relevant journal articles concerning failure of small businesses, as well as in several textbooks and papers. These theories were classified into three categories or themes: resources and opportunities framework; multiple origins framework; and small business failure emanating from the use of metaphors serving as images for understanding the small business failure phenomenon (for example, venture life cycle and liability metaphors).

Consequently, it has been highlighted that the three themes need to be reconceptualised via the critical realist approach by paying attention to the roles that are played or need to be played by the key stakeholders/supportive environment in the business failure processes. From such a perspective, it emerges that focusing on the activities of the owners of businesses *per se* is reductionist and therefore inadequate for a deeper understanding of the failure causes (Triki, Redjeb & Kamoun 2007:10).

It should be noted that the small business entity does not exist in isolation. The causes need to be grounded on the positioned practices of supporting stakeholders/supportive environment and even competing organisations to obtain insights into how their practices could affect the performance of the owners of small businesses. The critical realist approach thus differs from the theories discussed by the emphasis it places on ontological issues, that is, how in general things are constituted (for example, what SMMEs failure mechanisms (and what they are capable of doing by virtue of their constitution) are and not what causes small businesses to fail). Understanding the elements of the failure mechanism can assist the owner-managers to resolve their problems and thereby reduce the high failure rate.

In the following chapter, attention is paid to how the critical realist approach can assist to disclose the conceptual framework for this research.

**CHAPTER 3**  
**CONCEPTUAL FRAMEWORK FOR THE RESEARCH**



**Figure 3.1: Layout of Chapter 3**

## CHAPTER 3

### CONCEPTUAL FRAMEWORK FOR THE RESEARCH

#### 3.1 INTRODUCTION

Chapter 2 ended on the note that certain lessons could be learnt from the existing small business failure theories to serve as important input in developing a conceptual framework for this research. These inputs relate to concepts which this research will now consider as essential building blocks necessary for addressing the objectives of this research.

This chapter will elaborate on those issues under the following broad headings:

- The need to recognise the importance of grounding business failure research and the corresponding explanatory theories in the context of local realities.
- The importance of the business owner adhering to certain basic business management principles or rules (causal factors) as a way of avoiding business failure.
- Recognising and conceptualising the failure factors (causality) as sets of inter-related elements with inherent powers or tendencies to close down businesses.
- The role of critical realism in addressing the above issues.
- At the end of the above discussions, the conceptual framework for this research would have been specified for data collection in Chapter 4.
- Using research findings as frameworks for owner positive change.

## **3.2 GROUNDING RESEARCH IN THE LOCAL CONTEXT**

### **3.2.1 The statistical situation as evidence of small business failure**

The importance of grounding social research in local circumstances has been addressed from a number of South African perspectives. Ojala (2002:1), Kiggundu (2002:254), Mellahi & Wilkinson (2004:21) and Arinaitwe (2006:1670), for example, have discussed why the wholesale adoption in developing countries of explanatory models from developed countries would not carry that much relevance. Dockel & Ligthelm (2002:20) and Crutzen & Van Caillie (2007:10) emphasise that no meaningful use can be made of research results and statistics if they are not related to local issues. Sayer (2000:15), Mouton (2002:168) and Fleetwood & Ackroyd (2004:13) make similar statements from the perspective of the critical realist method.

The importance of recognising local statistical realities in business activities has also been discussed by Henderson (1999:281) from the business competitive perspective. Kaplan & Norton (2000:65), Junor (2001:30) and Kam (2005:399) are among others who have stressed the importance of using the grounded theory idea in undertaking and measuring performance in empirical research. From the South African perspective, the reports by the Department of Trade and Industry (**dti** 2004:4) and Sunter (2000:10), among others, highlight the importance of taking account of issues emanating from local statistics in the conceptualisation of the objects of the research. As has emerged from the literature review, people are constrained and enabled by their local circumstances. This chapter will therefore discuss the relevance of this statement as the backdrop to the conceptual framework for this research.

### **3.2.2 The number of small businesses in South Africa**

As indicated above, one contribution which this research intends to make in terms of the relevant failure causes is to demonstrate how important it is to base the failure explanations on local social and economic conditions. This idea of ensuring that research on the business failure problems needs to be locally-grounded is undertaken by first providing some important statistical information on SMMEs.

Statistical information has been gathered to provide background data regarding the particular position, contributions, challenges, problems and prospects of SMMEs and how such realities should influence research on their failures. It needs to be noted that the discussions in this sub-section of the chapter will focus on the disclosure of the small business-related statistical situation, in view of its importance. This is supplemented by other forms of information to indicate the grounds for ensuring that the explanatory factors reflect local conditions.

The statistical discussion commences with Table 3.1 which gives a summary of the small business sectoral distribution in the provinces of South Africa to appreciate the significance and magnitude of the small business industry.

**Table 3.1: Distribution of South African small businesses by province, 2002**

Province	Number of SMMEs	Percentage of total number of SMMEs in South Africa (%)
Gauteng	414 166	38.3
Kwazulu-Natal	198 749	18.4
Western Cape	144 594	13.4
Eastern Cape	94 253	8.7
North West	56 117	5.2
Mpumalanga	53 636	5.0
Limpopo	49 985	4.6
Free State	49 335	4.6
Northern Cape	19 791	1.8
RSA	1 080 626	100.0
<b>Source:</b> Distribution of South African SMMEs by province (dti 2002:43).		

Table 3.1 indicates that there were 1 080 626 formal SMMEs alone in South Africa during 2002. This is quite a large number by all indications.

Table 3.2 is further reason that SMME failures cannot continue unabated. For purposes of this part of the research, it should be noted that the SMMEs studied comprise those businesses employing fewer than 5 people each. Table 3.2 provides information on the sizes and turnover of the businesses across the various sectors.

**Table 3.2: Threshold for classification as micro, very small or medium enterprises**

Sector or sub-sector in accordance with the standard industrial classification	Size or class	Total full-time equivalent of paid employees	Total annual turnover (Rm)	Total gross asset value (excluding fixed property) (Rm)
<b>Agriculture</b>	Medium	100	5.0	5.0
	Small	50	3.0	3.0
	Very small	10	0.5	0.5
	Micro	5	0.2	0.1
<b>Mining and quarrying</b>	Medium	200	39.0	23.0
	Small	50	10.0	6.0
	Very small	20	4.0	2.0
	Micro	5	0.2	0.1
<b>Manufacturing</b>	Medium	200	51.0	19.0
	Small	50	13.0	5.0
	Very small	20	5.0	2.0
	Micro	5	0.2	0.1
<b>Electricity, gas and water</b>	Medium	200	51.0	19.0
	Small	50	13.0	5.0
	Very small	20	5.1	1.9
	Micro	5	0.2	0.1
<b>Construction</b>	Medium	200	26.0	5.0
	Small	50	6.0	1.0
	Very small	20	3.0	0.5
	Micro	5	0.2	0.1

Sector or sub-sector in accordance with the standard industrial classification	Size or class	Total full-time equivalent of paid employees	Total annual turnover (Rm)	Total gross asset value (excluding fixed property) (Rm)
<b>Retail and motor trade and repair services</b>	Medium	200	39.0	6.0
	Small	50	19.0	3.0
	Very small	20	4.0	0.6
	Micro	5	0.2	0.1
<b>Wholesale trade, commercial agents and allied services</b>	Medium	200	64.0	10.0
	Small	50	32.0	5.0
	Very small	20	6.0	0.6
	Micro	5	0.2	0.1
<b>Catering, accommodation and other trade</b>	Medium	200	13.0	3.0
	Small	50	6.0	1.0
	Very small	20	5.1	1.9
	Micro	5	0.2	0.1
<b>Transportation, storage, and communications</b>	Medium	200	26.0	6.0
	Small	50	13.0	3.0
	Very small	20	3.0	0.6
	Micro	5	0.2	0.1
<b>Finance and business services</b>	Medium	200	26.0	5.0
	Small	50	13.0	3.0
	Very small	20	3.0	0.5
	Micro	5	0.2	0.1
<b>Community, social and personal services</b>	Medium	200	13.0	6.0
	Small	50	6.0	3.0
	Very small	20	1.0	0.6
	Micro	5	0.2	0.1

**Source:** Schedule 1 to the National Small Business Act of 1996, as revised by the National Small Business Amendment Act, Act 26 of 2003 (RSA 2003).

### **3.2.3 Job creation by South African small businesses**

One sector which creates jobs in South Africa is SMMEs. Table 3.3 provides information about the number jobs being created by SMMEs in South Africa and their contribution to the national economy in the context of the unemployment situation.

**Table 3.3: SMMEs in the context of the South African employment situation, 2004**

Province	Number of employed people	Number of unemployed people	Working age population (15 to 65 years)	Number of formal SMMEs	Number of informal SMMEs
Mpumalanga	788 674	260 011	1 943 577	14 879	206 000
Western Cape	1 691 129	386 616	3 147 046	76 876	126 000
Eastern Cape	1 277 582	536 474	4 005 226	21 772	224 000
Northern Cape	228 792	74 045	576 527	4 759	32 000
Free State	777 074	311 427	1 909 446	12 524	144 000
KwaZulu-Natal	2 092 406	840 551	5 930 954	53 045	595 000
North-West	384 824	324 639	2 399 174	10 971	190 000
Gauteng	3 069 516	1 062 496	6 267 459	196 715	631 000
Limpopo	882 734	339 122	3 134 202	9 493	281 000
<b>Total for South Africa</b>	<b>11 192 731</b>	<b>4 135 381</b>	<b>29 313 611</b>	<b>401 034</b>	<b>2 429 000</b>
<b>Source:</b> Statistics South Africa (Stats SA) (Stats SA 2005:16).					

With a population of some 45 million, and an unemployment figure of some 4 135 381 in 2004, Table 3.14 paints a bleak picture of the challenge of job creation in South Africa. There are limited job prospects in the formal sector, a high output of secondary school leavers and also high numbers of retrenched workers, all of which justify a programme of job creation through the SMMEs. Table 3.14 indicates that there are about 3 000 000 formal and informal SMMEs in the country which are an important resource for national development.

From the above statistical information, it can be asserted that any analysis of small business failures needs to take account of the problems facing the SMMEs; their potential to create jobs in the South African economy, as well as the necessity of getting access to the owners of small businesses regarding what they think needs to be done about the fate of their ventures. Since the global meltdown of 2008/2009 the shedding of jobs has been increasing in the formal sector. This reality needs to turn attention to small businesses as a key driver to the development of the South African economy.

### **3.3 CONVENTIONAL CAUSES OF FAILURE BY CATEGORY**

The reviewed literature indicates that failure may be categorised as discussed below

#### **3.3.1 Management-related causes of failure**

The evidence of small business failure is now presented in terms of management-related causes, administrative-related causes, operational-related causes, strategic causes as well as the owner-managers' perceptions-related causes of business failures in both developed and developing countries. Table 3.4 shows the management-related causes of failure.

**Table 3.4: Management-related causes of failure by category in developed and developing countries**

Failure category	Percentage failure (%)	Developed / developing countries	Failure description	Source
Managerial incompetence	>85 %	Developed countries	General managerial incompetence	Knotts (2003:2) Scarborough & Zimmerer (2003:9) Wiklund & Shepherd (2005:71)
Management weaknesses	89 %	Developed countries	Going into business for wrong reasons	Holland (1998:2)
		Developed countries	Start-up cognitive orientations	Gatewood, Shaver & Gartner (1995:371)
	Developed countries	Factors for business start-up	Lee & Osteryoung (2001:193)	
	Developed countries	Entrepreneur falls in love with the product/-business	Holland (1998:2)	
Management weaknesses	26 %	Developed countries	Lack of financial responsibility and awareness	Holland (1998:2)
		Developed countries	Lack of clear focus	Holland (1998:2)
		Developed countries	Living too high for the business	Holland (1998:2)
Management weaknesses	26 %	Developing countries	Entrepreneur falls in love with the product/-business	Tushabomwe-Kazooba (2006:30)
		Developing countries	Poor management of workers	Wright (1995:48) Tushabomwe-Kazooba (2006:30)
Management weaknesses	78 %	Developed countries	Poor work relationships	Longenecker, Neubert & Fink (2007:148)

Failure category	Percentage failure (%)	Developed / developing countries	Failure description	Source
Incompetence	46 %	Developed countries	Lack of planning and control  No knowledge about pricing  Little effort to market the business Lack of know-how	Holland (1998:2) Chittenden, Poutziouris & Michaelas (1999:5)  Laitinen & Gin Chong (1999:89)  Grünhagen & Mishra 2008:1 Littunen, Storhammar & Nenonen (1998:199)
		Developing countries	Emotional pricing  Living too high for the business  Poor management skills  No experience in record keeping	van Aardt <i>et al</i> (2000:250)  Tushabomwe-Kazooba (2006:30)  Baard (2004:1)  Wright (1995:48)
Poor business planning and control	78 %	Developed countries	Poor planning and control	Monk (2000:12) Perry (2001:201) Khan (2006:2)
		Developing countries	Poor planning and control	Wright (1995:48)
Poor financial planning	82 %	Developed countries	Poor cash flow	Stancill (1987:38) Monk (2000:12) FEE (2004:7) Khan (2006:2)
		Developing countries	Poor cash flow	Wright (1995:48) Nieman (1999:8) Baard (2004:1)
Inadequate revenue	65 %	Developed countries	Business not earning enough money	Watson, Hogarth-Scott & Wilson (1998:229)

Failure category	Percentage failure (%)	Developed / developing countries	Failure description	Source
Unbalanced experience/ lack of managerial experience/ lack of start-up experience	30 %	Developed countries	Poor credit-granting practices Excessive bad debts Expansion too rapid Ineffective communication skills/practices Poor work relationships/interpersonal skills Person-job mismatch Delegation and empowerment	Sexton <i>et al</i> (1997:1) Holland (1998:2) Longenecker <i>et al</i> (2007:148) Cressy (1996:1254) Shepherd (2003:318) Cooper <i>et al</i> (1994:371) Khan (2006:2)
		Developing countries	Inadequate borrowing practices breakdown Failing to adapt and break old habits quickly	van Aardt <i>et al</i> (2000:250) Baard (2004:1)
Lack of experience in line of goods or services	11 %	Developed countries	Carry inadequate inventory No knowledge of suppliers	Holland (1998:2) Holland (1998:2)
		Developing countries	Wasted advertising budget	Maasdorp (2002:733)
Combined human factor	92 %	Developing countries	Incompetence Inadequate experience Lack of managerial experience	Moolman (2003:34) Moolman (2003:34) Moolman (2003:34)
Neglect/fraud	1 %	Developed countries	Poor monetary control	Holland (1998:2)
Lack of action	3 %	Developing countries	Lack of problem solving	Maasdorp (2002:733)

Failure category	Percentage failure (%)	Developed / developing countries	Failure description	Source
Managerial failure	81 %	Developed countries	Ineffective communication skills/practices	Longenecker <i>et al</i> (2007:148)
	78 %		Poor work relationships	Longenecker <i>et al</i> (2007:148)
	69 %		Person-job mismatch	Longenecker <i>et al</i> (2007:148)
	64 %		Failure to clarify directions/performance expectations	Longenecker <i>et al</i> (2007:148)
	57 %		Failing to adapt and break old habits quickly	Longenecker <i>et al</i> (2007:148)
	56 %		Delegation and empowerment breakdown	Longenecker <i>et al</i> (2007:148)
	52 %		Lack of personal integrity and trustworthiness	Longenecker <i>et al</i> (2007:148)
	50 %		Unable to develop co-operative/teamwork	Longenecker <i>et al</i> (2007:148)
	47 %		Unable to lead/motivate others	Burke (2006:93) Longenecker <i>et al</i> (2007:148)
	45 %		Poor planning practices/reactionary behaviour	Longenecker <i>et al</i> (2007:148)
	40 %		Failure to monitor actual performance and provide feedback	Longenecker <i>et al</i> (2007:148)
	37 %		Failing to remove performance barriers/roadblocks	Longenecker <i>et al</i> (2007:148)
	36 %		Ego, attitude and indifference problems	Longenecker <i>et al</i> (2007:148)
	33 %		Fail to select, promote, and develop talented people	Longenecker <i>et al</i> (2007:148)
31 %	Lack of or misuse of critical resources	Longenecker <i>et al</i> (2007:148)		

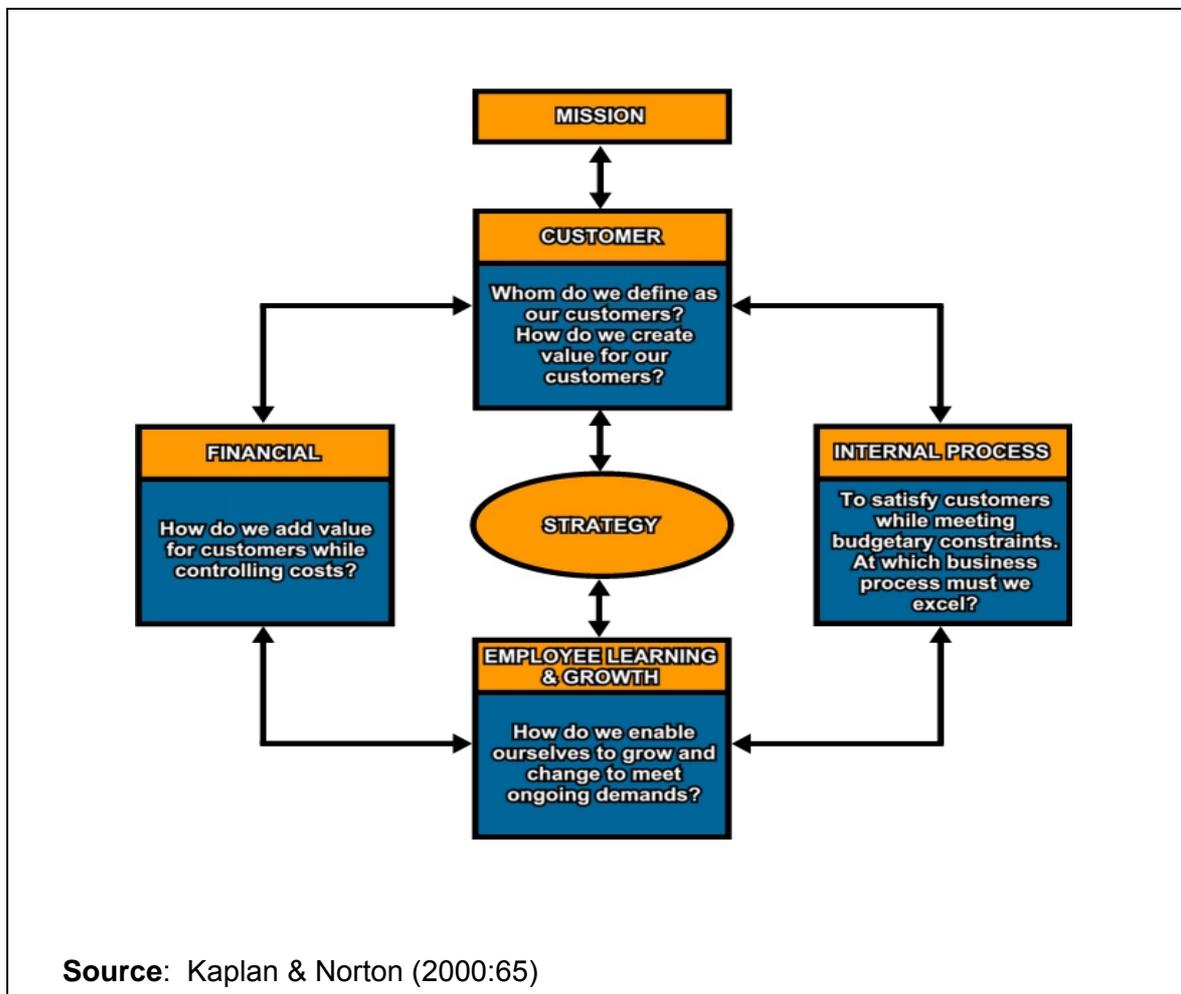
Failure category	Percentage failure (%)	Developed / developing countries	Failure description	Source
Internal administrative management	Not available	Developed countries	Financial	Sheldon (1994:534) Cooper <i>et al</i> (1994:375) Gaskill, van Auken & Manning (1993:19) Mudambi & Treichel (2005:543)
			Organisational	Sheldon (1994:534) Cooper <i>et al</i> (1994:375) Gaskill, van Auken & Manning (1993:19) Mudambi & Treichel (2005:543)
	Not available	Developing countries	Human resources	Tushabomwe-Kazooba (2006:30)
Internal strategic management	36 %	Developed countries	Human resources Marketing Planning Inadequate competitive strategies Strategic persistence  Failure to handle growth	Carter <i>et al</i> (1994:21) Sheldon (1994:534) Jennings & Beaver (1995:185) Jennings & Beaver (1995:185) Greening, Barringer & Macy (1996:233) Tezuka (1997:83) Kisfalvi (2000:611) Weitzel & Jonsson (1991:7)
		Developing countries	Inaction and lack of corrective actions	Tushabomwe-Kazooba (2006:30)
External administrative management	36 %	Developed countries	High rent charges	Sheldon (1994:534)
		Developing countries	High rent charges	Tushabomwe-Kazooba (2006:30)
External strategic management	Not available	Developed countries	Marketing Economic Ineffective marketing	Sheldon (1994:534) Tezuka (1997:83) English <i>et al</i> (1996:17)

Failure category	Percentage failure (%)	Developed / developing countries	Failure description	Source
Poor management	70 %	Developed countries	Not recognising what they do not do well and not seeking help, followed by insufficient business experience and poor delegation	Monk (2000:12) Perry (2002:417) Beaver & Jennings (2005:9) Khan (2006:2) Burke (2006:91)
Weaknesses in marketing	82 %	Developed countries	Inadequate sales distribution and advertising	Wu & Young (2002:8) Song <i>et al</i> (2008:7)
Cash flow	34 %	Developing countries	Negative cash flow	Tushabomwe-Kazooba (2006:30)
Record keeping	33 %	Developing countries	Poor record keeping	Tushabomwe-Kazooba (2006:30)
Management	26 %	Developed countries	Poor management  Ineffective financial controls	English <i>et al</i> (1996:17) Collin & Jarvis (2002:100) Pratten (2004:248)
		Developing countries	Ineffective financial controls	Tushabomwe-Kazooba (2006:30)
Corporate governance	Not available	Developed countries	Weak corporate governance	Mardjono (2005:272)
Cash burn	48 %	Developed countries	Inadequate cash  Using cash too fast	Stokes & Blackburn (2002:21) Mudambi & Treichel (2005:543, 552)
Turnaround	Not available	Developed countries	Failure to turn venture around until it is too late	Lorke, Bedeian & Palmer (2004:65) Sheppard & Chowdhury (2005:239) Rasheed (2005:239) Salazar (2006:1)
Personal reasons and cash flow	42 %	Developed countries	Personal reasons (ill-health; family succession)	Watson <i>et al</i> (1998:229)
Misunderstanding the changing external environment	Not available	Developed countries	Neglect or ignoring changing external environment until it is too late	Cannon & Edmondson (2005:26)

Failure category	Percentage failure (%)	Developed / developing countries	Failure description	Source
Top team weaknesses	Not available	Developed countries	Top team deterioration  Shortage of good judgement and understanding at the very top	Hambrick & D'Aveni (1988:2) Hambrick & D'Aveni (1992:1445)  Posner (1993:1) Barker III (2006:9)
Organisational inertia	Not available	Developed countries	Resistance to environmental change due to lack of innovation when organisations age	Van Witteloostuijn (1998:501)
Business culture	Not available	Developed countries	Lack of knowledge about business partners	Elenkov & Fileva (2006:140)
Performance threshold	Not available	Developed countries	Performance below economic and performance threshold	Gimeno-Gascon <i>et al</i> (1997:751)
Attribution error	Not available	Developed countries	Venture owners blame others for their failures	Zacharakis <i>et al</i> (1999:1) Riquelme & Watson (2002:400) Rogoff <i>et al</i> (2004:365)
Goal dissonance	Not available	Developed countries	Entrepreneur-organisation goal dissonance	Seshadri (2007:55)
Hubris error	Not available	Developed countries	Overconfident entrepreneur	Hayward <i>et al</i> (2006:160)
Cesspool syndrome	Not available	Developed countries	Losing good employees due to incorrect downsizing	Bedeian & Armenakis (1998:58)
Partnership and proprietorship	Not available	Developed countries	Weaker partnerships	Watson (2003:264)
Undercapitalisation	Not available	Developed countries	Insufficient start-up capital	English <i>et al</i> (1996:17)
<b>Source:</b> Own compilation based on literature review.				

Table 3.5 highlights that the majority of causes for small business failure emanate from management-related causes. The table gives a breakdown of the administrative or management causes as percentages of overall causes of small business failure.

The model in Figure 3.2 indicates an example of the four business administrative/management principles that need to be adhered to by small businesses including South African SMMEs. The model is used here as a normative tool to guide business owners to success. It gives an idea about some of the conditions that business owners need to address in order to achieve success.



**Figure 3.2: The balanced scorecard model**

Figure 3.2, therefore, demonstrates that running a small business is a balancing act between internal and external factors (Timmons & Spinelli 2003:261, 2007:91, 2009:561). These assertions make Figure 3.2 even more important in explaining failure in small businesses. Specifically, the owners of small businesses need to strike a balance between the four factors: internal processes, finance, customers, and innovation or development.

Any imbalances, according to Kaplan & Norton (2000:65), predispose small businesses to failure. As confirmation of Kaplan & Norton's position, Table 3.5 provides evidence on the areas of poor performance that lead to failure in small business and their percentages. For example, according to Burt, Dawson & Sparks (2003:358) underperformance equals failure.

### **3.3.2 Administration-related causes of failure**

Table 3.5 represents administrative causes of failure in developing countries.

**Table 3.5: Administration-related causes of small business failure in developing countries**

Failure category	Percentage failure (%)	Source
Financial factors	37 %	Maasdorp (2002:733)
Management experience	11 %	Maasdorp (2002:733) van Scheers & Radipere (2007:87)
Limited experience	7 % 96 % 70 %	van Aardt <i>et al</i> (2000:250) Okpara & Wynn (2007:27) van Scheers & Radipere (2007:87)
No experience	8 %	Al-Shaikh (1998:81)
Lack of financing	16 %	Al-Shaikh (1998:81)
Poor recordkeeping/accounting	Major	Okpara & Wynn (2007:27)
Lack basic business skills	Major	Okpara & Wynn (2007:27)
Finance	Major	Okpara & Wynn (2007:27)
Personnel unskilled	Major	Arinaitwe (2006:177)
Negative cash flow	34 %	Tushabomwe-Kazooba (2006:30)
Management problems	26 %	Tushabomwe-Kazooba (2006:30)
Lack of planning	17 %	Tushabomwe-Kazooba (2006:30)
Trouble among partners	14 %	Tushabomwe-Kazooba (2006:30)
Domestic and family situations	32 %	Tushabomwe-Kazooba (2006:30)
<b>Source:</b> Own compilation based on literature review.		

Table 3.5 indicates that, when administrative causes of business failure in developing countries (including South Africa) are considered for their contribution to small businesses failure, a large portion of the blame is attributed to:

- Owner inexperience
- Financial factors
- Inadequate basic business skills
- Negative cash flow.

Table 3.6 illustrates the causes of failure emanating from operational issues in developing countries.

**Table 3.6: Operational causes of small business failure in developing countries**

Failure category	Percentage failure (%)	Source
Lack of action	3	Maasdorp (2002:733)
Poor management	14	Al-Shaikh (1998:81) van Scheers & Radipere (2007:87)
Marketing	Major	Okpara & Wynn (2007:26)
Inventory	Major	Okpara & Wynn (2007:26)
Production	Major	Okpara & Wynn (2007:26)
Operations	Major	Okpara & Wynn (2007:26)
Delays in processing applications	31	Tushabomwe-Kazooba (2006:30)
<b>Source:</b> Own compilation based on literature review.		

Table 3.6 indicates that the major areas of the operations contributing to small business failure are:

- Marketing issues (that is, sales demand forecasting; customer service)
- Inventory issues (that is, stock control or stock taking)
- Production issues (that is, quality management)

- Overall operation issues (that is, cost control; budgeting; planning).

The above possible causes of small business failure are largely under the control of the owner of the business, making them strategic in nature. Strategic causes of failure are discussed in the next section.

### 3.3.3 Strategic causes of failure

According to Okpara & Wynn (2007:25), the strategic causes of failure involve the ability of the owners of small businesses to match their products or service with the demands of the external environment. The areas covered under their strategic causes of small business failure are: financial analysis, uncontrolled growth, wrong pricing and planning. Rates of strategic causes of failure in developing countries are presented in Table 3.7.

**Table 3.7: Strategic causes of small business failure in developing countries**

Failure category	Percentage failure (%)	Source
Neglect	3 %	van Aardt <i>et al</i> (2000:250)
No response	6 %	Al-shaikh (1998:81)
Poor planning	21 %	Al-shaikh (1998:81)
Financial analysis	Major	Okpara & Wynn (2007:26)
Uncontrolled growth	Major	Nieman <i>et al</i> (2003:278)
Wrong pricing	35 %	Tushabomwe-Kazooba (2006:30)
<b>Source:</b> Own compilation based on the literature review.		

From Table 3.7 the following strategic issues contribute disproportionately to small business failure in South Africa:

- Financial analysis (that is, reading and interpreting financial statements);

- Uncontrolled growth (that is, overtrading issues and lack of adequate refinancing capital);
- Wrong pricing (that is, setting too low or too high prices for particular product ranges); and
- Poor planning (that is, inability to anticipate technological and competitive forces in the business environment).

#### **3.3.4 Organisational causes of failure**

As noted in Section 3.2.1, the running of a small business, then, is a balancing act (Timmons & Spinelli 2003:261; 2009:561) between internal strategy and external environmental issues. The organisational causes of failure in developed countries are presented in Table 3.8.

**Table 3.8: Organisational causes of small business failure in developed countries**

Failure category	Percentage failure (%)	Failure description	Source
<b>Systems failure</b>	80 %	Lack of franchise protocol	Gerber (2001:91)
		No systems	Roberts & Bea (2001:180)
<b>Size of business</b>	80 %	Liability of smallness (lack of innovativeness)	Southard & Swenseth (2003:578) Laitinen (1992:324) Hall (1994:737) Thornhill & Amit (2003a:497) Pratten (2004:247) Strotmann (2007:84) Audretsch (2003:6) Buehler, Kaiser & Jaeger (2005:5)
		Absolute plant size, difference between plant size and industry mean plant size	Winker (1999:181) Tveterås & Eide (2000:77) Rutherford, McMullen & Oswald (2001:64) Disney <i>et al</i> (2003:91) Medway & Byrom (2006:527) Doyle, Ge & McVay (2007:201)

Failure category	Percentage failure (%)	Failure description	Source
<b>Age of business</b>	80 %	<p>Failure due to young age</p> <p>Liability of newness</p> <p>Liability of adolescence</p> <p>Liability of obsolescence</p>	<p>Nucci (1999:31) Perry (2002:417) Medway &amp; Byrom (2006:527)</p> <p>Buehler <i>et al</i> (2005:7) Agarwal &amp; Gort (1996:492) Thornhill &amp; Amit (2003a:497) Pratten (2004:247) Wood (2006:441) Strotmann (2007:84)</p> <p>Jensen, Webster &amp; Buddelmeyer (2006:19) Disney <i>et al</i> (2003:91) Strotmann (2007:84)</p> <p>Strotmann (2007:84) Doyle <i>et al</i> (2007:201)</p>
<b>Minimum efficient scale</b>		The larger the industry's minimum efficient scale, the greater the risk for venture failure	Strotmann (2007:84)

Failure category	Percentage failure (%)	Failure description	Source
<b>Entrance barrier</b>		<p>The lower the entrance barrier, the higher the failure rate (for example, the retail industry)</p> <p>Absolute barriers terminate a venture</p> <p>High entrance barriers result in high infant mortality</p>	<p>Geroski (1995:427) Agarwal &amp; Gort (1996:489) English <i>et al</i> (1996:18) Robertson <i>et al</i> (2003:308)</p> <p>Kouriloff (2000:62)</p> <p>Eriksson &amp; Kuhn (2006:1022) Mata &amp; Portugal (2002:340)</p>
<b>Location</b>		Poor location	<p>Stearns <i>et al</i> (1995:23) English <i>et al</i> (1996:17) Fotopoulos &amp; Louri (2000:319)</p>
<b>Non-franchise businesses</b>	77 % to 88 % within 5 to 10 years	Conventional businesses have higher failure rates than franchised businesses	English <i>et al</i> (1996:18)
<b>Density</b>		Mortality rate increases when density reaches carrying capacity and competition in a population becomes fierce	Petersen & Koput (1991:399)
<b>Source:</b> Own compilation based on literature review.			

Table 3.8 indicates that when considering the causes of failure in small businesses in the developed world, organisational systems, business size, business age, business locality and small business density (or overcrowding) are the greatest contributors to failure.

### **3.3.5 Environment-related causes of failure**

If acquired resources are not properly maintained or deployed, a symbiotic relationship between the environment and the organisation can turn into a negative outcome, culminating in small business failure emanating from environmental influences. These environmentally derived influences are presented first for developed countries (Table 3.9) followed by the situation in developing countries including South Africa (Table 3.10).

**Table 3.9: Environmentally related causes of small business failure in developed countries**

Failure category	Percentage failure (%)	Failure description	Source
<b>Economic factors</b>	75 %	Lack of profits	Holland (1998:2)
	65 %	Business not earning money	Watson <i>et al</i> (1998:229)
	30 % to 50 %	Interest rate	Everett & Watson (1998:371)
<b>Strategic perseverance</b>		Lack turnaround	Lorke <i>et al</i> (2004:63)
<b>Marketing</b>	64 %	Ignoring competition and inadequate business promotion	Khan (2006:2)
<b>Poor trading conditions</b>			Watson <i>et al</i> (1998:229)
<b>Environmental complexity heterogeneous task uncertainty)</b>		Complexity, for example, due to more product lines	Anderson & Tushman (2001:675)

Failure category	Percentage failure (%)	Failure description	Source
<b>Environmental uncertainty (unpredictability)/ dynamism/ turbulence (demand uncertainty, technology uncertainty)</b>		<p>Turbulent environments catalyse failure among firms with high customer dependence</p> <p>Failure due to a lack of balancing between capital structure and the competitive environment</p> <p>Failure due to changing environment. The higher the uncertainty, the higher the exit rate</p> <p>Environmental turbulence causing internal instability (for example, government legislation supporting birth and development of ventures, large companies, and society)</p>	<p>Venkataraman <i>et al</i> (1990:277)</p> <p>Dean &amp; Meyer (1996:107); Simerly &amp; Li (2001:38)</p> <p>Richardson <i>et al</i> (1994:9) Anderson &amp; Tushman (2001:675)</p> <p>Meyer (1982:515) Slevin &amp; Covin (1997:55) Venkataraman &amp; van de Ven (1998:231)</p>
<b>Low environmental munificence (resource abundance or scarcity)</b>		<p>Supportive environment</p>	<p>Castrogiovanni (1991:542) Maggioni, Sorrentino &amp; Williams (1999:287) Anderson &amp; Tushman (2001:675) Kodithuwakku &amp; Rosa (2002:461).</p>
<b>Founding conditions</b>		<p>Organisations founded in adverse environments experience higher mortality rate</p>	<p>Swaminathan (1996:1350)</p>
<p><b>Source:</b> Own compilation based on literature review.</p>			

In developing countries (including South Africa), external causes of failure involve a lack of vigilance by the owner-manager over the external environmental factors or changes (Mambula 2002:58; Kiggundu 2002:239; van Eeden *et al* 2003:45; Maas & Herrington 2006:35; Tushabomwe-Kazooba 2006:30; Okpara & Wynn 2007:26; van Scheers & Radipere 2007:86). The external causes of failure elements are discussed under infrastructure issues, economic issues, corruption, disasters, new technology, and low demand or sales. In this model, small business failure stems from the entrepreneur's inability to overcome internal weaknesses when faced with rapid environmental changes or turbulences that cause uncertainties. The external uncertainties can emerge from competitive intensities, high interest rates, high government taxes, load shedding as well as high petrol prices. Due to smallness and newness small business ventures may be perceived as not legitimate, resulting in failure to access funds from financial institutions. Finally, acute cash shortage may create a state of no performance. Stressing the foregoing, Nieman *et al* (2003:111) note:

Resources are the fuel needed to start and operate a business, just as petrol or diesel is the fuel for vehicles. If a business has insufficient resources or an inappropriate mix of resources, it cannot start or will operate just as poorly as the car with not enough or the wrong kind of fuel.

Table 3.10 summarises small business failures from the external environment that arise in developing countries.

**Table 3.10: Environmentally related causes of small business failure in developing countries**

Failure category	Percentage failure (%)	Source
Economic	45.0 %	Maasdorp (2002:733) van Scheers & Radipere (2007:87)
	47.7 %	van Aardt <i>et al</i> (2000:250)
Disaster	1.6 %	Maasdorp (2002:733)
Fraud	1.4 %	Maasdorp (2002:733)
Other	3.7 %	van Aardt <i>et al</i> (2000:250)
	24.5 %	Al-shaikh (1998:81)
Competition from large firms	12.0 %	Al-shaikh (1998:81)
Infrastructure issues	Major	Okpara & Wynn (2007:26)
Corruption	Major	Okpara & Wynn (2007:26)
Technology	Mentioned	Okpara & Wynn (2007:26)
Low demand	Mentioned	Okpara & Wynn (2007:26)
High interest rates/charges	36.0 %	Tushabomwe-Kazooba (2006:30)
High inflation	Mentioned	Tushabomwe-Kazooba (2006:30)
Fluctuating exchange rates	Mentioned	Tushabomwe-Kazooba (2006:30)
High taxation	53.0 %	Tushabomwe-Kazooba (2006:30)
Load shedding	50.0 %	Tushabomwe-Kazooba (2006:30)
<b>Source:</b> Own compilation based on literature review.		

### 3.3.6 Increasing awareness of small businesses as a source of investment

Research on business failures also needs to be grounded on the increasing awareness of the general South African public about the important role played by small business in the nation's economy and political stability. This positive mindset is an asset that cannot be ignored in any research on the failure of small businesses. With each passing day, potential small-scale entrepreneurs in South Africa see SMMEs as the avenue for them. The unemployed eye the SMME sector as the most expedient route for employment (Carter *et al* 1994:21; van Scheers & Radipere 2007:85). The relationship between the unemployment problem and the job creation potential of SMMEs places SMMEs in a unique position. Any mention of deaths of SMMEs should create concern among would-be entrepreneurs (van Scheers & Radipere 2007:85). This concern has already been noted in previous chapters.

Failure of small businesses is generally treated with some cognitive dissonance as they are anticipated to succeed around the world as well as in South Africa. Small businesses are regarded as a panacea for all ills. Table 3.11 confirms these widely held positions.

As discussed in Chapter 1, since 1994, the government of South Africa has attempted to improve its economic landscape by countering the idea that corporate South Africa is the key engine for growth via the promulgation of the National Small Business Act, Act 102 of 1996 of the Republic of South Africa (RSA) (RSA 1996). Simultaneously, in a bid to improve its efficiencies and embark on low-cost leadership through automation, corporate South Africa has been shedding employment in huge numbers. Consequently, the South African government is faced with numerous challenges from escalating unemployment (measured in 2007 at 25.5 % (strict definition) and 38.3 % (expanded definition); and high interest rates; high inflation figures; low foreign direct investment earnings; fluctuating Rand to US Dollar exchange rates, increasing petrol prices, and load shedding (Roodt 2008:211). Illustrating further the South African plight, the South African Global Entrepreneurial Monitoring (Foxcroft *et al* 2002:13) reports that there are only six entrepreneurs for every 100 adults that are surveyed.

**Table 3.11: Public awareness of the usefulness of the small business sector in South Africa**

Increased public awareness	Source
The SMME sector is globally regarded as the driving force in economic growth and job creation	Baron (1998:1) van Eeden <i>et al</i> (2003:13)
Worldwide, entrepreneurship is seen as one of the most important solutions to unemployment, poverty and low economic growth. The creation of new ventures and the growth of existing businesses are vital contributing factors to any economy	Botha <i>et al</i> (2007:163)
South Africa is a country of growing business opportunity in which the spirit of free enterprise is evident. The small business sector is an essential factor in promoting and achieving economic growth and development and the widespread creation of wealth and employment. Small business undertakings create about 80 % of all new job opportunities and more than 70 % of all South Africans are employed in the small business sector.	van Scheers & Radipere (2007:85)
<b>Source:</b> Own compilation based on the literature review.	

As compared with the rest of the 35 developing countries sampled, South Africa's formal sector entrepreneurial activities rank lowest (von Broembsen *et al* 2005:21) (Table 3.12) which is a worrying scenario for the country's economy and political stability.

**Table 3.12: Ratio and ranking by country of established business owners to early-stage entrepreneurs**

Country	Established business owners : early-stage entrepreneurs	
	Ratio	Global rank
Brazil	0.89	14
Thailand	0.68	24
Jamaica	0.56	28
Argentina	0.52	29
Venezuela	0.34	32
Chile	0.34	33
Mexico	0.32	34
South Africa	0.25	35
<b>Average</b>	<b>0.48</b>	

**Source:** Adapted from von Broembsen *et al* (2005:21).

The following information was obtained from the survey:

- Only five out of every 100 adults owned or managed a business younger than 3.5 years (an improvement on the position reported by Foxcroft *et al* 2002:13);
- Only 1.3 out of every 100 adults had a business older than 3.5 years;
- South Africa's start-ups were among the least likely to survive;
- Small start-ups employed few, if any, staff;
- Businesses did not differentiate themselves from their competitors through their products, consumer orientation or use of technology;
- Entrepreneurial education and skills were lacking;
- The number of entrepreneurs remained steady and was not growing;
- Complicated government regulation and taxation existed; and
- Only three out of every 100 adults were opportunistic entrepreneurs, while three out of every 100 were necessity entrepreneurs.

### **3.3.7 Roles of government organisations in supporting small business**

The South African government has recognised the need to assist SMMEs and has invested large amounts of resources to support the growth of the small businesses (RSA, 1996). The government has instituted organisations such as Khula, Ntsika and Seda to assist them to implement their SMME policy. Although government interventions have not had the maximum intended goals, the general South African public is aware that the government has genuine intentions to support SMMEs as a key engine of economic growth. This is another reason research into SMME failures needs to take account of the enormous resources that the government is committing to the growth of SMMEs (Ladzani & van Vuuren 2002:154) (Table 1.5).

### **3.4 CATALYTIC ACTIVITY OF SYSTEMS AS CONSTRAINING AND ENABLING STRUCTURES**

From the critical realist perspective, stakeholders can be conceptualised as sets of catalytic activity systems/mechanisms that can either support or threaten (catalyse) the existence, and finally accelerate the closing down, of businesses.

These systems thus have their own causal powers to affect small businesses in specific ways (Harre & Madden 1975:10; Lukacks 1978:34; Fleetwood & Ackroyd 2004:13). Their impacts on the businesses are, however, not deterministic but contingent on the interpretations given by the owners of the businesses.

The basic difference between the business success and failure factors then is that they represent opposing forces, dialectics of power or power struggles as mentioned previously. The business owner who is confronted with failure factors will naturally develop anxieties and, depending upon his make-up and coping skills, may be overwhelmed by the possibilities of failure and give up. It is in this connection that the role of meanings and perceptions about the situations that people face is an important element in this research. There is the need for one to understand and disclose the meanings which the people concerned attach to situations of uncertainty and stress and how they ultimately cope (Hill *et al* 2002:363; Krohne *et al* 2002:220; Shook *et al* 2003:392; Bouchard, Guillemette &

Landry-Léger 2004:222; Singh, Corner & Pavlovich 2007:333; Shepherd *et al* 2009a:590). From such understanding solutions can be found for the problems concerned (Yirenkyi-Boateng 1997:153; Danermark *et al* 2006:200).

From the above discussions, the critical realist method stands out as an approach which can justifiably be used as the conceptual framework for this research. The various discussions have indicated that the research problem translates basically into one of disclosing how the owners of the failed businesses have interpreted the business management principles and problems to create particular outcomes. The conceptual framework, as modelled in Figure 3.3, indicates the key processes involved to demonstrate the relations between the mechanisms and structures in the real level (the business management principles in their social context) and how they are interpreted by the agents (the owners of the businesses) located in the actual levels to produce the outcomes (business failures) at the empirical level. This type of conceptualisation can be better understood in terms of the following statement:

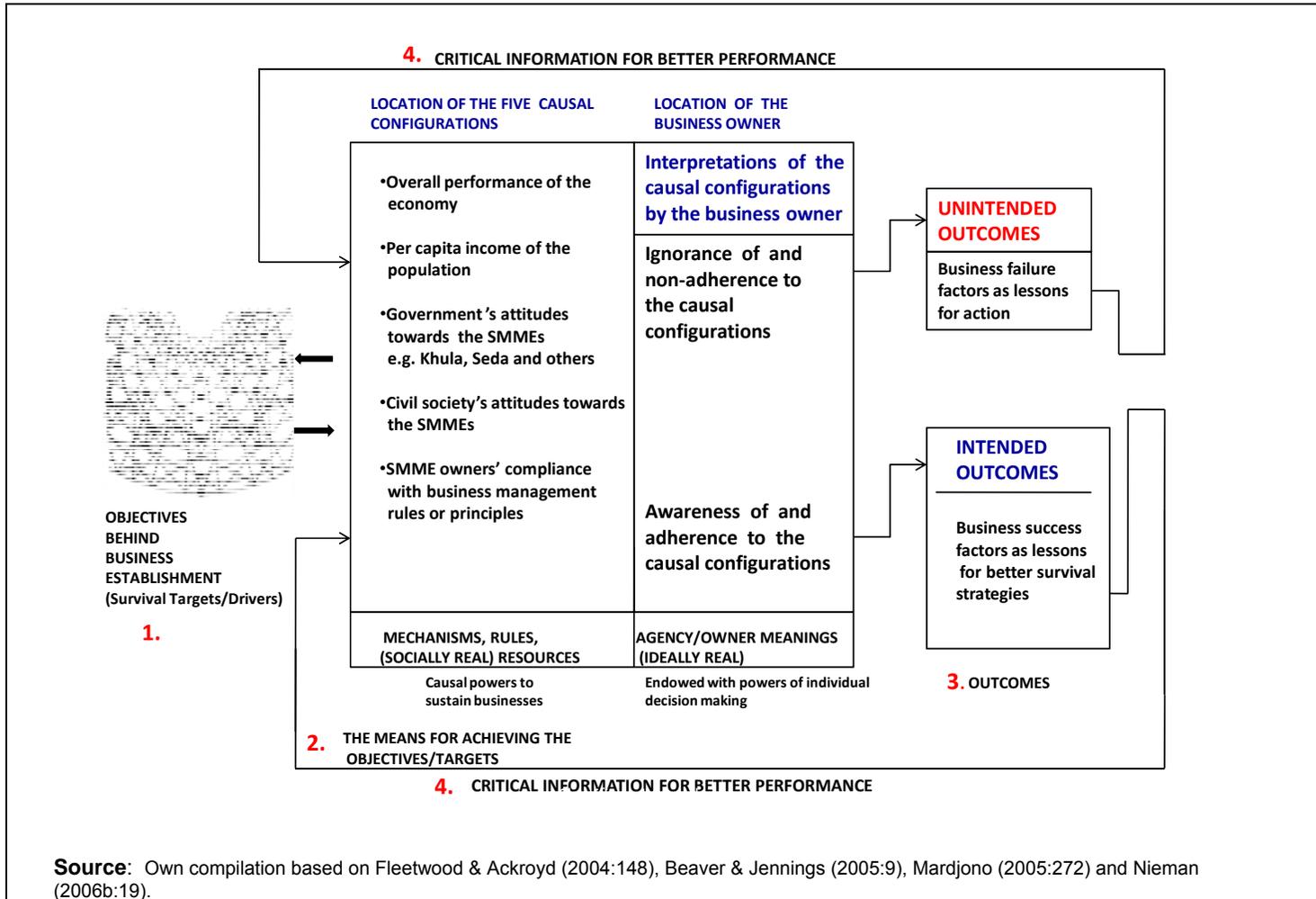
Organisations are structures that are reproduced by the participants in them, but they have emergent properties that bind participants into a particular pattern of relationship (Fleetwood & Ackroyd 2004:148).

The model (Figure 3.3) indicates that the owners of businesses establish their ventures in order to succeed (Wickham 2006:193). According to him, “entrepreneurs aim to be successful”. They set up their objectives with the aim of succeeding. Then comes the means to be employed to achieve the set goals. Figure 3.3 indicates that the means refer to some basic business management principles which need to be followed (Beaver & Jennings 2005:9; Nieman 2006b:19). It is such normative principles that were touched upon in Figure 3.2. These principles appear in Figure 3.3 as several related variables or business success elements with causal powers to ensure success (Thorne 2000:2). Next to the business management principles in Figure 3.3 is the location of agency in which the business owner interprets the principles to give rise to either success or failure. The outcomes, in turn, become the conditions for future events. This link between the outcomes and future processes is what is termed the causal relations between output and input or the dialectic relations in realist research (Wickham 2006:193).

Another issue which emerged from the above is that the mechanisms behind the business operations are constituted by particular materials responsible for their manifest properties as objects with the tendencies or potentials to ensure business success (Fleetwood & Ackroyd 2004:56;. Beaver & Jennings 2005:10). This concept is noteworthy and has been incorporated into this research as an element of critical realist research which can be located at the real level in the critical realist stratification model (Figure 3.3). The task of the business owner then is to establish these critical business success variables and the necessary conditions for their existence. This highlights one key feature of realism – its imputation of necessity to objects.

The business key success factors could thus, from this perspective, be described as having certain causal powers to ensure survival and sustainability by virtue of their inherent qualities (Mouton 1994:79; Macleod 1995:22; Fleetwood & Ackroyd 2004:12; Danermark *et al* 2006:54). In the critical realist method, causation is treated as based on causal powers or liabilities (susceptibilities) possessed by objects by virtue of the connections between the elements involved. Causal powers are seen as lying in the entire web of relations between the success variables or business management principles. A particular form of causal power will thus be possessed by the sets of variables concerned by virtue of their internal make-up. The business success causal powers are thus related directly to the nature of the objects or structures of which they are properties. Figure 3.3 is also linked conceptually to Figure 2.5 which indicated how failure to take account of certain business principles related to resources and opportunities, metaphors and other multiple feedback mechanisms could cause businesses to close down.

Figure 3.3 depicts the conceptual framework for the research. It summarises much of what was discussed in Chapter 2 and also what is going to be discussed in Chapters 4 and 5. The relations indicated in the model can be described from a number of perspectives.



**Figure 3.3: Proposed small business management conceptual framework**

Figure 3.3 is based on the three-tiered ontology of the critical realist research approach. The model relates three steps to the three levels in the real, actual and empirical, together with a fourth level – the feedback loop mechanism. The following explanations are provided for Figure 3.3:

**1 Objectives behind business establishment**

A study in the business management principles (structure) which are necessary for sustaining the small businesses. These are followed by the key success factors necessary for success, only when adhered to, but failure can ensue if the key success factors are not strictly adhered to (Beaver & Jennings 2005:9). By adherence or non-adherence, the outcomes can indicate who fails and who succeeds. Here all owners of businesses start a business with the intention to succeed by following business management principles.

**2 The means for achieving the objectives or targets**

Flowing from the first step is the study in structure-agency (business-to-owner fit) relations, the way individual owners of businesses (agency) interpret processes occurring within the real level. Decision making by the owners of businesses is involved at this step. The owners of businesses can decide to succeed or inadvertently to fail. This step distinguishes those who fail from those who succeed. The decision-making mechanism involves how different owners use their value judgements or perceptions to influence the small business' end results.

**3 Outcomes**

Directly from the second step follows the causal link between perceptions and failure, the meanings owners of businesses put on their business realities, the dialectic relations between outcomes and inputs for decision making. Here, the outcomes can be intended (success) or unintended (failure) as, in the beginning, all the owners of businesses are aiming for success.

#### **4 Critical information for better performance**

Lastly, there follows a critical feedback loop, either from intended consequences or unintended outcomes (failure) which improves, modifies, revises or revolutionises the current reality in the key success factors. The feedback loop mechanism becomes a study in the dialectics of power between small business failure and the business owner's belief systems (Neely 2002:120; Netswera 2001:31).

### **3.5 CONCLUSION**

This chapter has highlighted some pertinent issues that need to be taken into account in relating the business failure causes to the meanings connected with the practices of the owners of the failed businesses and other stakeholders. It has demonstrated that one cannot analyse the existence of business failure problems outside of the broader environment of business management principles.

This chapter has thus supplied the conceptual framework needed for resolving the research objectives. The next chapter indicates how the issues addressed in this chapter were implemented in terms of data collection and analysis.

## CHAPTER 4 RESEARCH METHODOLOGY

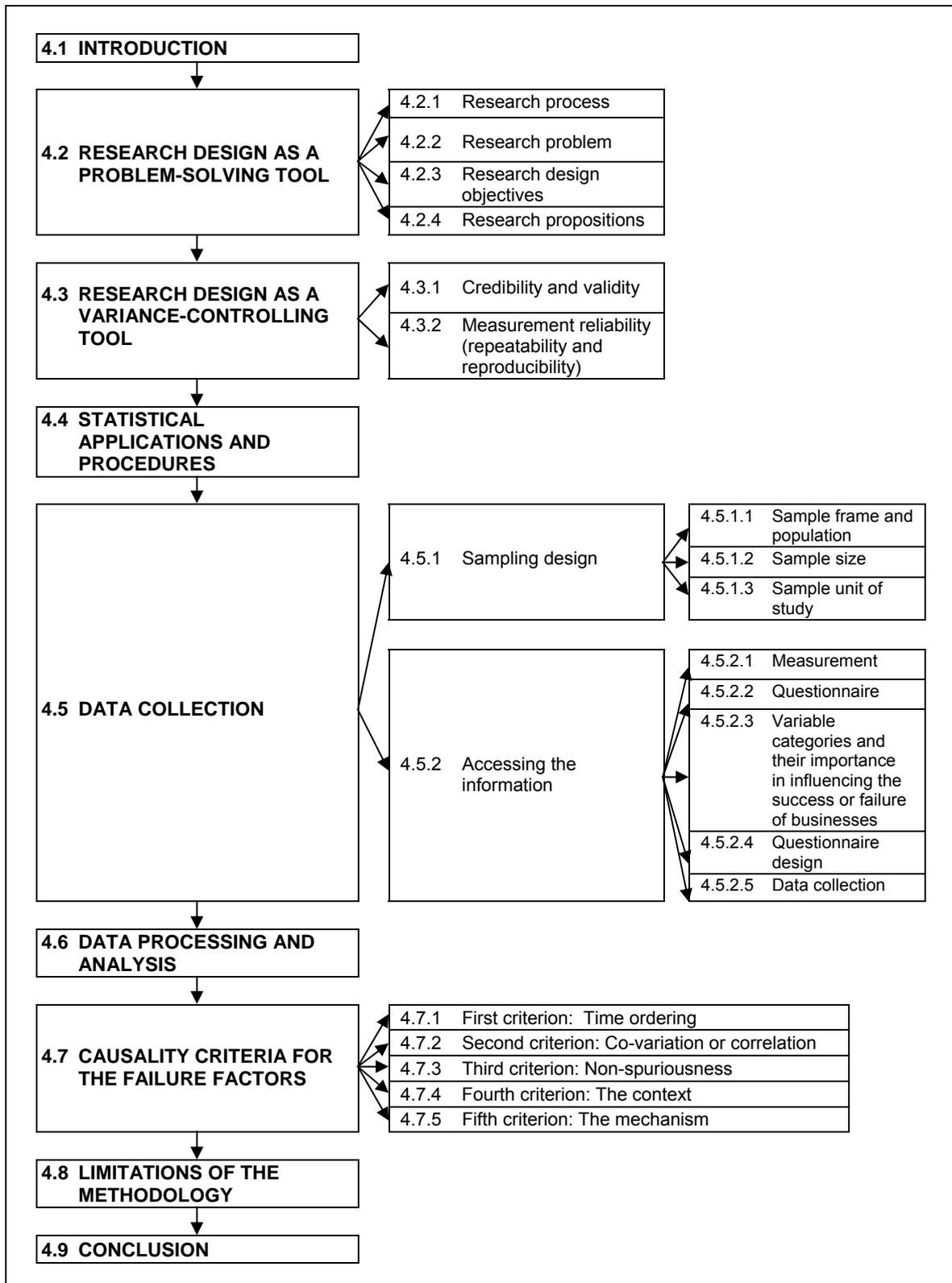


Figure 4.1: Layout of Chapter 4

## CHAPTER 4

### RESEARCH METHODOLOGY

#### 4.1 INTRODUCTION

In keeping with the issues addressed in Chapter 2 (Literature Review) and Chapter 3 (Conceptual Framework for the Research), the procedures for data collection and analysis in this chapter involved obtaining an account of what the owners of failed small businesses perceived as having caused their businesses to fail. This task was undertaken to enable this research to establish the causes of failures from the perspectives of the business owners themselves to address the second research question, “What causes do owners of the failed businesses report as having caused their business to fail?”. This chapter discusses the research design, data collection, data processing, causality criteria, and limitations of the research methods.

The data collection procedure involved obtaining empirical data from the owners of failed small businesses about the factors which closed down their businesses, finding statistical relationships between the variables concerned, and developing a causal explanatory model of the business failure processes from the variables. Kerlinger & Lee (2000:450) emphasise the significance of research methodology as a variable controlling mechanism by saying that research design helps investigators obtain answers to the questions of research and to control the experimental, extraneous, and error variances of the particular research problem under study. Further, according to Leedy & Ormrod (2005:93), data are like ore because they contain pieces of the truth but are in a rather unrefined state. To extract meaning from the data, what is commonly known as research methodology is employed. Data and methodology are inextricably interdependent (Juvan, Bartol & Boh 2005:485). For this reason, the methodology to be used for a particular research problem must always take into account the nature/type of data that are collected in the resolution of the problem. It is generally accepted that the nature of

the research problem must dictate the research method to be followed to collect the data.

As the data for this research are historical, the method used is retrospective or *ex post facto*. To answer why the retrospective or *ex post facto* methodology is suitable for this research, the approach was used to obtain information about objects which no longer exist. The retrospective or *ex post facto* design was consequently specific for the data to be collected.

According to Thornhill & Amit (2003a:506) a post-mortem analysis is preferred to other methodologies if the data being used are historic in nature. In approaching the causes of failure from a post-mortem approach, it has become clear that causes of small business failure can only be validated by the owners of the businesses who were present when the failure occurred. An explanatory methodological approach was required which allowed for the identification of the causes of the business failures, “How?” and “Why?” they failed in the research areas as a means to understand the complex nature of the phenomenon of failure.

Using this method there should therefore be no arguments regarding the causes of failure of the small businesses as the owner-managers emerged as the eye witnesses who possess first-hand information on the causes of the failure. As the owner-managers of failed businesses do know what caused the failure of their ventures, interviewing them eliminated any extraneous variables, thereby strengthening the cause-and-effect relations even in the absence of a control, normally used in scientific experiments.

A review of the extant approaches warranted the selection of an inductive, qualitative and quantitative methodology. According to Kerlinger & Lee (2000:558), and Johnson & Christensen (2004:346), in retrospective research, the researcher typically starts with the dependent variable (that is, with an observed result or outcome) and then moves backward in time, locating information on variables that help explain individual’s status on the dependent variable. Retrospective questions ask people to recall something from an earlier time in their lives. In explanatory non-experimental/retrospective research, researchers are interested in theories that explain “How?” and “Why?” a phenomenon operated as it did.

This type of explanatory research can be along cross-sectional or longitudinal time dimensions. Before cause-effect can be established, at a minimum level the three necessary conditions for concluding that the relationship between variable A and variable B is causal are: (1) there must be a statistically correlated/covariance relationship between variable A and variable B; (2) variable A must occur before variable B, and (3) spurious relationships must be eliminated. In retrospective analysis direct control is not necessary. Controlling for any extraneous variables is achieved through (1) matching, (2) restricting the study to a subpopulation, and (3) a statistical control. As far as the limitations of retrospective interpretation are concerned, according to Leedy & Ormrod (2005:85) and Kumar (2005:97), there are three notable weaknesses about which researchers need to be aware:

- The inability to manipulate independent variables;
- The lack of power to randomise; and
- The risk of improper causal interpretation or explanation.

Thornhill & Amit (2003a:506) point out that there is value to be gained from research into failed organisations:

Just as medical science would be unlikely to progress by studying only healthy individuals; organisation theory may also be limited in the knowledge attainable only from the study of successful firms.

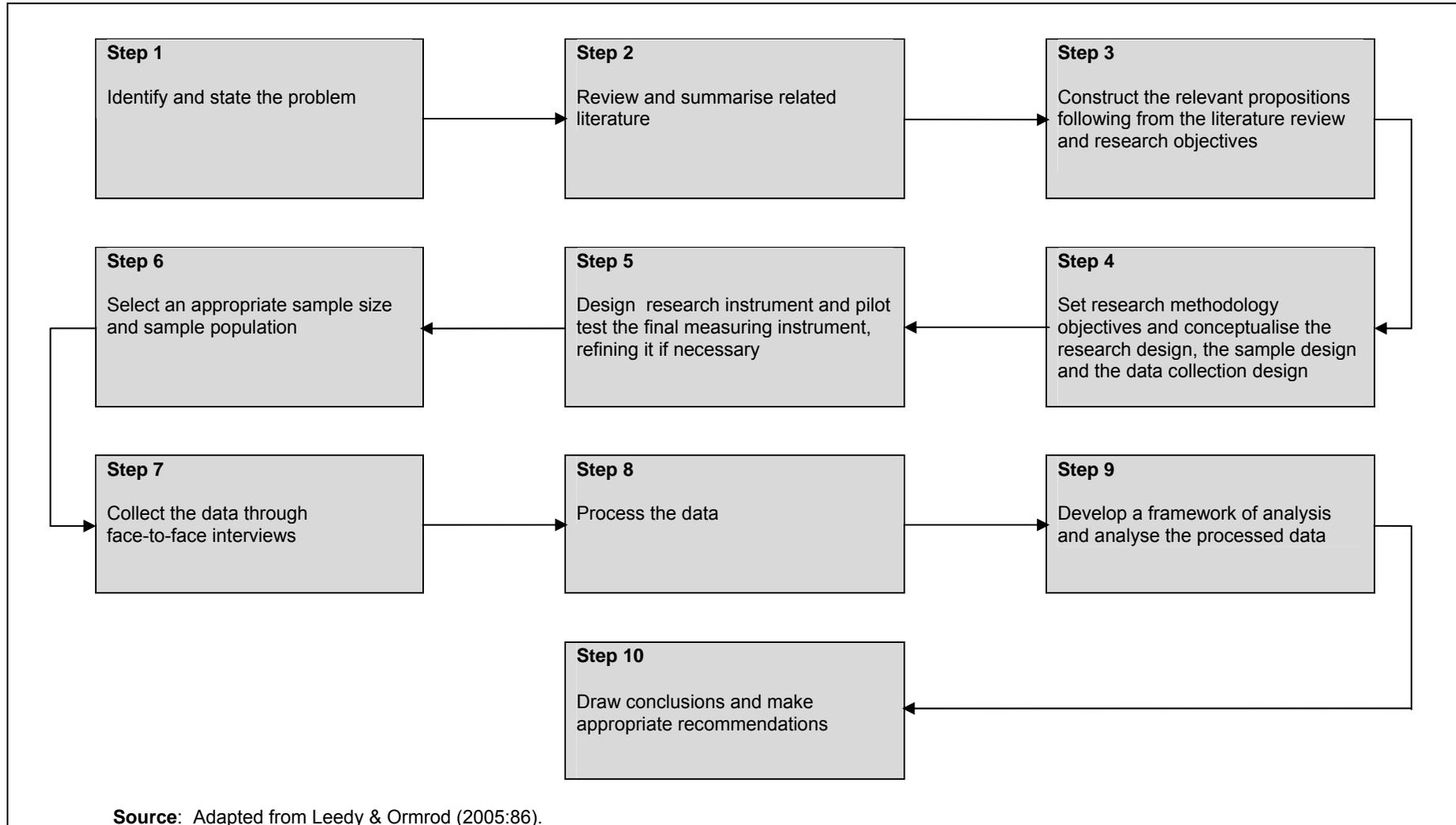
The ability to probe the causes of failure by studying specific instances, rather than macro-economic indicators, is a unique strength of the method. It follows, therefore, that the post-mortem methodology is suitable from an ontological and epistemological position to investigate and describe the causes of the small business failures in the research areas. The research design is explained in the next section.

## **4.2 RESEARCH DESIGN AS A PROBLEM-SOLVING TOOL**

The research design as a problem-solving tool follows the processes outlined in Section 4.2.1 as discussed by the following researchers: Zikmund (2003:42); Cooper & Schindler (2008:153); Mouton (2002:193), and Fouché & Delpont (2006:71).

#### **4.2.1 Research process**

According to Leedy & Ormrod (2005:85) research design provides the overall structure for the procedures the researcher follows, the data the researcher collects, and the data analyses the researcher conducts. The research process as recommended by the above researchers (p.85) was followed in this research and is depicted in Figure 4.2:



**Figure 4.2: Detailed research process followed in this research**

#### **4.2.2 Research problem**

As noted in Chapter 1, the research questions that prompted the research methodology of this research are restated as:

1. What causes do owners of the failed businesses report as having caused their business to fail?
2. How different are such causes from the existing theories?
3. Can a model for the better understanding of the causes of the business failures be created?

#### **4.2.3 Research design objectives**

The objectives underlying the research design are to:

- Handle non-experimental and retrospective data;
- Design a causal modelling methodology;
- State the research propositions underlying the study;
- Address the procedure for data collection; and
- Design a framework for the data analysis.

Having outlined the objectives behind the research design, attention is now focused on the research propositions related to the above design objectives.

#### **4.2.4 Research propositions**

The tentative solutions to the research problems stated in Chapter 1 are now stated as propositions in this section. Generally, propositions are tentative statements indicating what the present research expects to find in the field. They are specific expectations to be verified as hypotheses (Mouton 2002:187; Leedy & Ormrod 2005:270; de Vos 2006a:34). Indeed, there are those researchers who use propositions and hypotheses interchangeably (Cooper & Schindler 2008:64; de Vos 2006a:34). By relying on the propositions, one can obtain a good indication of what to expect in the findings of Chapter 5.

Attention is now redirected to the propositions for this research (Section 1.6), which are:

- P<sub>1</sub>** Monitoring and control contributes to failure in small businesses.
- P<sub>2</sub>** Experience and planning in finance and marketing contributes to failure in small businesses.
- P<sub>3</sub>** Income constraints contribute to failure in small businesses.
- P<sub>4</sub>** Cash control contributes to failure in small business.

These propositions are critical in disclosing the nature of the concrete or exact causes of the failures of the businesses under study. These concrete causes will emerge in Chapter 5.

### **4.3 RESEARCH DESIGN AS A VARIANCE-CONTROLLING TOOL**

Kerlinger & Lee (2000:455) stress the significance of research design as a variance controlling mechanism by emphasising that the main technical function of research design is to control variance. A research design is, in a manner of speaking, a set of instructions to the investigator to gather and analyse data in certain ways. It is thus a control mechanism.

According to Kerlinger & Lee (2000:456), controlling of variances involves:

- Maximising variances in variables from the hypothesis (dependent variable influenced by the independent variable);
- Controlling variance of extraneous or unwanted variables that may have an effect on the experimental outcomes; and
- Minimising sampling errors or random variance, including so-called errors of measurement.

### 4.3.1 Credibility and validity

Credibility and initial direction for the interviews were achieved in this research by ensuring internal validity. Initially 10 business people were approached and interviewed in a pre-pilot study (in 2005) on an ad hoc basis to establish what they believed caused small businesses to fail within a period of seven years from their initial start-up (Appendix C).

Using this input, an open-ended structured questionnaire was compiled which was pilot-tested (in 2006) on a further 50 owners-managers of small businesses that had failed within seven years of their start-up (Appendix B). These responses were used to fine-tune the final (2007) questionnaire (Appendix A) which was administered to a different sample of 254 owners-managers of small businesses that had failed within seven years of their start-up.

The aforementioned processes enhanced the internal validity of the instrument, thus avoiding extraneous factors to ensure that the instrument was designed to measure exactly what it was supposed to measure, that is, the small business failure process. The two types of threats to validity in retrospective design are internal validity threats and external validity threats.

Threats to internal validity in this research were reduced by optimising the selection of the sample, as there was no need to control other internal variances (Martella *et al* 1999:178). Threats to external validity were reduced by considering generalisations with reference to this research (Martella *et al* 1999:180). The measurement of the dependent variable (that is, the high failure rate of SMMEs), as well as the interaction of history and treatment effects were also considered.

#### 4.3.1.1 **CONSTRUCT VALIDITY**

Construct validity refers to the extent to which a set of measured variables actually represents the theoretical latent construct (unobservable) which they are designed to measure (Grimm & Yarnold 2002:99; Hair *et al* 2006:771; Cooper & Schindler 2008:253). In this research, ensuring construct validity implied at first scrutinising the theory and the instrument at hand. A higher than 0.7 Cronbach alpha value indicates that the instrument measured what it was supposed to measure, that is,

the causes of failure of the SMMEs. In Chapter 5, high Cronbach alpha values are reported, ranging from 0.80 to 0.98 across all the factors (Table 5.10).

#### **4.3.1.2      *CONTENT VALIDITY***

The content validity of a measuring instrument (composite of measurement scales) is the extent to which it provides adequate coverage of the investigative questions guiding the research (Hair *et al* 2006:771). In this research, ensuring the content validity meant including all construct or criterion validity as in the foregoing variables that were relevant to answering the research question and measuring them inclusively, to ensure that they were all included in the final measurement.

#### **4.3.1.3      *CRITERION VALIDITY***

Criterion-related validity reflects the success of the measures used for prediction or estimation (Cooper & Schindler 2008:253). It means predicting present or future outcomes of a condition or behaviour of a theory or construct under consideration. This involves multiple measurements and is established by comparing scores on an instrument with an external criterion known to measure the concept. In this research, the criterion measures were judged by ensuring their relevance, their freedom from bias, their reliability, and availability.

Mouton (2002:17) states that the three forms of validity are interrelated. For example, predictive validity would be handy for estimating the causes of failure from failed small businesses/ventures, while the variables to be used for prediction are introduced into the instrument via the construct validity. To include the full range of the construct to be measured in order to estimate the causes of failure in the small businesses is then a matter of content validity (the full range of all constructs to be estimated for their contribution to the failure).

In summary, when one asks how valid the above instrument is implies posing three questions about the small business failure process:

- What does this instrument mean? What is it in fact measuring, and how and why does it operate the way it does? (construct validity);
- How well does the instrument measure the small business failure process it wants to measure? (content validity); and

- How well does the instrument compare with one or more external criteria purporting to measure the small business failure? (criterion validity).

#### **4.3.2 Measuring reliability (repeatability and reproducibility)**

Reliability is the extent to which a variable or set of variables is consistent with what it is intended to measure. If multiple measurements are taken, the reliable measures will all be consistent in their values. Reliability differs from validity in that it relates not to what should be measured (accuracy/exactness), but instead indicates how it is measured (Hair *et al* 2006:771). According to Cooper & Schindler (2008:292) reliability is concerned with estimates of the degree to which a measurement is free of random or unstable error. Reliability is further understood as a partial contributor to validity (p.292). Reliability consists of the following constructs: stability, equivalence, internal consistency, and practicality.

##### **4.3.2.1 STABILITY**

Stability in this research was ensured during the interviews by remaining consistent in the method of obtaining answers from the respondents. All the respondents were treated in such a way that if they were to be approached a long time after the interviews, they would still be expected to answer in the same way if the identical question were posed to them under the same conditions or environment.

##### **4.3.2.2 EQUIVALENCE**

Equivalence was ensured by allowing the same interviewer to conduct and complete the research, asking questions in the same way while the scales remained the same to allay the fear of the interviewees in the same way. This thereby created some consistency in the manner of approach to the entire sample.

##### **4.3.2.3 INTERNAL CONSISTENCY**

Internal consistency or homogeneity in this research was realised during the interview process by making use of the split-half technique, in which similar questions were inserted under different variables. For example, under the factor

“experience and planning in finance and marketing” (factor 2) the same answers were expected although two discernibly different categories of questions were posed (Appendix A.2.2: questions 10 and 14). The high Cronbach alpha among factors obtained in the research served as evidence of the correlation of the assertions.

#### **4.3.2.4 PRACTICALITY**

The measurement in this research met the test of practicality by making it cost-effective and convenient for the interviewer to administer and the respondents to interpret.

### **4.4 STATISTICAL APPLICATIONS AND PROCEDURES**

Without statistics, the processing and analysis of the vast array of data would have been a daunting task, since, as stressed by Leedy & Ormrod (2005:30), statistics have two prime functions: to help the researcher (1) describe the data and (2) draw inferences from the data.

The main types of statistics used in handling and processing the mass of data during this research were factor analysis and the analysis of variance (ANOVA).

Lastly, to determine whether the different forms of behaviour of the variables were purely due to experimental interventions, chance or due to methodological designs, the research used inferential statistics, that is, making estimates from samples and applying them to the population. This refers to the statistical method whereby the research arrives at decisions by making inferences from the collected data as explained before.

### **4.5 DATA COLLECTION**

Data collection is a process of identifying samples from which to collect data (Leedy & Ormrod 2005:6). Schematically, it involves the relationship between a population, elements, and a sample. In this research, all small businesses in South Africa constitute the “universe”. All the failed small businesses are known as the

“population”. The failed small businesses in this research are the “sample”. Each failed small business is an “element”. Thus, an Element < Sample < Population < Universe.

#### 4.5.1 Sampling design

Mouton (2002:136) asserts that the key concept in sampling is representativeness. Unless the sample from which we will generalise truthfully or faithfully represents the population from which it was drawn, we have no reason to believe that the population has the same properties as those of the sample.

To overcome the problem of sample bias, this research made use of the systemic random sampling method to select failed small businesses.

This was followed by a “snowball” sampling technique, explained by Cooper & Schindler (2001:194, 2008:388) as follows:

“Snowball” sampling has found a niche in recent years, in applications where respondents are difficult to identify and are best located through referral networks. In the initial stage of snowball sampling, individuals are discovered and may or may not be selected through probability methods. This group is then used to locate other respondents who possess similar characteristics and who, in turn, identify others. Similar to a reverse search for bibliographic sources, the snowball gathers subjects as it rolls along.

A list of 55 000 failed small businesses was obtained in 2006 from the **dti** department responsible for registering small businesses (the Companies and Intellectual Property Registration Office). Additional lists of failed small businesses were obtained in 2006 from the Limpopo Development Corporation, the Mpumalanga Economic Empowerment Corporation, and the Botswana Development Corporation.

From these lists, a random selection of 254 failed small businesses was made for the purpose of addressing the objectives of the research. These ventures had failed between the period 2000 and 2006. At first, every 100<sup>th</sup> failed venture was selected using names and addresses through a random systematic sampling

method. Those who did not agree to be interviewed suggested the names of other failed small businesses and, using this snowball sampling method, finally 254 interviews were completed. The end result was a sample consisting of 254 failed small businesses in the Gauteng, Limpopo and Mpumalanga provinces of the Republic of South Africa and also from Gaborone in Botswana whose owners were interviewed between January 2007 and December 2007.

#### **4.5.1.1 SAMPLE FRAME AND POPULATION**

Business methods researchers, such as Cooper & Schindler (2001:170, 2008:383) and Zikmund (1997:420, 2003:511), define the sample frame as being closely related to the population. The sample frame is understood as the list of elements from which the sample was actually drawn. In this research the sample frame thus refers to all the closed SMMEs in the research area.

#### **4.5.1.2 SAMPLE SIZE**

Statisticians maintain that a larger sample is always better because of a lower random sampling error (Cooper & Schindler 2001:170, 2008:385; Zikmund 1997:471, 2003:511). The following parameters of interest dictated what sample and what sample size were needed:

- Variation (heterogeneity) or dispersion within the population;
- The desired precision or repeatability;
- The higher the confidence levels in the estimate, the larger the sample needed for the research.

According to Hair *et al* (2006:112), researchers should not analyse by factorising a sample of fewer than 50 observations, and preferably the sample size should be 100 or larger. As a rule, the minimum is to have at least five times as many observations as the number of variables to be analysed, and a more acceptable sample size would have a 10:1 ratio.

The final sample for this research consisted of 254 failed small business owners-managers as discussed in Section 4.5.1. The geographical areas covered were: Gauteng Province, Limpopo Province, Mpumalanga Province, and Gaborone in Botswana. Table 4.1 provides details of the respondents interviewed in the

research area and is related to the “referral” or “snowballing” method of sampling used.

**Table 4.1: Table of respondents**

Province	Number of respondents (n)	Percentage of sample (%)
Gauteng	113	44.5
Mpumalanga	51	20.1
Limpopo	76	29.9
Botswana	14	5.4
<b>Total</b>	<b>254</b>	<b>100.0</b>
<b>Source:</b> Own compilation from empirical research.		

#### **4.5.1.3 SAMPLE UNIT OF STUDY**

A sample unit is understood as a single element or group of elements subject to selection in the sample (Zikmund 1997:423, 2003:496). The survey unit is the SMMEs that failed in the Gauteng, Limpopo and Mpumalanga provinces of the Republic of South Africa, and Gaborone in Botswana within seven years of their start up (namely, between 2000 and 2006). The list of the businesses in the four research areas is stored both on compact discs and in hard copy format. The information is confidential in accordance with the respondents’ request for privacy.

#### **4.5.2 Accessing the information**

Participation and interaction with the owner-managers of the failed businesses enabled them to freely explain the causes of their business failures. The qualitative method used in the research enabled a deeper understanding to be obtained of the meanings attributed to the business management principles by the owner-managers of the failed businesses (Silverman 2001:101; Beaver & Jennings 2005:15).

The researcher undertook all the interviews to collect the data. The data were collected after the instrument had been pilot-tested on 50 owners-managers of failed small businesses and fine-tuned.

Data collection took place between January 2007 and December 2007. The theory of causal comparative (non-experiment) or critical realist retrospective methodology guided the researcher on how the data should be collected.

#### **4.5.2.1 MEASUREMENT**

Measurement is the process of quantifying or scoring variables influencing the business failure process. Measurement occurs after the data have been collected (Gay, Mills & Airasian 2006:128). A 4-point Likert scale was used to measure differences among the demographic groups classified as categories. These categories were scored by measuring from “strongly disagree” = 1 to “strongly agree” = 4. The factor analysis method was also used to measure the strengths of the failure variables.

#### **4.5.2.2 QUESTIONNAIRE**

The designed questionnaire sought to explore the possible causal relationships between the variables (Gall, Borg & Gall 1996:373). The chosen design was retrospective, causal-comparative or non-experimental. According to Charles (1998:350), causal-comparative research highlights cause-and-effect relations. The retrospective or *ex post facto* design is specific for the collection of data. Thornhill & Amit (2003a:506) are of the opinion that a post-mortem analysis is preferred to other methodologies in investigating failure mainly because it deals with instances of failure, as already stated.

In using the variables collected from the field to build causal models, it was ensured first that the variables selected complied with the principles of empirical associations, appropriate time order, non-spuriousness, the identification of a mechanism and external validity (as discussed in Chapter 1).

The complete questionnaire used in 2007 is provided in Appendix A and consists of 15 close-ended questions and one open-ended question. The reasons certain variables were chosen for inclusion in the questionnaire follow in the next sections.

#### **4.5.2.3 VARIABLE CATEGORIES AND THEIR IMPORTANCE IN INFLUENCING THE SUCCESS OR FAILURE OF BUSINESSES**

The interactions with the owner-managers of the failed small businesses led to the emergence of the concepts and variables associated with the business failures.

The variables are discussed under two headings:

- those related to the production, sales and monitoring processes in business management (the internal environment); and
- those related to the activities of the stakeholders/supportive or networking business environment associated with the owners of the businesses (the external environment).

In terms of the foregoing, the review of the causes of the business failures suggests 51 possible variables. Those variables relate to the state of the finances of the business, the demand factors, the extent of innovation adoption, and the overall sustainable management of the business. The variables were informed by the Literature Review (Chapter 2); the discussions in Chapter 3; the information garnered from the pre-pilot and pilot tests and from the hindsight information emanating from the owner-managers of the failed small businesses. The 51 variables which were used represent the answers the respondents gave for the failure of their businesses. In the questionnaire, the respondents were given the opportunity to indicate their opinions on the influences they felt the variables imposed on their normal operations and the steps they took before the businesses finally closed down.

One cannot readily make sense of such a large number of apparently unrelated variables. A method of reducing the large numbers into a manageable set of groups therefore became necessary. The data were thus subjected to reduction using the method of factor analysis. The factor analysis-based classification produced the ultimate/final groups upon which the recommendations of the research are based.

#### **4.5.2.4 QUESTIONNAIRE DESIGN**

Ten business people were approached and interviewed in 2005 in a pre-pilot study on an ad hoc basis to establish what they believed caused small businesses to fail

within seven years from their initial start-up (Appendix C). From this input, a qualitative questionnaire was designed (Appendix B) and tested in 2006 on 50 owners-managers of small businesses that had failed within seven years of start up to check for validity and accuracy. The input obtained from the pilot study (Appendix B – conducted in 2006) was used to fine-tune the final research questionnaire which was administered in 2007 (Appendix A). The set of owner-managers who was interviewed for the 2006 pilot study was not interviewed again when the final instrument was administered to avoid test bias. A fresh set of 254 owner-managers of small businesses that had failed within seven years of start up was identified from the Gauteng, Limpopo and Mpumalanga provinces in the Republic of South Africa as well as from Gaborone in Botswana and interviewed to collect the final data.

#### **4.5.2.5 DATA COLLECTION**

Data were collected in 2007 by conducting face-to-face interviews with 254 owner-managers of small businesses that had failed within seven years of start up in the Gauteng, Limpopo and Mpumalanga provinces of the Republic of South Africa, and Gaborone in Botswana. The method of face-to-face interviews was chosen to administer the final questionnaire because it enhanced the accuracy of data collection. It also increased the response rate (which was 100 %) as firm appointments were made to interview the respondents. The appointments were confirmed telephonically prior to the interviews. The final data were collected in two sections, namely, demographics and the causes of the failure.

The interview commenced with the interviewer reassuring the respondents that the outcomes of the research would be made available to trainers, financiers and policy makers of small businesses as input in the future development of the small business sector. This reassurance assisted the respondents to understand that, by participating in this research, they stood the chance of benefiting from small business developers, financiers, as well as the relevant policy makers. The tone of the questionnaire was friendly to reduce the respondents' anxiety during the interviews.

The first part of the questionnaire concerned mainly the small business' demographics and other background information which served as a memory-jogger in retrieving the causes of past failure for those respondents who suffered memory lapses.

The second section of the questionnaire related to the causes of failure variables, such as business management skills, experience and financial management. The last question in this section was unstructured and open-ended to bring the understanding of failure to completion from the owner-manager's perspective and enabled the researcher to obtain freely divulged information to understand the causes of their business failures.

During the interview, the interviewer took notes of hindsight and anecdotal evidence not explored by the questionnaire. These notes were transcribed afterwards and studied to find any nuances that might need further probing to enrich the value of the research.

The processing of data and its analysis is discussed in the next section.

#### **4.6 DATA PROCESSING AND ANALYSIS**

The processing of the data entailed the checking of the completed questionnaires, coding, and data capturing as well as the computer processing that involved a methodology known as BMDP4M Factor Analysis from the Statistics Department of the University of Pretoria. The same program was used to execute the factor analysis model. The researcher checked the output from the analysis prior to constructing the tables. The ANOVA involved the use of the SAS GLM computer program<sup>1</sup>. Further analysis was conducted by using frequencies for analysing

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<sup>1</sup> Copyright (c) 2002-2008 by SAS Institute Inc., Cary, NC, USA.

rankings. The results gave some direction into the statistical empirical associations inherent in the data reflecting the concrete actions of the owner-managers of the failed small businesses.

The results of quantitative data analysis merely disclose statistical associations at the empirical level. To undertake the process of causal modelling within the realist approach, there was the need to follow certain procedures ending in the identification of the causal mechanism behind the business failures and context for the research (Martin & McIntyre 2002:10). These procedures were applied through the causality criteria following in the next section.

#### **4.7 CAUSALITY CRITERIA FOR THE FAILURE FACTORS**

As indicated in various sections of this research, searching for the causes of failure of the businesses studied constitutes the key objective of this research (Johnson & Christensen 2004:231). Fleetwood & Ackroyd (2004:169) point out that there are two types of causal relationships: causal description and causal explanation. Causal description refers to describing the consequences of manipulating an independent variable. Causal explanation/causality/causation, in contrast, refers to explaining the mechanisms under which a causal relationship holds (Johnson & Christensen 2004:231). Both causal relationships are applicable to this research. One merit of this research thus relates to its use of both qualitative and quantitative research methods.

Researchers are continually being required to place the construction of “causal models” at the forefront of theories in business and social research. This development stems from the increasing realisation that the success of specific social interventions and the consequent credibility of social research in general depend on our knowledge of the specific mechanisms which make certain things to happen (Danermark *et al* 2006:54).

“Causal modelling” involves identifying a group of independent (predictor) variables which influence the object of research to yield certain outcomes or effects (dependent variables). Fleetwood & Ackroyd (2004:152) opine that an action (X) is causal if its outcome (Y) is produced by a mechanism operative in a

given context. According to Cooper & Schindler (2001:151, 2008:153); Johnson & Christensen (2004:231); and Gay *et al* (2006:334) research organised within the framework of causality needs to satisfy a number of conditions/criteria. In this research the three historical criteria have been extended for the completeness of causality testing to the five criteria which follow:

#### **4.7.1 First criterion: Time ordering**

This indicates that the action of the cause comes first in time. This implies that researchers must ensure that the one that occurs first is the cause of the one that occurs second – that is, the cause X actually creates the effect Y. Thus, in this research, the researcher ensured that the factors behind the business failures were there before the businesses failed (precursors), and not the other way round. In Chapter 5, four such factors are identified.

#### **4.7.2 Second criterion: Co-variation or correlation**

Even if the first condition has been satisfied, the second condition is that the variables concerned must also co-vary. The variables must move together in some patterned way. Statistical correlations have been used in Chapter 5 to satisfy this condition by relating the SMME failures to a number of variables which were subsequently reduced to four factors. Such statistical correlations do not, however, “make” causal explanations.

Before one can be sure that one has found a causal connection between any two variables, one must satisfy a third requirement for causality which is that the relationship must not be spurious (an extraneous intervening variable should not influence the relationship between two variables, X and Y, that are understood to have a causal relationship).

#### **4.7.3 Third criterion: Non-spuriousness**

A spurious or intervening relationship exists when there is an apparent but not a genuine causal connection between two variables, X and Y. With a spurious relationship, the appearance of a causal connection between two variables X and

Y is due to the fact that both variables are causally linked to a third variable, Z. If one is unaware of the presence and influence of Z, one can mistakenly conclude that X is causing Y whereas, in fact, Z could cause X and/or Y. This condition has also been satisfied in this research by ensuring that the questions posed to the respondents in Appendix A sought to establish direct links between the business failures and the underlying causes.

After the above three conditions have been met, for completeness, a further two criteria are also important. These conditions are: the context and the mechanism.

#### **4.7.4 Fourth criterion: The context**

When relationships among variables differ across geographic units like countries or across other social settings, researchers say there is a contextual effect. Identification of the context in which a causal relationship occurs can help to understand that relationship (Fleetwood & Ackroyd 2004:152). In this research, it needs to be noted that the context refers to the circumstances under which the data were collected from the 254 respondents. This also includes the critical position occupied by the SMMEs in their development of South Africa's economy.

#### **4.7.5 Fifth criterion: The mechanism**

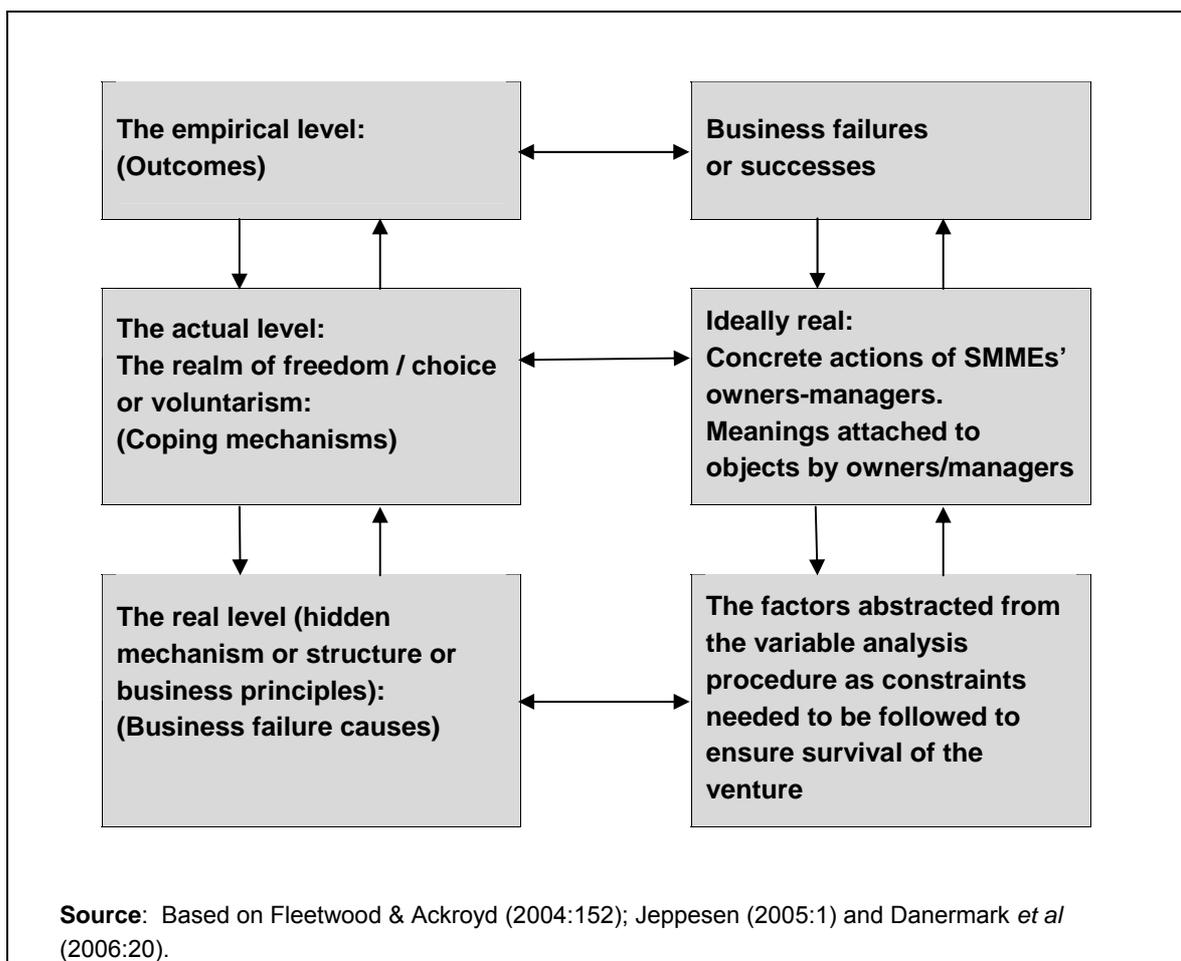
Lastly, this research applies processes or mechanisms operating at the real level in explaining the causes of the business failures as central to this research (Fleetwood & Ackroyd 2004:152; Danermark *et al* 2006:55).

In Chapter 3, a model (Figure 3.3) was presented as constituting the broad conceptual framework for this research. It was indicated that the critical realist approach was going to be used to conceptualise the business management principles and the business environment/stakeholders as groups of related elements which could be interpreted by the owners of the businesses to produce some particular outcomes. These appear in Figures 4.3.

Fleetwood & Akroyd (2004:152) classify real objects into four: materially real, ideally real, artefactually real and socially real. The mode of realism employed in

this research belongs to the second and fourth versions. These two elements of the real concept in the application of critical realism were selected to address the issues that were raised under Section 3.5. They explain that ideally real focuses on how the ideas, beliefs, opinions and meanings impact on the concrete actions of agents. Socially real in this research will apply to elements such as the stakeholders, laws, rules, and guidelines on business management principles that need to be adhered to to enable certain things to happen (as illustrated in Figure 3.3).

Figure 4.3 is a model indicating how the business management principles element is positioned in the real level of the realist stratification model as rules, key success factors, resources or opportunities.



**Figure 4.3: The real, actual and empirical levels indicating the two perspectives of the research objectives**

Further, Figure 4.3 focuses on the activities of the owner-managers of the failed small businesses by indicating the relations between the concrete business management failure factors and the meanings which the business owner-managers attach to them. The business failure factors now occupy the real level. This model (Figure 4.3) is thus based on the critical realist three-tiered ontology comprising the real, the actual level and the empirical levels as discussed below (Sayer 2000:15; Fleetwood & Ackroyd 2004:21,79; Jeppesen 2005:1; Danermark *et al* 2006:80).

Critical realist work identifies the relationships between what one experiences (“What?”), what actually happens (“How?”) and the underlying mechanisms (“Why?”).

A brief account of the levels follows.

- The **real level** in these models indicates the mechanism (the sets of related variables under which the businesses operate). This socially real level is constraining and enabling in the sense that the individual entrepreneur can interpret the powers of the mechanisms differently to produce different outcomes.
- The **actual level** is the realm of events. The entrepreneur can interpret the constraints, resources, opportunities, and tendencies in the real level in various ways to produce different outcomes at the empirical level. The actual level then represents the location of freedom or agency where the entrepreneur can take concrete decisions to address particular goals. Wickham (2006:152) opines that owners of businesses who are predisposed to believing in failure will obviously fail. Such business owners would reify the business challenges and problems, seeing them as somehow immutable. Owners of businesses who see nothing but success in their business operations would, however, have the tendency to succeed.

One virtue of the critical realist approach is that new information and other forms of assistance can always be given to agents (the owner-managers of the failed small businesses in the present case) to enable them to overcome their weaknesses, threats, problems and challenges and also make maximum use of their opportunities, resources, strengths and potentials. Such resources and

opportunities can, in fact, be used to transform the nature of the processes within the real level. The realist approach is therefore an open-ended and action-oriented research.

- Finally, the **empirical level** represents the outcomes of the interactions between the real and actual levels. Here, everybody can observe intended outcomes (business successes) and the unintended outcomes (business failures). Figure 4.3 thus indicates that, to understand the business failures, one has to examine the processes in both the real and actual levels.

The models above thus give a picture of the importance of understanding the nature of processes occurring both within the real and actual levels.

The research findings and analysis in Chapter 5 will focus attention largely on how the real and actual levels have operated to influence the outcomes (business failures) in the empirical level.

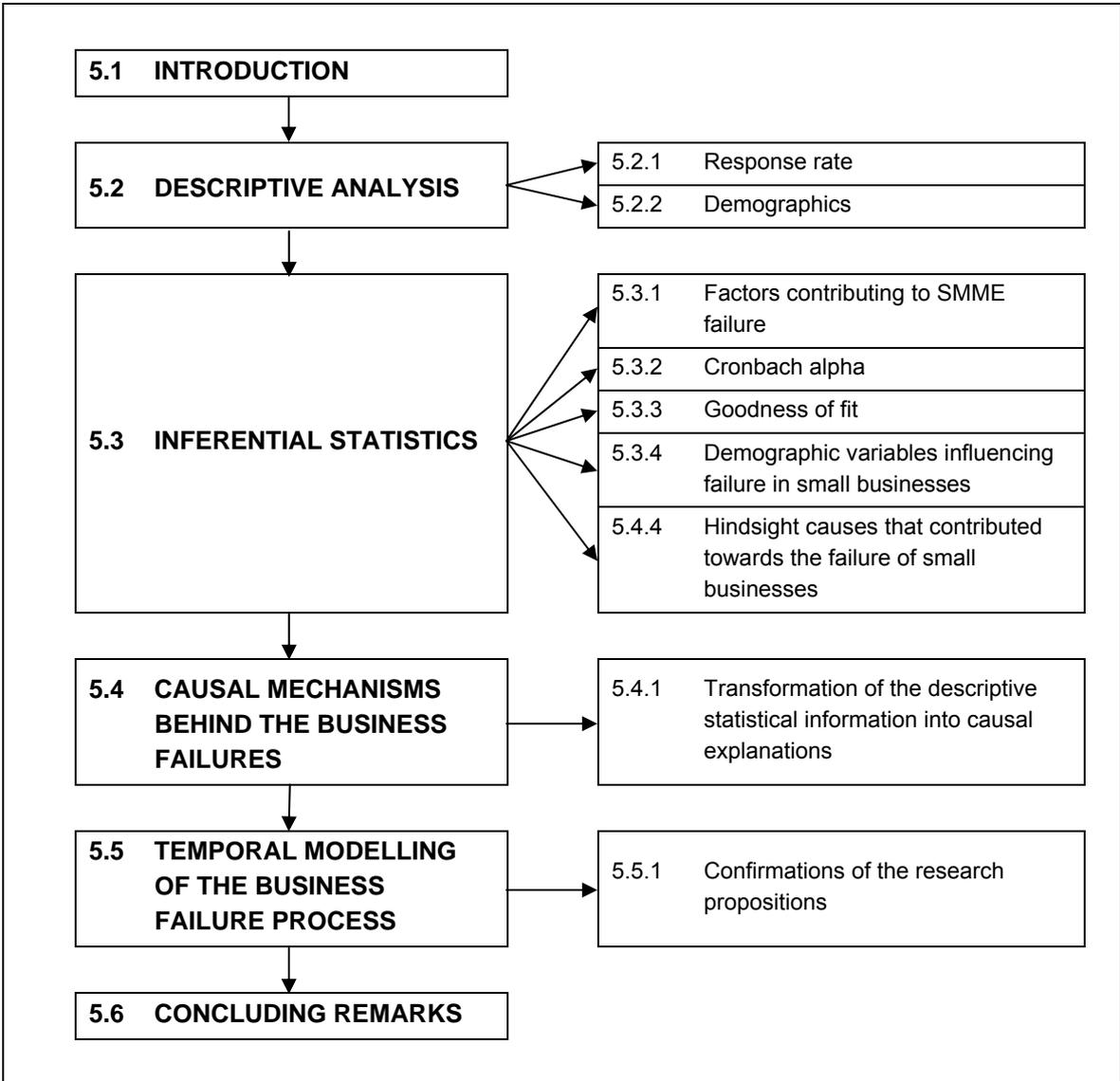
#### **4.8 LIMITATIONS OF THE METHODOLOGY**

A research report without limitations could indicate that the researcher is unprofessional and possibly unethical. Despite the prospects of realist research to establish causal relationships between or among variables, such interpretations were made with caution. A number of problems were faced during the data collection process: some of details regarding the owner-managers of failed small businesses were not updated, making them difficult to trace. Some potential respondents refused to be interviewed because they were still being haunted by the effects of failure and those owing their creditors were afraid to be interviewed as they thought the police were after them.

#### **4.9 CONCLUSION**

The chapter introduced the relevant and historic data-specific methods that were used to collect and analyse the data to address the research objectives. In the next chapter, attention is given to the findings and analysis of the research.

**CHAPTER 5**  
**FINDINGS AND ANALYSIS**



**Figure 5.1: Layout of Chapter 5**

## CHAPTER 5

### FINDINGS AND ANALYSIS

#### 5.1 INTRODUCTION

The goal of any research endeavour remains to find answers to questions (Graziano & Raulin 2000:369).

This chapter reports the findings under two sections. Section 5.2 deals mainly with the descriptive analysis, whilst Section 5.3 focuses on inferential statistics as well as the explanatory or causal modelling process explaining the causes of the business failures. The analysis is presented in Section 5.4 and Section 5.5. Section 5.6 concludes the chapter.

#### 5.2 DESCRIPTIVE ANALYSIS

This section deals with the description of and findings on the demographics of the sample.

##### 5.2.1 Response rate

Interviewing the respondents (the owner-managers of the failed small businesses) face-to-face enhanced the response rate and accuracy of the research. The researcher had ample opportunity to clarify any possible misunderstandings which could otherwise have skewed the answers and resulted in potential response bias. The response rate was high (100 %) since the respondents had agreed to be interviewed and a firm appointment was set up for each interview. As discussed in the sample design (Section 4.5.1), the random systematic sampling method and the snowball method were used to identify respondents. All 254 respondents were available, willing, and managed to complete the questionnaire as presented to them.

## 5.2.2 Demographics

In order to profile the respondents, demographic information was obtained as a backdrop for the research. The parameters probed involved venture ownership; years before venture failure; business ownership and experience held before the venture failed; the nature of the business; exposure to a role model (mentor); frequency of business planning, and frequency of conducting cash-flow budgeting. These data were deemed useful in the appropriateness of a future training programme for directing it to the relevant trainers. The type of venture ownership and management is given in Table 5.1.

**Table 5.1: Type of venture ownership and management**

Ownership	Frequency (n)	Percentage (%)
Owner	8	3.15
Manager	4	1.57
Both	242	95.28
<b>Total</b>	<b>254</b>	<b>100.00</b>

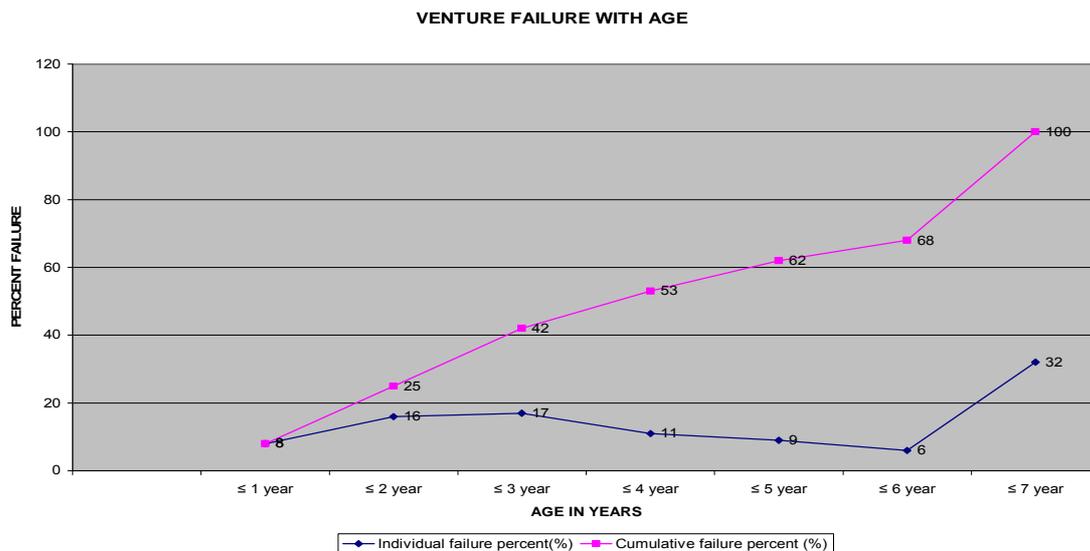
The above information was to find out who owned and operated the small business before it failed.

Table 5.2 shows how long the respondent had been operating the small business before it ceased to exist.

**Table 5.2: Years before venture failed**

Years before failure	Individual frequency (n)	Cumulative frequency (n)	Individual failure percentage (%)	Cumulative failure percentage (%)
≤ 1 year	22	22	8.66	8.66
≤ 2 years	41	63	16.14	24.80
≤ 3 years	43	106	16.93	41.73
≤ 4 years	28	134	11.02	52.75
≤ 5 years	23	157	9.06	61.81
≤ 6 years	16	173	6.30	68.11
≤ 7 years	81	254	31.89	100.00
<b>Total</b>	<b>254</b>	<b>254</b>	<b>100.00</b>	<b>100.00</b>

It is interesting to note (Table 5.2) that 32 % of the sampled small businesses failed in the first seven years of operation. The evidence is illustrated graphically in Figure 5.2.



**Source:** Own compilation based on Table 5.2.

**Figure 5.2: Individual and cumulative percent scores versus years before failure**

Figure 5.2 shows that cumulative failure increases with years, as expected.

The results are contrary to the situation in developed countries as observed by Cressy (2006:103) who notes that chances of failure first rise steeply and then tail off gradually to converge on a small, long-run failure rate. As a result, Cressy asserts: “most firms die young”. However, in South Africa, the government – together with financiers – offers grants to SMMEs to reduce failure at birth, so they survive for the first three years and then start to fail in larger numbers due to liability of adolescence (Table 1.3, Section 1.3, Table 2.3, Table 2.5, Section 2.5.2.2, Figure 2.7 and Figure 2.8).

The next issue that was examined related to business ownership and management experience before failure (Table 5.3).

**Table 5.3: Business ownership experience before failure**

Business ownership experience	Frequency (n)	Percentage (%)
Yes	72	28.35
No	182	71.65
<b>Total</b>	<b>254</b>	<b>100.00</b>

Table 5.3 indicates that those respondents without prior business ownership experience represent 71.65 % of the failed sample.

The sectoral distribution of the failed small businesses is presented in Table 5.4.

**Table 5.4: The nature of the business (business sector)**

Business sector	Frequency (n)	Percentage (%)
Retail and wholesale industry	117	46.06
Transport industry	2	0.79
Service industry	43	16.93
Tourism industry	92	36.22
<b>Total</b>	<b>254</b>	<b>100.00</b>

Table 5.4 indicates that the highest failure rate (46.06 %) occurred in the retail sector. The second-highest failure rate (36.22 %) was in the tourism industry, with the third-highest failure rate (16.93 %) in the service industry. These results have important implications for SMME training and development policy formulation.

The extent to which the respondents were exposed to role models or mentors to assist them to manage and grow their businesses was another important variable that was considered in the research (Table 5.5).

**Table 5.5: Exposure to a role model/mentor by the respondents**

Exposure to role model/mentor	Frequency (n)	Percent (%)
Yes	71	27.95
No	183	72.05
<b>Total</b>	<b>254</b>	<b>100.00</b>

From Table 5.5, 72.05 % of respondents had not been exposed to a successful small business management role model (mentor).

Business management issues – such as business planning and cash-flow budgeting – are critical in the successes and failures of firms. Tables 5.6 and 5.7 expedit these dimensions.

**Table 5.6: Business management and planning by respondents**

Undertook monthly business planning	Frequency (n)	Percentage (%)
Not done at all	115	45.28
Did on ad hoc basis	139	54.72
<b>Total</b>	<b>254</b>	<b>100.00</b>

Table 5.6 indicates that only 54.72 % of the respondents attempted ad hoc business management and planning, whilst 45.28 % did no management and planning whatever.

The frequency of income, product sales and cash-flow monitoring was another demographic probed (Table 5.7).

**Table 5.7: Frequency of income, product sales and cash-flow monitoring by respondents**

Undertook monthly cash-flow budgeting	Frequency (n)	Percentage (%)
Not done at all	131	51.57
Did on ad hoc basis	123	48.43
<b>Total</b>	<b>254</b>	<b>100.00</b>

Table 5.7 indicates that 51.57 % of respondents did income, product sales and cash-flow monitoring, whilst 48.43 % did so on an ad hoc basis.

Table 5.8 shows the annual business turnover, which indicates that 95.67 % of respondents, made an annual turnover of less than R150 000 whilst 4.33 % made turnover greater than R150 000 per annum.

**Table 5.8: Annual business turnover**

Annual Turnover	Frequency (n)	Percentage (%)
<R150 000	243	95.67
>R150 000	11	4.33
<b>Total</b>	<b>254</b>	<b>100.00</b>

Table 5.9 shows the number of employees in the failed business and indicates that 92.52 % of respondents had less than 10 employees, whilst 7.48 % had more than 10 employees.

**Table 5.9: Number of employees in the failed business**

Number of employees	Frequency (n)	Percentage (%)
Less than 10	235	95.52
Greater than 10	19	7.48
<b>Total</b>	<b>254</b>	<b>100.00</b>

Having presented the demographics and a descriptive analysis of the sample of failed small businesses, attention now turns to a discussion of the inferential statistics of the causal factors researched.

### 5.3 INFERENCE STATISTICS

Inferential statistics make judgements about the accuracy of a given sample in reflecting characteristics of the population from which it was drawn. The interviews with the respondents produced a number of response variables largely related to business management principles that were not adhered to. The information presented below thus focuses on causality issues, commencing with a discussion on factor analysis. Table 5.10 provides information about the nature of the variables concerned.

#### 5.3.1 Factors contributing to small business failure

Factor analysis is a statistical technique for determining the extent to which variables that are related can be grouped together with minimal loss of information so that they can be treated as one combined variable or factor (component) rather than as a series of separate variables. It is an interdependence technique, whose primary purpose is to define the underlying structure among variables in the analysis (Hair *et al* 2006:104).

Four factors were extracted through “screen testing” and factor analysis using the BMDP4M Factor Analysis Program<sup>2</sup>. On processing the collected data using the statistical software program, the variables were initially reduced from 51 to 42 by removing the non loadings and the double loadings. The following extracted four factors represent all the variables:

- Monitoring and control (factor 1);
- Experience and planning in finance and marketing (factor 2);
- Income constraints (factor 3); and
- Cash control (factor 4).

The output from the BMDP4M program gave for all factors Cronbach alpha values ranging from 0.80 to 0.98 which served as evidence that the instrument was reliable and valid (Section 4.3.1.1). The factor loadings are reported in Table 5.10.

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<sup>2</sup> BMDP 4M Statistical Software, Inc.  
12121 Wilshire Blvd, Suite 300  
Los Angeles, CA 90025 USA  
Phone: (310) 207-8800  
Fax: (310) 207-8844  
Release: 7.1 (IBM/CMS)  
Manual: BMDP Manual Volumes 1, 2, and 3.

BMDP Statistical Software  
Cork Technology Park, Model Farm Rd  
Cork, Ireland  
Phone: 353 21 542722  
Fax: +353 21 542822  
DATE: 16 MAR 2006 AT 13:58:32  
Digest: BMDP User's Digest.

**Table 5.10: Rotated factor loadings and Cronbach alpha calculated by the BMDP4M program**

(Note: Factor loadings less than 0.250 are reported as 0.000)

Question	Factor loadings			
	1	2	3	4
V45. Continual monitoring of cash payment (disbursement) books would have forewarned me of possible misappropriation/mismanagement of funds before venture failed.	<b>0.980</b>	0.000	0.000	0.000
V43. Accurate record keeping would have helped us to take immediate corrective actions.	<b>0.954</b>	0.000	0.000	0.000
V46. Monitoring of monthly financial statements (results versus budgets) would have helped arrest decline in venture's profits.	<b>0.952</b>	0.000	0.000	0.000
V47. Managing weekly cash-flow projections/forecasting records would have stopped venture from running out of cash.	<b>0.946</b>	0.000	0.000	0.000
V42. Monitoring of inventory records would have helped improve sales of slow-moving stocks before stock became redundant.	<b>0.937</b>	0.000	0.000	0.000
V48. Monitoring of stock levels (daily records) would have aided me in identifying redundant/slow-moving stocks.	<b>0.935</b>	0.000	0.000	0.000
V49. Monitoring of stock losses/shrinkage records would have helped to stamp out theft before venture failed.	<b>0.935</b>	0.000	0.000	0.000
V44. Regular monitoring of cash receipt books would have halted venture failure.	<b>0.933</b>	0.000	0.000	0.000
V41. Better response to sales records could have contributed to better cash flow in the venture.	<b>0.929</b>	0.000	0.000	0.000

Question	Factor loadings			
	1	2	3	4
V14. More experience of the industry would have halted failure of the venture.	0.000	<b>0.838</b>	0.000	0.000
V13. More venture start-up experience would have halted failure of the venture.	0.000	<b>0.724</b>	0.000	0.000
V15. More business planning in finance and marketing would have halted failure of the venture.	0.000	<b>0.682</b>	0.000	0.000
V17. Previous experience as an owner-manager would have halted failure of the venture.	0.000	<b>0.484</b>	0.000	0.000
V57. Acquiring more assets to offset declining sales accelerated venture failure.	0.000	<b>0.454</b>	0.000	0.000
V53. Undercapitalisation was one of the fatal reasons for failure.	0.000	<b>0.440</b>	0.000	0.000
V21. Declining customer traffic is an important reason for the failure that was experienced.	0.000	<b>0.390</b>	0.000	0.000
V56. High uncontrolled running costs contributed to venture failure.	0.000	<b>0.383</b>	0.000	0.000
V19. Managing venture under the guidance of a successful mentor would have helped me steer the venture to success.	0.000	<b>0.368</b>	0.000	0.000
V52. Incorrect costing was responsible for poor profits.	0.000	<b>0.348</b>	0.000	0.000
V33. Inadequate initial financing contributed heavily to failure.	0.000	<b>0.329</b>	0.000	0.000
V20. Obtaining expert advice would have saved the venture from failure.	0.000	<b>0.307</b>	0.000	0.000
V28. Regular cash shortages were typical of the venture before failure.	0.000	<b>0.303</b>	0.000	0.000
V55. Too high expenditure overwhelmed the venture.	0.000	<b>0.298</b>	0.000	0.000

Question	Factor loadings			
	1	2	3	4
V51. Too high prices of goods led to lower sales.	0.000	0.000	<b>0.635</b>	0.000
V24 Ignoring customers' complaints substantially influenced the venture's failure.	0.000	0.000	<b>0.609</b>	0.000
V23 Comparatively too expensive prices of goods contributed to failure.	0.000	0.000	<b>0.589</b>	0.000
V60 Evading tax payment was one of the business practices of the venture before failure.	0.000	0.000	<b>0.584</b>	0.000
V58 Financing the venture's assets using high-interest-bearing, short-term debt is one of the reasons the venture failed.	0.000	0.000	<b>0.536</b>	0.000
V27 Regular cash shortages were typical of the venture before failure.	0.000	0.000	<b>0.530</b>	0.000
V61. Over-reliance on only one large customer was one of the reasons the venture failed.	0.000	0.000	<b>0.469</b>	0.000
V59. Inability to pay interest on debt was typical of the venture before failure.	0.000	0.000	<b>0.461</b>	0.000
V26. Bypassing newly constructed toll road diverted consumer traffic from the failed venture.	0.000	0.000	<b>0.460</b>	0.000
V63. Frequent reprocessing due to inferior product quality contributed to failure.	0.000	0.000	<b>0.445</b>	0.000
V54. Excessive use of credit contributed heavily to failure.	0.000	0.000	<b>0.391</b>	0.000
V35 "Dipping of fingers" into company cash registers was one of the contributory factors to failure.	0.000	0.000	<b>0.359</b>	0.000
V62. Overstocking of products contributed to failure.	0.000	0.000	<b>0.357</b>	0.000
V40. Failing to pay government company taxes was typical of the failed venture.	0.000	0.000	<b>0.352</b>	0.000

Question	Factor loadings			
	1	2	3	4
V30. Slow-paying customers contributed to the venture not being able to pay its monthly bills.	0.000	0.000	0.000	<b>0.960</b>
V31. Bad debts resulted in the venture running out of cash before failure.	0.000	0.000	0.000	<b>0.910</b>
V37. Delays in debt collection reduced the venture cash levels before failure.	0.000	0.000	0.000	<b>0.895</b>
V38. Difficulties in paying monthly bills were typical of the venture before failure.	0.000	0.000	0.000	<b>0.352</b>
V25. Lack of product advertising fuelled venture failure.	0.000	0.000	0.000	<b>0.330</b>
<b>Eigenvalue</b>	<b>9.41</b>	<b>4.67</b>	<b>4.37</b>	<b>2.23</b>
<b>Proportion of variance explained</b>	<b>20.95</b>	<b>8.89</b>	<b>8.57</b>	<b>6.22</b>
<b>Cumulative variance explained</b>	<b>20.95</b>	<b>29.84</b>	<b>38.41</b>	<b>44.63</b>
<b>Cronbach alpha</b>	<b>0.98</b>	<b>0.82</b>	<b>0.80</b>	<b>0.82</b>
<b>Canonical correlation</b>	<b>0.99</b>	<b>0.96</b>	<b>0.93</b>	<b>0.90</b>

In Table 5.10 the variables are grouped together (in terms of shading) by the factor analysis programme. The findings from Table 5.10 thus constitute an important aspect of this research.

On the basis of the variable loadings the four factors have been named:

#### **5.3.1.1 “MONITORING AND CONTROL” (FACTOR 1)**

This factor was named after the following high factor loading, venture “monitoring and control” variables:

- Continual monitoring of cash payment (disbursement) books;
- Accurate record keeping;
- Monitoring of monthly financial statements (results versus budgets);  
and
- Managing weekly cash-flow projections/forecasting records.

#### **5.3.1.2 “EXPERIENCE AND PLANNING IN FINANCE AND MARKETING” (FACTOR 2)**

The factor was named after the following high factor loading, “experience and planning in finance and marketing” variables:

- More experience of the industry would have halted failure in the venture;
- More venture start-up experience would have halted failure in the venture; and
- More business planning in finance and marketing would have halted venture failure.

#### **5.3.1.3 “INCOME CONSTRAINTS” (FACTOR 3)**

The factor was named after the following high factor loading, “income constraints” variables:

- Too high prices of goods led to lower sales;
- Ignoring customers’ complaints substantially influenced the failure of the venture;
- Comparatively too expensive prices of goods contributed to failure;

- Evading tax payment was one of the business practices of the venture before failure; and
- Financing of venture's assets using high-interest-bearing, short-term debt, is one of the reasons the venture failed.

#### **5.3.1.4 “CASH CONTROL” (FACTOR 4)**

The factor was named after the following high factor loading, “cash control” variables:

- Slow-paying customers contributed to the venture not being able to pay its monthly bills;
- Bad debts resulted in the venture running out of cash before failure;
- Delays in debt collection reduced the venture cash levels before failure; and
- Difficulties in paying monthly bills were typical of the venture before failure.

#### **5.3.2 Cronbach alpha**

The high Cronbach alpha values (0.80 to 0.98) (Table 5.10) are evidence that the measuring instrument is reliable and valid. Additionally, reliability implies validity, although the opposite does not necessarily hold true.

#### **5.3.3 Goodness of fit**

The data collected for this research yielded a chi-squared distribution ( $\chi^2$ ) = 2317.189 with p-value = 0.000. The “goodness of fit” obtained for this research can therefore be interpreted as follows: a chi-squared distribution ( $\chi^2$ ) > 0 and a p-value of 0.000 for an  $\alpha = 0.05$  level of significance. This is a highly significant statistical difference which indicates that the model being tested has the best fit to the test scores, that is, any significant difference is not by chance (sampling error or methodological design error), but is due to experimental treatment of the independent variables. In this case, the independent variables being referred to are the causes of failure in the small businesses researched.

### 5.3.4 Demographic variables influencing failure in small businesses

The ANOVA technique used a SAS GLM procedure to conduct the analyses of variation. ANOVA generally refers to one dependent variable being examined at a time. The aim of the ANOVA is to determine which demographics account for a large proportion of the overall variance in the factors (Cramer 2003:146). The ANOVA is based on the assumption that populations from which the samples are drawn have a normal distribution and equal or homogeneous variances (Cooper & Schindler 2001:509, 2008:289). The four factors extracted using the BMDP4M Factor Analysis Program were thus subsequently subjected to a variance analysis to find out if within each of the factors the mean scores of the demographic groups differed significantly.

#### **5.3.4.1 ANALYSIS OF VARIANCE FOR “MONITORING AND CONTROL” (FACTOR 1) AS A CAUSE OF FAILURE IN SMALL BUSINESSES**

The ANOVA for all the factors was conducted in a sequence involving three steps and these were (an example is provided below for factor 1):

- Is there a statistically significant difference between the venture “monitoring and control” (factor 1) mean scores for different demographic groups or demographic class levels, that is, is the p-value of “monitoring and control” (factor 1) less than the levels of significance,  $\alpha = 0.05$  (Table 5.11)?;
- Which demographic groups or class levels show statistically significant differences, that is, have a p-value which is less than  $\alpha = 0.05$  (Table 5.11)?;
- How do the “monitoring and control” (factor 1) mean scores differ between the statistically significant groups, for example, the difference in mean scores for the statistically significant group (cash-flow budgeting) (Table 5.11)?

**Table 5.11: Analysis of variance for “monitoring and control” (factor 1) as a cause of failure of small businesses**

Source	DF	Sum of squares	Mean square	F-value	Pr > F
Model	9	10.7623	1.1958	2.08	0.0333
Error	200	115.2287	0.5761		
<b>Corrected total</b>	<b>209</b>	<b>125.9910</b>			

Table 5.11 indicates that “monitoring and control” (factor 1) varies depending on some demographic factors as shown by its F-value of 2.08 which is greater than unity, and p-value of 0.0333 for an  $\alpha = 0.05$  level of significance. There is a statistically significant difference between the “monitoring and control” (factor 1) mean scores for different demographic groups.

Table 5.12 indicates which demographics were responsible for the statistically significant difference. The categories which support the overall statistically significant difference of “monitoring and control” (factor 1) are underpinned by frequency of cash-flow budgeting (Table 5.12).

**Table 5.12: Demographic variables influencing “monitoring and control” (factor 1) as a cause of failure of small businesses**

Independent variable	Monitoring and control (factor 1)				
	DF	Type III SS	Mean square	F-value	Pr > F
Duration of business ownership	2	1.4815	0.7408	1.29	0.2787
Business management experience	1	0.3569	0.3569	0.62	0.4321
Type of business	3	1.7662	0.5887	1.02	0.3840
Influence by a role model / mentor	1	0.3905	0.3905	0.68	0.4113
Level of planning	1	0.5360	0.5360	0.93	0.3359
Frequency of cash-flow budgeting	1	4.6960	4.6960	8.15	0.0048

Table 5.12 shows that frequency of cash-flow budgeting (with an F-value of 8.15 and p-value of 0.0048) statistically and significantly contributed to “monitoring and control” (factor 1) as a cause of small business failure. Taking the matter further, the mean score for frequency of cash-flow budgeting illustrated that the statistically significant difference in “monitoring and control” (factor 1) was the cause of small business failure.

In Table 5.13, the mean score for those who never did cash-flow budgeting before their small businesses failed was 3.8419. This mean score is higher than 3.4983 for those who did cash-flow budgeting before their ventures failed. This means that those who never practised cash-flow budgeting before their small businesses failed believed more that “monitoring and control” (factor 1) influenced the failure of their businesses. This is higher than the mean 2.5.

**Table 5.13: Mean scores for frequency of cash-flow budgeting in “monitoring and control” (factor 1) as a cause of failure of small businesses**

Demographic variable	Never	Done	p < 0.05
Frequency for cash-flow budgeting mean scores	3.8419	3.4983	0.0048

#### **5.3.4.2 ANALYSIS OF VARIANCE FOR “EXPERIENCE AND PLANNING IN FINANCE AND MARKETING” (FACTOR 2) AS A CAUSE OF FAILURE IN SMALL BUSINESSES**

The ANOVA for “experience and planning in finance and marketing” (factor 2) as a cause of failure in small businesses is presented in Table 5.14.

**Table 5.14: Analysis of variance for “experience and planning in finance and marketing” (factor 2) as a cause of failure of small businesses**

Source	DF	Sum of squares	Mean square	F-value	Pr > F
Model	9	2.1797	0.2422	1.38	0.1991
Error	200	35.1008	0.1755		
<b>Corrected total</b>	<b>209</b>	<b>37.2805</b>			

Table 5.14 indicates that in terms of “experience and planning in finance and marketing” (factor 2) there was no statistically significant difference for its F-value of 1.38 and p-value of 0.1991.

The instrument also measured whether “experience and planning in finance and marketing” (factor 2) had any influence on the failure of small businesses. The outcomes of the measured perceptions are reported in Table 5.15 which contains demographic information on the variables influencing “experience and planning in finance and marketing” (factor 2).

**Table 5.15: Demographic variables influencing “experience and planning in finance and marketing” (factor 2) as a cause of failure of small businesses**

Independent variable	Experience and planning in finance and marketing (factor 2)				
	DF	Type III SS	Mean square	F-value	Pr > F
Duration of business ownership	2	0.3002	0.1501	0.86	0.4267
Business management experience	1	0.2568	0.2568	1.46	0.2278
Type of business	3	0.7850	0.2617	1.49	0.2182
Influence by a role model / mentor	1	0.0312	0.0312	0.18	0.6735
Level of planning	1	0.3024	0.3024	1.72	0.1908
Frequency of cash-flow budgeting	1	0.0892	0.0892	0.51	0.4765

Table 5.15 confirms that no statistically significant differences were found for the demographic variables influencing “experience and planning in finance and marketing” (factor 2). This means that the mean scores of the different demographic groups were not statistically significantly different.

#### **5.3.4.3 ANALYSIS OF VARIANCE FOR “INCOME CONSTRAINTS” (FACTOR 3) AS A CAUSE OF FAILURE IN SMALL BUSINESSES**

The instrument was also used to measure the perceptions of the respondents on the contribution that “income constraints” (factor 3) might have had on the failure. The ANOVA for the measured perceptions appear in Table 5.16.

**Table 5.16: Analysis of variance for “income constraints” (factor 3) as a cause of failure of small businesses**

Source	DF	Sum of squares	Mean square	F-value	Pr > F
Model	9	6.9696	0.7744	1.70	0.0915
Error	201	91.6817	0.4561		
<b>Corrected total</b>	<b>210</b>	<b>98.6513</b>			

Table 5.16 indicates that for “income constraints” (factor 3) there was no statistically significant difference for the F-value of 1.70 and the corresponding p-value of 0.0915.

To substantiate that there was no significant difference, the instrument also measured the perceptions of the respondents on what demographic variables contributed to “income constraints” (factor 3) resulting in the small business failure. The measured perceptions appear in Table 5.17.

**Table 5.17: Demographic variables influencing “income constraints” (factor 3) as a cause of failure of small businesses**

Independent variable	Income constraints (factor 3)				
	DF	Type III SS	Mean square	F-value	Pr > F
Duration of venture ownership	2	1.3923	0.6962	1.53	0.2198
Business management experience	1	1.0385	1.0385	2.28	0.1329
Type of business	3	3.0149	1.0050	2.20	0.0889
Influence by a role model / mentor	1	0.0013	0.0013	0.00	0.9567
Level of planning	1	0.0499	0.0499	0.11	0.7411
Frequency of cash-flow budgeting	1	0.2988	0.2988	0.66	0.4192

Table 5.17 indicates no statistically significant differences were found between the mean scores of the demographic variables influencing “income constraints” (factor 3).

#### **5.3.4.4 ANALYSIS OF VARIANCE FOR “CASH CONTROL” (FACTOR 4) AS A CAUSE OF FAILURE IN SMALL BUSINESSES**

The perceptions of the respondents were also measured by the influence of “cash control” (factor 4) on small business failure, for which the ANOVA is presented in Table 5.18.

**Table 5.18: Analysis of variance for “cash control” (factor 4) as a cause of failure of small businesses**

Source	DF	Sum of squares	Mean square	F-value	Pr > F
Model	9	14.4239	1.6027	2.71	0.0053
Error	201	118.7335	0.5907		
<b>Corrected total</b>	<b>210</b>	<b>133.1574</b>			

Table 5.18 indicates that “cash control” (factor 4) varies depending on some demographic factors as shown by its F-value of 2.71 and p-value of 0.0053. There was a highly significant statistical difference between the “cash control” (factor 4) mean scores for different demographic groups.

Table 5.19 shows which demographic categories influenced the statistically significant difference. The categories which support the overall statistically significant difference of “cash control” (factor 4) are: business management experience (with an F-value of 7.64 and a corresponding p-value of 0.0062) as well as frequency of planning (with an F-value of 8.60 and a corresponding p-value of 0.0038).

**Table 5.19: Demographic variables influencing “cash control” (factor 4) as a cause of failure of small businesses**

Independent variable	Cash control (factor 4)				
	DF	Type III SS	Mean squares	F-value	Pr>F
Duration of business ownership	2	2.9266	1.4633	2.48	0.0865
Business management experience	1	4.5151	4.5151	7.64	<b>0.0062</b>
Type of business	3	2.2538	0.7513	1.27	0.2852
Influence by a role model / mentor	1	1.6696	1.6696	2.83	0.0943
Level of planning	1	5.0778	5.0778	8.60	<b>0.0038</b>
Frequency of cash-flow budgeting	1	0.8810	0.8810	1.49	0.2234

Table 5.19 indicates that frequency of planning and business management experience statistically significantly influenced “cash control” (factor 4) as a cause of failure in small businesses.

Table 5.20 indicates that the mean score for respondents who had no business management experience before the failure of their small business was higher at 3.52 than for respondents who had business management experience (mean score 3.30). The difference in the means indicates that respondents who had no previous business management experience before failure of their ventures believed that receiving more hands-on training on “cash control” (factor 4) could have made a difference.

**Table 5.20: Mean scores for “cash control” (factor 4) as influenced by business management experience as a cause of failure of small businesses**

Demographic variable	Never	Done	p < 0.05
Business management experience	3.52	3.30	0.0062

Table 5.21 indicates that the mean score for respondents who lacked frequency of planning before the failure of their small businesses was lower at 3.30 than for respondents who had frequency in planning before the failure of their small businesses (mean score 3.57).

**Table 5.21: Mean scores for frequency of planning in influencing “cash control” (factor 4) as a cause of failure of small businesses**

Demographic variable	Never	Done	p < 0.05
Frequency of planning	3.30	3.57	0.0038

The difference in the means (Table 5.21) indicates that respondents who had frequency of planning before the failure of their ventures believe that “cash control” (factor 4) contributes to the failure in their small businesses.

Table 5.21 supports the finding ( $p = 0.0038$ ), that respondents who never did planning believed that a lower frequency in planning contributed to “cash control” (factor 4) as a factor of small business failure.

In summary, both demographic groups – which were: business management and lack of frequency of planning – believed that “cash control” (factor 4) contributed significantly to small businesses failure. The findings above support researchers such as Chittenden *et al* (1999:5) who note that studies of the reasons for small business failure inevitably show poor or careless financial management to be the most important cause.

### **5.3.5 Hindsight causes that contributed towards the failure of small businesses**

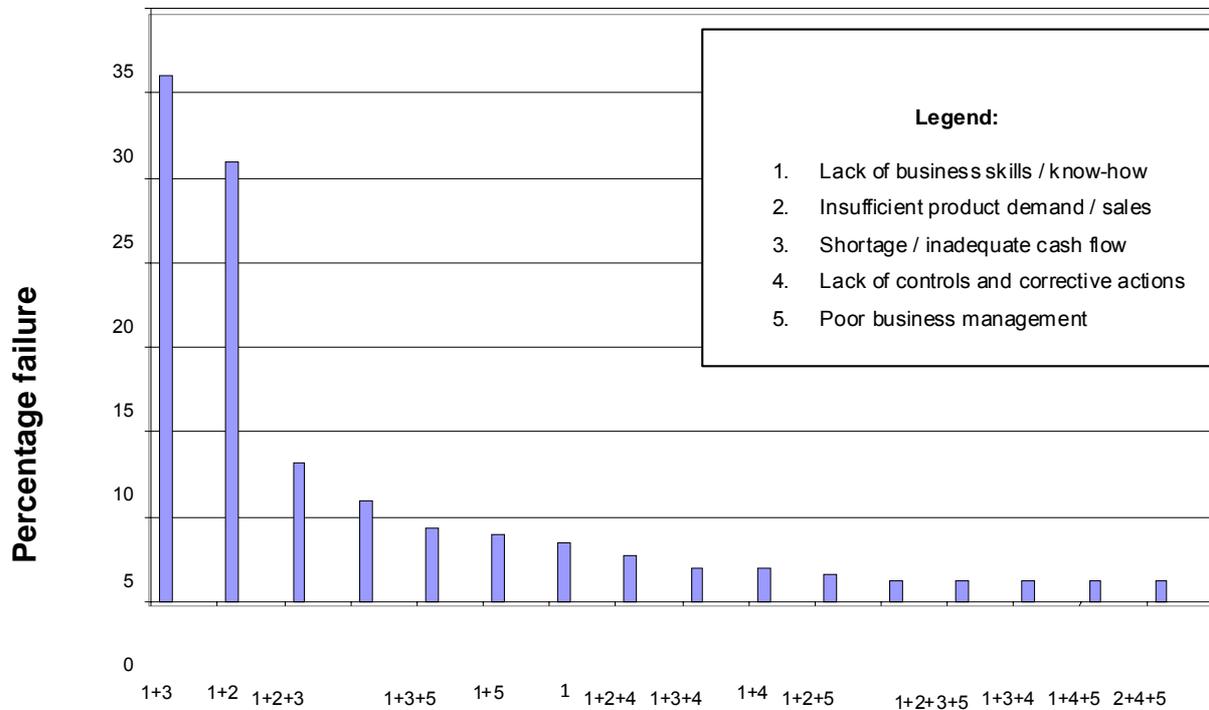
In addition to the structured research questions posed to the respondents, the last question (Question 16) was an unstructured open-ended question about combined issues perceived by the respondents as being the processes or events which operated to close down the businesses. The issues that emerged from the respondents’ hindsight in the open-ended questionnaire were:

- The meanings/interpretations which the respondents had for the causes of the business' failure (how the owners perceived the causes of failure;
- The coping mechanisms used by the respondents to survive initially;
- How the businesses finally failed; and
- The psychological effects of the failures.

These issues were rated in terms of their links with the failure of the small businesses. Table 5.22 lists the combined hindsight causes of the failures and serves as a legend for Figure 5.3 and Table 5.23.

**Table 5.22: Summary of hindsight causes that contributed to the failure of small businesses**

Cause number	Category	Description of variable
1	Resources	Lack of business skills / know-how
2	Opportunity	Insufficient product demand / sales
3	Resources	Shortage/inadequate cash flow
4	Resources	Lack of controls and corrective actions
5	Resources	Poor business management



**Combined hindsight causes of failure**

**Source:** Own compilation of combined hindsight causes of small business failure.

**Figure 5.3: Percentage small business failure versus combined hindsight causes of failure**

Figure 5.3 and Table 5.23 indicate the individual respondents' stated combined causes that contributed to the failure of their ventures. Combined causes of failures below 4.0 % were excluded as they were too low for any meaningful discussions.

**Table 5.23: Combined hindsight causes of failure of small businesses**

<b>Combined causes of small business failure</b>	<b>Meaning of the combined causes of small business failure</b>
<b>Combined failure cause (1+3)</b>	Represents a lack of business skills and shortage of cash:  <b>Reported by 31.0 % of the respondents as causing failure.</b>
<b>Combined failure cause (1+2)</b>	Represents a lack of business skills and insufficient product demand/sales:  <b>Reported by 25.9 % of the respondents as causing failure.</b>
<b>Combined failure cause (1+2+3)</b>	Represents a lack of business skills and insufficient product demand/sales and shortage of cash:  <b>Reported by 8.2 % of the respondents as causing failure.</b>
<b>Combined failure cause (1+2+3+4+5)</b>	Represents a lack of business skills and insufficient product/demand and inadequate cash flow and lack of controls and poor business management:  <b>Reported by 5.9 %* of the respondents as causing failure.</b>
<b>Combined failure cause (1+3+4+5)</b>	Represents a lack of business skills, inadequate cash flow, and poor business management:  <b>Reported by 4.3 %* of the respondents as causing failure.</b>
*These figures are added together to make 10.2 % in Sections 5.5.1.1.4 and 5.5.1.4.4.	

Attention is now turned to the explanatory analysis or causal mechanism behind the business failures.

## 5.4 CAUSAL MECHANISMS BEHIND BUSINESS FAILURES

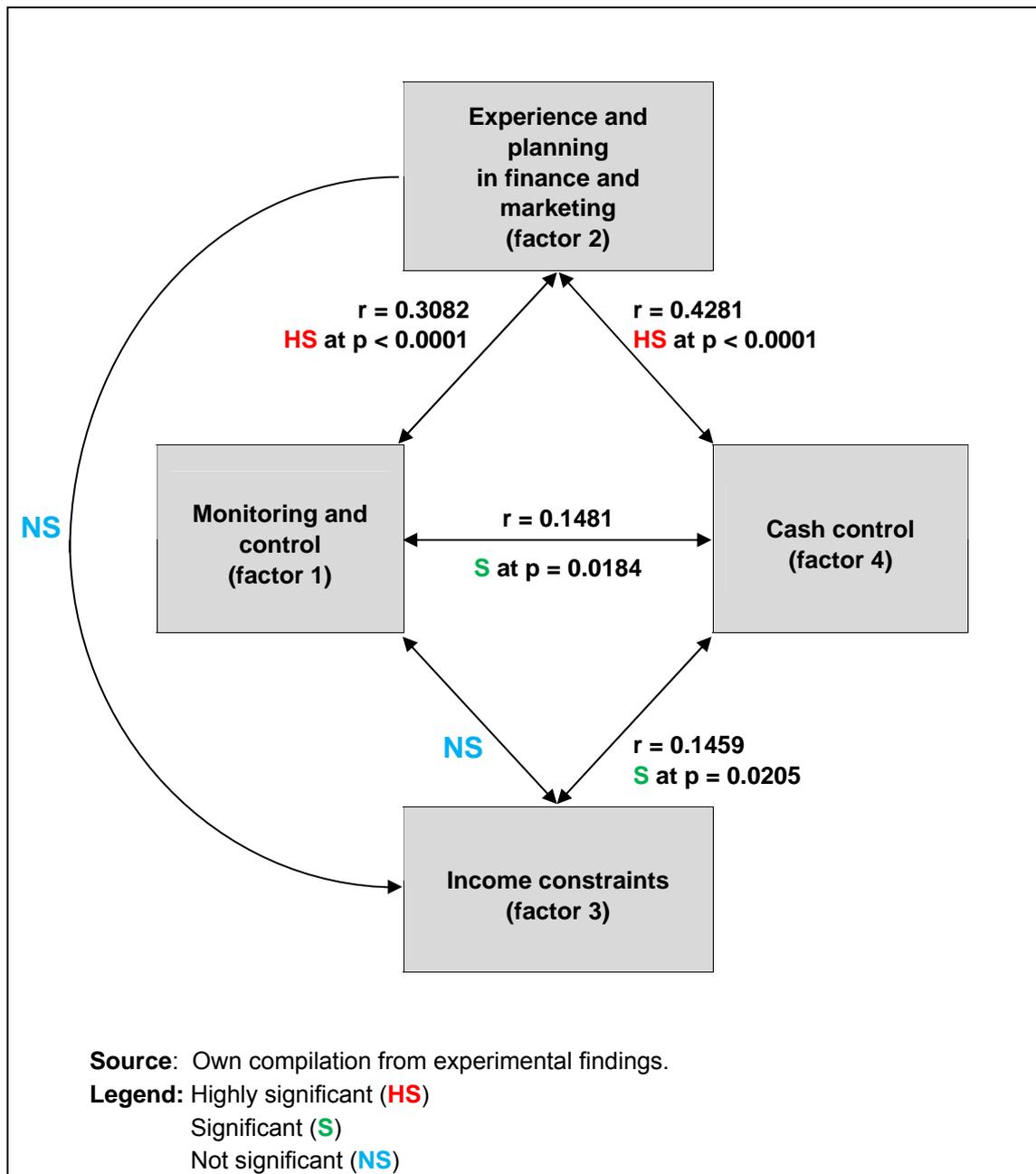
### 5.4.1 Transformation of the descriptive statistical information into causal explanations

So far, the research has demonstrated the statistical relations inherent in the four factors which have been abstracted from the 51 variables. The four factors were also found to be related as shown in Table 5.24.

Table 5.24 indicates that venture “monitoring and control” (factor 1) was highly significantly correlated ( $p < 0.0001$ ) with “experience and planning in finance and marketing” (factor 2). “Monitoring and control” (factor 1) was significantly correlated ( $p = 0.0184$ ) with “cash control” (factor 4) for an  $\alpha = 0.05$  level of significance. “Experience and planning in finance and marketing” (factor 2) and “cash control” (factor 4) were highly significantly correlated ( $p < 0.0001$ ). Lastly, “income constraints” (factor 3) and “cash control” (factor 4) were statistically significantly correlated ( $p = 0.0205$ ) for an  $\alpha = 0.05$  level of significance. Figure 5.4 illustrates the statistically significant associations between the four factors.

**Table 5.24: Factor correlation matrix**

	Pearson Correlation Coefficients				
	Prob >  r  under H <sub>0</sub> : Rho=0				
	Number of observations				
		Monitoring and control (factor 1)	Experience and planning in finance and marketing (factor 2)	Income constraints (factor 3)	Cash control (factor 4)
<b>Monitoring and control (factor 1)</b>	Correlations	1			
	p-values				
<b>Experience and planning in finance and marketing (factor 2)</b>	Correlations	0.3082	1		
	p-values	<b>&lt;0.0001</b>			
<b>Income constraints (factor 3)</b>	Correlations	0.0912	<b>0.0381</b>	1	
	p-values	0.1496	0.5476		
<b>Cash control (factor 4)</b>	Correlations	0.1481	0.4281	0.1459	1
	p-values	<b>0.0184</b>	<b>&lt;0.0001</b>	<b>0.0205</b>	
<b>Source:</b> Based on the GLM factor analysis tool.					



**Figure 5.4: The associations of the four causes of small business failure**

Figure 5.4 indicates that the four factors were interlinked, presenting statistical associations. These associations do not, however, imply causality (Mouton 1994:79, 2002:194; Cooper & Schindler 2001:155, 2008:517). Statistical associations represent only one of the conditions for developing causal models. As

can be observed in Table 5.24 there are significant statistical relations between the four factors which suggest the need to explore the possibility of finding actual causal relations. That the four factors are significantly related statistically is grounds for further investigation (Mouton 1994:79, 2002:194; Cooper & Schindler 2001:155, 2008:517). This concern stems from the fact that one key objective of this research is to find the causes which have operated to close down the businesses in the research area.

As mentioned in Chapter 4, five expanded and more complete causality procedures/principles or steps follow in Table 5.25, as compared with the original three steps identified by Cooper & Schindler (2001:151, 2008:153) and Hair *et al* (2006:706) (described by points 1 to 3 in Table 5.25).

The aforementioned five expanded steps were introduced to obtain the statistical associations between the variables used in this research for a deeper understanding (or mechanism) of the failure of small businesses.

**Table 5.25: The five expanded causality criteria**

Criterion	Details
1	The variables must show that they are empirically associated (covariance or significantly correlated)
2	Replicable time sequence
3	There are no cases of spuriousness (eliminated or controlled for extraneous variables)
4	Concerned with explaining the concept of mechanism in the research (how and why failure happened), using the critical realist approach
5	This criterion is about the context of the research

- With reference to **Criterion 1**, the statistical relationships or correlations above have helped to establish the condition of covariance or associations. Figure 5.4 indicates the relationships between the four factors.
- With reference to **Criterion 2**, it was found from the retrospective field research with the respondents concerned that failure occurred after the causes had emerged.

- With reference to **Criterion 3**, efforts were made to ensure that the variables selected satisfied the condition of non-spuriousness barring external factors, that is, that there was no other extraneous observed factor influencing the failure of the small businesses by obtaining testimony about failure from respondents.
- With reference to **Criterion 4**, that is, identifying the mechanism, the realist approach was applied to the four factors as **socially** and **ideally** real objects. “Socially real” and “ideally real” objects are clarified below before an explanation of **Criterion 5**.

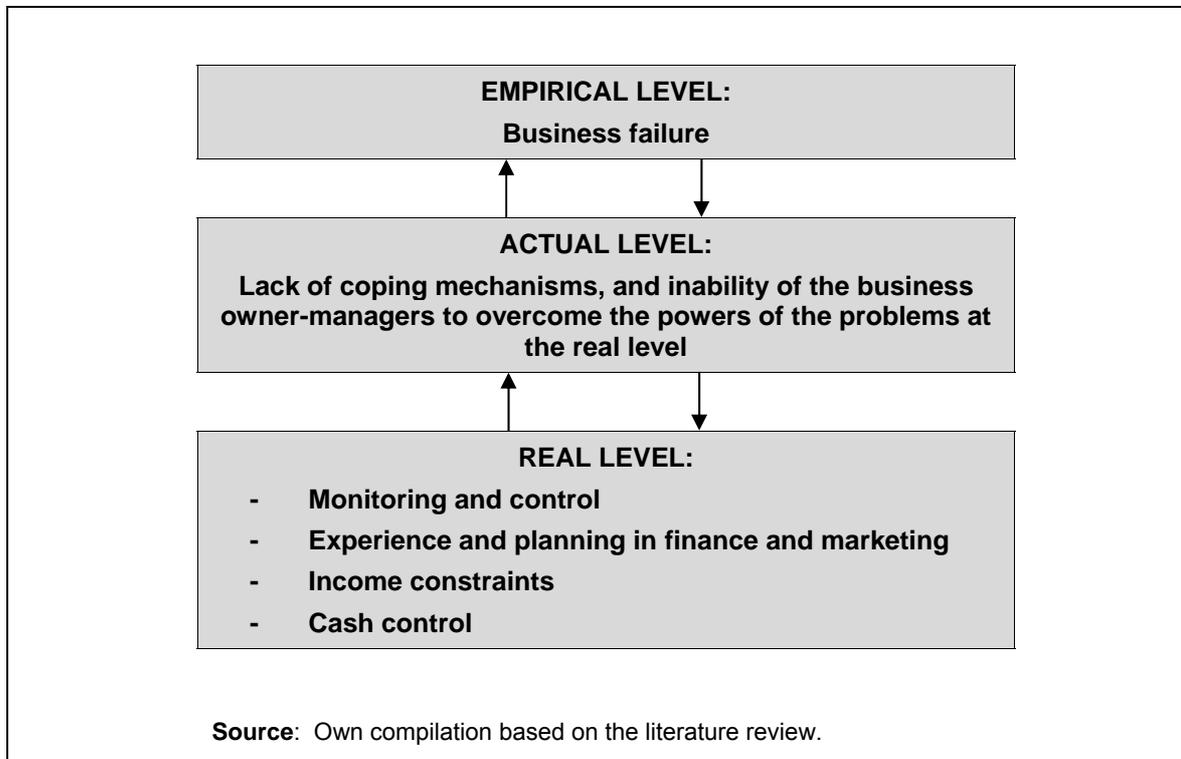
#### **5.4.1.1      *SOCIALLY REAL BUSINESS FAILURE MECHANISM AS THE CONTEXT***

This involved conceptualising the business management principles which should have been followed as guidelines or rules known by the owner-managers of the failed small businesses but which were wrongly interpreted or applied, thus leading to the failure of the businesses. In Chapter 2, these principles were clearly brought out as consisting of concrete business capital resources and opportunities comprising capital and human infrastructural resources and other necessities or conditions which were not applied or used correctly by the owner-managers of the failed small businesses, thus leading to failure (Figure 5.5).

#### **5.4.1.2      *IDEALLY REAL BUSINESS FAILURE MECHANISM***

This concept in Figure 5.5, in contrast, applied to the beliefs, opinions and fears of the owner-managers of the failed small businesses towards the four business failure factors. This has been previously referred to in Chapter 3 as the ideally real aspect of the realist conceptualisation process and is presented schematically in Figure 5.5. The owner-managers of the failed small businesses were observed to have seen the four problems as having binding constraints on their ventures. They saw the four causes as structures which operate as a group with causal powers to close down businesses necessarily (Fleetwood & Ackroyd 2004:46). From the perspective of the owner-managers of the failed small businesses, the four factors were formidable enough to close down their businesses. They therefore saw them as natural outcomes of logically interlinked processes over which they thought they had no control (Layder 1993:160; Singh *et al* 2007:334). The foregoing answers one of the problem statements which can be restated as: “What

documented theories are being blamed as being the causes of the failure of SMMEs?"; "What lessons could be learnt from such theories?" and "How relevant are such theories to the situation in South Africa?".



**Figure 5.5: A realist stratification model of the negative perceptions the owner-managers of the failed small businesses had towards the powers of their business problems that lead to their closures**

Figure 5.5 indicates that the owner-managers of the failed small businesses had become socialised in particular contexts to the four causes, seeing them as formidable problems over which they had little power. The precepts which the owner-managers of the failed small businesses had of themselves, of what was appropriate, right and fitting, of what their abilities and capacities were, of what they had to value – all of these ideas which comprised the images they had of their businesses – were a function of their belief systems.

The lack of effective coping mechanisms (Bouchard *et al* 2004:221; Singh *et al* 2007:334), and poor performance monitoring processes were found to be critical in the closure of the businesses. The owner-managers of the failed small businesses had poor consultation arrangements; lacked mentors; had little knowledge about

the possible assistance they could have obtained from institutions (such as Khula and Seda), and lacked contingency plans to sustain them in times of crisis. Under these conditions, their business had to close down (Fleetwood & Ackroyd 2004:29).

One theme in this business failure research thus relates to the idea of how people can succumb to the powers of their problems resulting in the closure of their businesses (Sayer 2000:15; Fleetwood & Ackroyd 2004:40; Singh *et al* 2007:334). This theme is closely related to the issue of power struggle between the business success and failure factors which was touched upon in Chapters 1, 2, and 3. The owner-managers of the failed small businesses managed (steered) their businesses apparently in the direction of failure. The failure outcomes at the empirical level were then unfortunately allowed to become conditions for their future decision-making processes at the actual level. Overwhelming causal powers were thus ascribed to the four failure causes. The four factors were accepted as somehow natural and finally determined the ultimate fate of the ventures (Layder 1993:164; Leca & Naccache 2006:627). What the owner-managers of the failed small businesses chose to do about their business problems, and how they chose to tackle them were thus properties of their interpretations (hermeneutics) of what the four failure causes meant to them (McKenzie & Sud 2008:129).

- With reference to **Criterion 5**, regarding the context, the findings of the sample are exclusively for the sampled area or geography and its socio-economic context. However, because of the high Cronbach alpha (0.80 to 0.98) and the goodness of fit ( $\chi^2 = 2317.189$ ), the results of the research may be generalised to the rest of the Republic of South Africa. These steps are the hallmark of the causality in the critical realist approach. Furthermore, realist theory in business management stresses, however, that business success or failure today is no guarantee of success or failure tomorrow since the powers of the opposing forces could be changed at any time (Layder 1993:160; David 2003:300). Successful businessmen should therefore not be lulled into complacency by their success. The owner-managers of small businesses also need to be encouraged to believe in the statement that change is permanent. The perceptions of the owner-managers of small businesses (at the actual level) towards the business management principles and problems (at the real level) must therefore determine what they do today. This is one way of

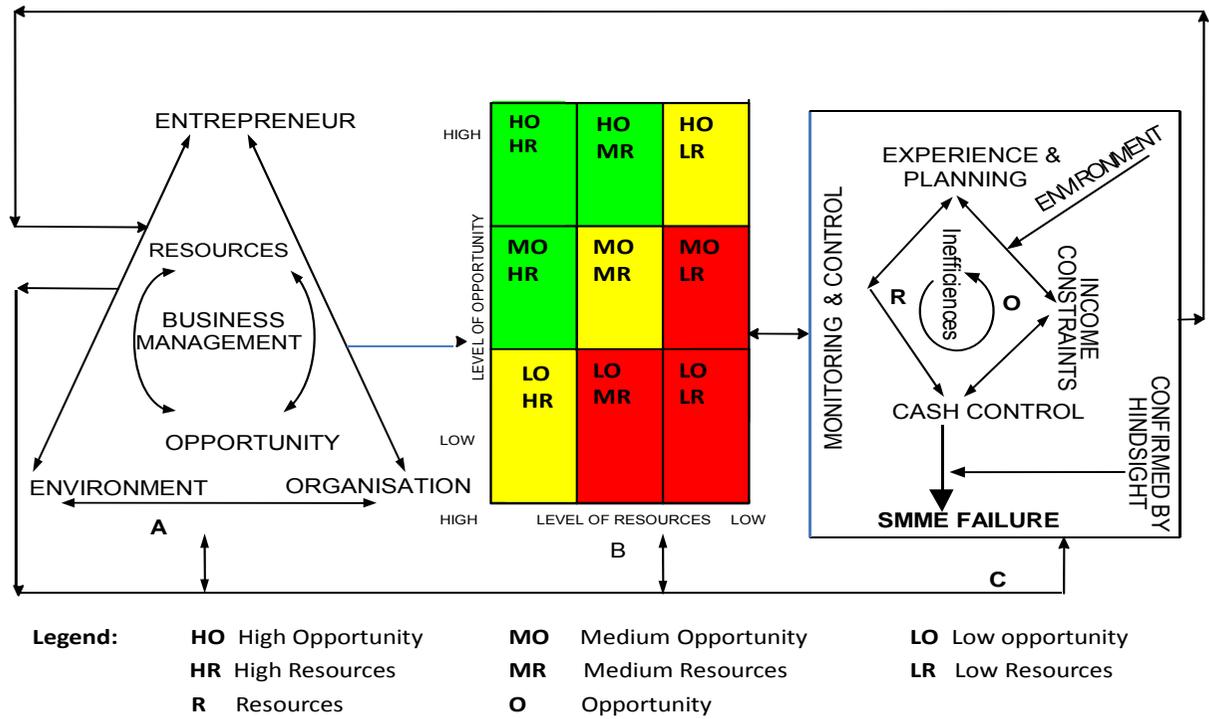
linking the future of their businesses to their mindsets in a positive way. Critical realist researchers can operate as important instruments in the form of mentors, advisors and social workers for producing the desired changes for the benefit of the owners-managers of small businesses.

This section of the findings thus introduces an important element in confirming the central approach of this research – namely, that the processes operating in the real level need not be seen by the owner-managers of small businesses as externally located objects which operate from the outside to impose their will on owner-managers of small businesses, but as objects that need to be internalised, interpreted and acted upon to serve the interests, goals and meanings of the owner-managers concerned.

## 5.5 TEMPORAL MODELLING OF THE FAILURE OF THE BUSINESSES STUDIED

An important perspective of the business failures can be outlined in the form of the sequence of events which led to their closures, as outlined in Figure 5.6. This represents the process of their failure involving resources and opportunities configurations and deployment. In Figure 5.6, the sequence of events leading to the business failures is: Steps A, B and C.

- **Step A:** Starting in the multiple origin triangle A, inefficiencies resulted from the entrepreneur's [human] poor business management, leading to the organisation's internal failures which were impacted upon by the environmental uncertainties. Poor business management reduced the optimal combinations of resources (R) and opportunities (O).
- **Step B:** When combinations in resource-opportunity levels reached unacceptable levels (signified in **red**), that is, the lower the resources and the lower the opportunities remaining fused together, the more predisposed the venture was to propel itself towards failure. **Yellow** indicates the survival prospects of the small business and was a mixture of low resources and high opportunity, medium resources and medium opportunity, or high resources and low opportunity. Optimal combinations are signified in **green** and propelled the venture towards sustainability. Thus failure and success was seen as opposite ends of the same continuum.



Source: Own compilation based on literature review and empirical evidence.

**Figure 5.6: Proposed small business failure process model**

- **Step C:** occurred when the interactions and associations of the four causal factors were influenced by the external environment as well as by the hindsight factors. The combined mass of C lead to the ultimate failure of the small business, partly due to inefficiencies as the venture become cash-strapped. As already noted, cash is the lifeblood of any business. The finding supports Abouzeedan & Busler (2004:158) and Ooghe & De Prijcker (2008:228) who mention that inefficient firms decline and exit while efficient firms survive and grow. Importantly, Jones' (1991:63) contention some 20 years ago about the absence of cash is still valid:

Cash might be described as the lubrication which is needed to make every major decision. Without it, just like an engine without oil, the business seizes up.

In conclusion, Figure 5.6 summarises the key features of the small business failure processes. The process of failure was such that in the beginning (Step A) the owner-manager's poor business management resulted in inefficiencies due to improper resource and opportunity combining in Step B, and empirically manifested as four causal factors in Step C. In the presence of the environmental uncertainties, as well as the hindsight causes, the causal factors predisposed the ailing venture to failure.

### 5.5.1 Confirmations of the research propositions

The confirmations of the research propositions developed in Chapter 3 are now analysed as statistical hypotheses (Leedy & Ormrod 2005:270). According to these researchers (p.270) the term "hypothesis" has two different meanings in research literature. The first meaning relates to a research hypothesis or proposition which refers to a tentative guess/conjecture needing to be tested using empirical evidence. The second relates to a statistical hypothesis associated with a sample needed for inference back to the population. As reported in the previous sections on the ANOVA, there were four factors that were extracted from the collected data.

The confirmations for each of the four propositions follow next, starting with the first proposition which is:

### **5.5.1.1 *P<sub>1</sub>: MONITORING AND CONTROL CONTRIBUTE TO FAILURE IN SMALL BUSINESSES***

#### **5.5.1.1.1 *Analysis of variance***

The application of the ANOVA indicates that “monitoring and control” (factor 1), with an F-value of 2.08 and  $p = 0.0333$  for an  $\alpha = 0.05$  level of significance, contributes a statistically significant difference to failure in small businesses.

#### **5.5.1.1.2 *Variable mean scores over some demographics***

It is understood that for an F-test an F-value of unity implies that there is similar relations, that is, the null hypothesis holds, but any value above unity with p-value less than  $\alpha = 0.05$  means that there is strong sample evidence to reject the null hypothesis and accept the alternative relationship. Scores that are greater than the mean score of 2.5 confirm that “monitoring and control” (factor 1) contribute to the small business’ failure. Specifically, the cash-flow demographic mean scores influencing “monitoring and control” (factor 1) had an F-value of 2.08 which is much greater than unity, and corresponding p-value of 0.0048 which is highly statistically significantly different, serving as further support that “monitoring and control” (factor 1) contribute to failure in small businesses.

#### **5.5.1.1.3 *The role of combined factors in the failure of small businesses***

When causes combine there seems to be more certainty that failure can result compared to when causes are only individually observed in the reaction mechanism. That is, when combined they seem to become more potent in predisposing the small businesses to failure than when they exist as individual causes of failure. The factor correlation matrix in Table 5.24, as well as the associations in Figure 5.4 and the failure process in Figure 5.6 support that the associations between “monitoring and control” (factor 1), “experience and planning in finance and marketing” (factor 2) and “cash control” (factor 4) were overwhelming combined causes to the small business owner-managers. These associations therefore contributed to the small business failure.

#### **5.5.1.1.4 Hindsight causes supporting “monitoring and control” (factor 1)**

The hindsight causes in Table 5.22 support “monitoring and control” (factor 1) as a total of 10.2 % (Table 5.23) of respondents say that their small businesses failed because of “monitoring and control” problems. This then serves to confirm that “monitoring and control” contribute to failure in small businesses. These hindsight support Brigham & Gapenski (2008:1075) who stress: “most business failures occur because a number of factors combine to make the business unsustainable”.

Constituting part of the hindsight causes for the small business failures, the following anecdotal evidence was provided by the respondents:

- “poor credit control often constrained our cash-flow levels”
- “withdrawals of business money for personal use – such as school fees and family groceries – was often a problem”
- “poor debt collection affected cash flow”
- “we experienced stock theft and were unable to contain the problem because we lacked record-keeping skills”
- “poor marketing resulted in a low customer base” and
- “overstocking resulted in goods expiring and wastages”.

#### **5.5.1.1.5 Literature supported by “monitoring and control” (factor 1)**

“Monitoring and control” (factor 1) as a cause contributing to small business failure is supported by Al-Shaikh (1998:81), Monk (2000:12), Tushabomwe-Kazooba (2006:30), Khan (2006:2), Okpara & Wynn (2007:27) and Crutzen & van Caillie (2007:20).

Based on the evidence above it can therefore be concluded that “monitoring and control” (factor 1) contributes to failure in small businesses.

The second proposition follows next as:

### **5.5.1.2 *P<sub>2</sub>: EXPERIENCE AND PLANNING IN FINANCE AND MARKETING CONTRIBUTE TO FAILURE IN SMALL BUSINESSES***

#### **5.1.1.2.1 *Analysis of variance***

The application of the ANOVA, with an F-value of 1.38 and  $p = 0.1991$ , indicates that the demographic variables did not differ, that is, there is no statistically significant difference between the “experience and planning in finance and marketing” (factor 2) mean scores of different demographic groups.

#### **5.1.1.2.2. *Variable mean scores over some demographics***

Collected data indicate that “experience and planning in finance and marketing” (factor 2) did differ over demographic variables. However, there was no statistically significant difference found between the different demographic groups influencing “experience and planning in finance and marketing” (factor 2) contributing to the failure in small businesses.

#### **5.1.1.2.3 *The role of combined factors in the failure of small businesses***

When “experience and planning in finance and marketing” (factor 2), “cash control” (factor 4), and “monitoring and control” (factor 1) combine, there seems to be more certainty that failure can result compared to when individual factors are observed in the reaction mechanism.

#### **5.1.1.2.4 *Hindsight causes supporting “experience and planning in finance and marketing” (factor 2)***

The hindsight causes in Table 5.22 support “experience and planning in finance and marketing” (factor 2) as a cause of small business failure as 31.0 % (Table 5.23) of respondents say that their small businesses failed because of a lack of experience, coupled with a shortage of cash or inadequate cash-flow planning.

Constituting part of the hindsight causes for the small business failures, the following anecdotal evidence was provided by the respondents:

- “we were not trained in business management... simply, we did not know how to run the business”

- “we had no knowledge how to deal with competition, for example, newly erected shopping malls, and from foreigners such as Nigerians, Pakistanis and Somalis, who have superior business skills”
- “we did not know how to manage people”
- “we lacked knowledge of how to price goods, that is the price structure was often dictated by our customers”
- “we did minimal planning, for example, we lacked resources such as a building to do business from or a van to distribute goods to customers”
- “we had no time to supervise the business”.

#### **5.5.1.2.5 Literature supported by “experience and planning in finance and marketing” (factor 2)**

“Experience and planning in finance and marketing” (factor 2) as a contributing factor towards failure in small businesses is supported by Wright (1995:48), Holland (1998:2), Al-Shaikh (1998:81), van Aardt *et al* (2000:250), Monk (2000:12), Perry (2001:201), Okpara & Wynn (2007:27) and Okpara & Kabongo (2009:7).

However, based on the evidence from this research it can therefore be concluded that “experience and planning in finance and marketing” (factor 2) does not contribute to failure in small businesses. The lack of statistical difference could possibly be due to ignorance about the importance of the variables on the part of the owner-managers of the failed small businesses.

The third proposition follows next as:

#### **5.5.1.3 P<sub>3</sub>: INCOME CONSTRAINTS CONTRIBUTE TO FAILURE IN SMALL BUSINESSES**

##### **5.5.1.3.1 Analysis of variance**

The application of the ANOVA, with an F-value of 1.70 and  $p = 0.0915$ , indicates there is no statistically significant difference between the “income constraints” (factor 3) mean scores of the different demographic groups influencing “income constraints” (factor 3) as a cause of failure in small businesses.

#### **5.5.1.3.2 Variable mean scores over some demographics**

There was no statistically significant difference found between the different demographic groups influencing “income constraints” (factor 3) as a cause contributing to failure in the small businesses.

#### **5.5.1.3.3 The role of combined factors in the failure of small businesses**

When “income constraints” (factor 3) and “cash control” (factor 4) combine, they become more potent in predisposing small businesses towards failure than when they are only observed individually in the reaction mechanism.

#### **5.5.1.3.4 Hindsight causes supporting “income constraints” (factor 3)**

The hindsight causes in Table 5.22 support “income constraints” (factor 3) as a cause of small business failure from respondents who say that the combined “experience and planning in finance and marketing”, “income constraints”/sales, inadequate cash flow, insufficient business controls, and poor business management, contributed a sum total of 44.3 % (Table 5.23) to the failure of the small businesses.

Constituting part of the hindsight causes for the small business failures, the following anecdotal evidence was provided by the respondents:

- “we lost sales to low-price undercutting competitors”
- “we often suffered ‘out of stocks’”
- “we were faced with not enough demand and this impacted on the income levels”
- “we were not collecting cash fast enough”
- “the location of our business was not ideal and this resulted in low customer traffic”
- “excessive running costs reduced cash levels”.

#### **5.5.1.3.5 Literature supported by “income constraints” (factor 3)**

“Income constraints” (factor 3) as a contributing factor towards the failure of small businesses is supported by Watson *et al* (1998:229) and Rwigema (2005d:159).

Based on the evidence above it can therefore be concluded that “income constraints” (factor 3) contributes weakly to failure in small businesses.

The fourth proposition follows next as:

#### **5.5.1.4 *P<sub>4</sub>: CASH CONTROL CONTRIBUTES TO FAILURE IN SMALL BUSINESSES***

##### **5.5.1.4.1 *Analysis of variance***

The application of the ANOVA for “cash control” (factor 4), with an F-value of 8.60  $p = 0.0038$  for an  $\alpha = 0.05$  level of significance, indicates that there is a highly significant statistical difference between the “cash control” (factor 4) mean scores for different demographic groups.

##### **5.5.1.4.2 *Variable mean scores over some demographics***

The demographic variables which were found to be influencing “cash control” (factor 4) as a cause of failure in small businesses are:

- Business management experience (with an F-value of 7.64 and  $p = 0.0062$ ); and
- Frequency of planning (with an F-value of 8.60 and  $p = 0.0038$ ).

Both the above demographic groups showed a highly significant statistical difference in influencing “cash control” (factor 4) as a cause of failure in small businesses.

##### **5.5.1.4.3 *The role of combined factors in the failure of small businesses***

When “cash control” (factor 4), “experience and planning in finance and marketing” (factor 2) and “income constraints” (factor 3) combine, they predispose the small business to failure more than when they react individually in the mechanism that explains failure.

##### **5.5.1.4.4 *Hindsight causes supporting “cash control” (factor 4)***

The hindsight causes in Table 5.22 support “cash control” (factor 4) as a cause of failure as the respondents stated that their small businesses failed because of

multiple causes in “experience and planning in finance and marketing”, “income constraints”, “monitoring and control” as well as business management.

The causes of failure in which “cash control” is a factor had a total contribution to failure of 10.2 % (Table 5.23).

Constituting part of the hindsight causes for the small business failures, the following anecdotal evidence was provided by the respondents:

- “we often ran out of cash”
- “our costs were higher than income, for example, we experienced high rentals and could not afford to pay the bills”
- “we could not afford to pay our employees”
- “we had no cash to stock enough goods”
- “we often used high-interest debt from a ‘mashonisa’ [loan shark]”
- “we experienced a lack of capital or cash injection into the business”.

#### **5.5.1.4.5 Literature supported by “cash control” (factor 4)**

“Cash control” (factor 4) as a cause contributing to small business failure is supported by Stancill (1987:38), Wright (1995:48), Wiseman & Bromiley 1996:530, the European Federation of Accountants (FEE 2004:11), Mudambi & Treichel (2005:552), Tushabomwe-Kazooba (2006:30) and Longenecker *et al* (2007:148).

Based on the evidence above it can therefore be concluded that “cash control” (factor 4) contributes to failure in small businesses.

By way of summary, the confirmations for the propositions follow in the next section.

#### **5.5.1.5 SUMMARY OF CONFIRMATIONS OF THE PROPOSITIONS**

A summary of the confirmations of the propositions of this research follows in Table 5.26.

**Table 5.26: Summary of confirmations of the propositions**

Proposition		Confirmation
P <sub>1</sub>	Monitoring and control contributes to failure in small businesses	Proposition is supported
P <sub>2</sub>	Experience and planning in finance and marketing contributes to failure in small businesses	Proposition is not supported
P <sub>3</sub>	Income constraints contribute to failure in small businesses	Proposition is not supported
P <sub>4</sub>	Cash control contributes to failure in small businesses	Proposition is supported

Not all propositions are supported by the statistical hypotheses to give clear insights into the roles of the four factors in closing down the businesses. The exercises were undertaken to indicate the robustness of the statistical technique used in the analysis of the data which were collected from the respondents.

## 5.6 CONCLUDING REMARKS

This chapter presented the findings of this research in terms of the factors which have closed down the businesses. It began with the identification of the set of variables which the respondents cited as having caused their businesses to fail. This was followed by the statistical descriptions of the relations between the variables which the respondents identified as having caused the failure of their small businesses. It was argued that the statistical associations did not provide any insights as to the causes of the business failures. Resort was, therefore, made to the concept of causal modelling in terms of a realist research approach to offer explanations via the critical realist causality principles.

Considering the grounded theory, the four factors that were abstracted were conceptualised as the mechanism behind the business failures. The mechanism was described as a particular combination of a specific set of causes, a structured

bond of relations, to demonstrate an historically specific way by which the businesses were closed down.

As far as grounded theory is concerned, the four derived causes can therefore be described as variable categories contributing to the theory behind the closure of the businesses. As stated succinctly by Neuman (2006:61),

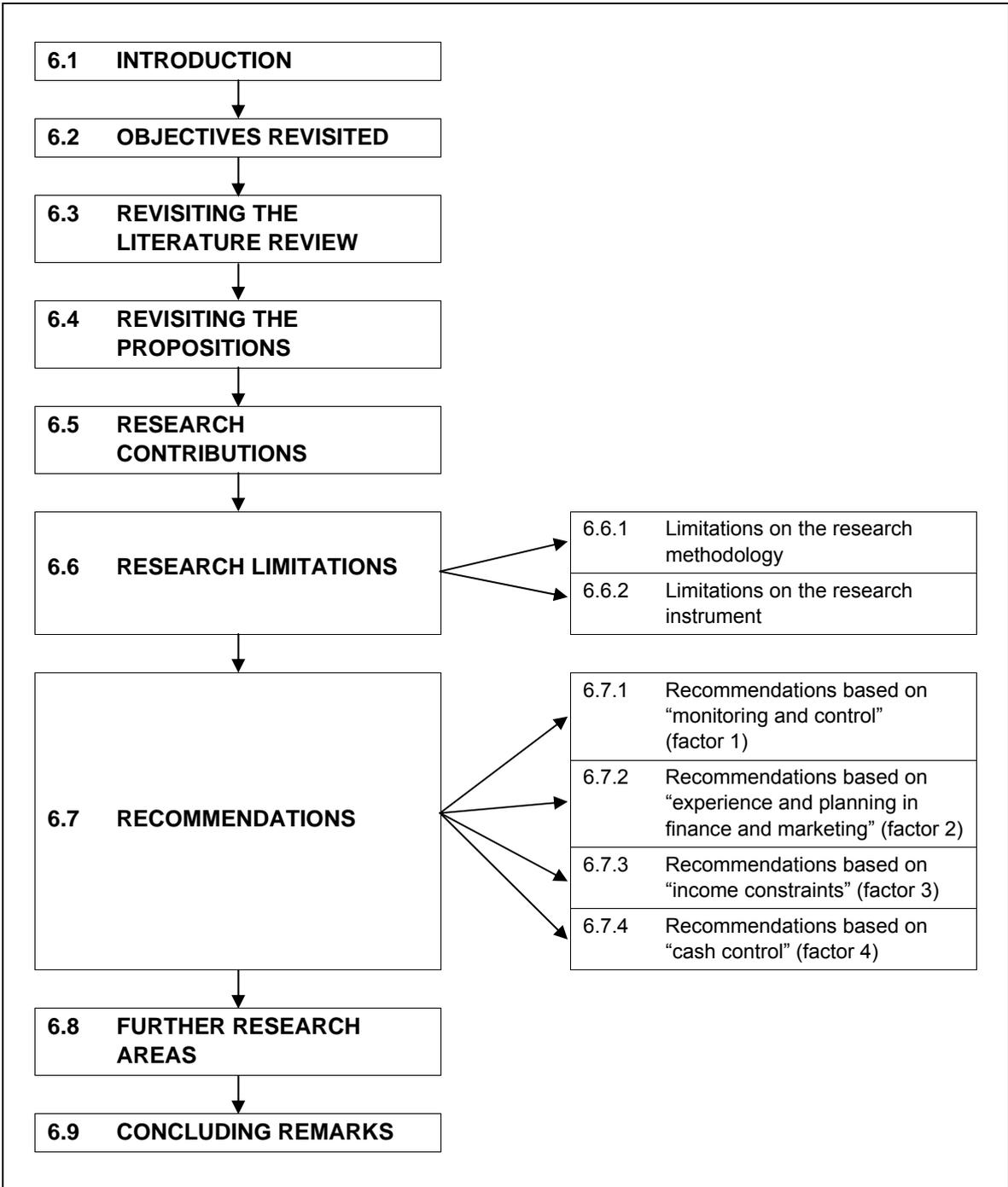
theory develops from the ground up as the researchers gather and analyse the data. Theory emerges slowly, concept by concept, and proposition by proposition, in a specific area.

The findings and theories in this research thus apply specifically to the particular context of the respondents.

As was indicated in this chapter, the respondents (that is, the owner-managers of the failed small businesses) need to be reminded that behind empirical events are hidden mechanisms which need to be disclosed to them. In this research it has been illustrated that the wrong meanings reflected in the anecdotal evidence which the business owner-managers attributed to their management principles and the failure problems ultimately led to the demise of their ventures.

In the next chapter, dealing with the conclusions and recommendations, attention is paid to how this situation could be addressed.

**CHAPTER 6**  
**CONCLUSIONS AND RECOMMENDATIONS**



**Figure 6.1: Layout of Chapter 6**

## CHAPTER 6

### CONCLUSIONS AND RECOMMENDATIONS

#### 6.1 INTRODUCTION

As in human beings, if disease is revealed early enough, some remedies can be taken. Unfortunately, very few authors are interested in causes, process, or remedies. They only work with symptoms of failure, often represented by financial ratios (Daubie & Meskens 2001:2).

As discussed in Chapter 1, this research, “Retrospective analysis of causes of failure in South African small businesses”, sought to establish the causes associated with the high failure of SMMEs (that is, “What?”). The *raison d’etre* for this research was to gain better insights into the high rates of failure in SMMEs in the Gauteng, Limpopo and Mpumalanga provinces of the Republic of South Africa and Gaborone in Botswana. Specifically, the research unearthed the mechanism for the failures, that is, “Why?” and “How?” the failures happened, or what the reaction mechanisms were.

Reflecting on the previous chapters, it is important to reiterate what the set goals were and what was achieved practically towards answering the research problems. In Chapter 1, it was noted that the objective was to obtain empirical information from the owners of failed small businesses with a view to developing an explanatory model of their business failures. To do this, a literature review was conducted to serve as a backdrop to this research. Chapter 2 covered the theories on the causes of small business failure. Chapter 3 then highlighted some key issues that needed to be addressed to enable a locally based explanatory model to be developed. In this study, the thrust of Chapters 3 and 4 was the need to place the perceptions of the owners of failed small businesses at the centre of the research to satisfy one of the key principles of realist research requiring researchers to always endeavour to interpret hermeneutically the texts of research

subjects to readers for purposes of facilitating mutual understanding – a move which supports McKenzie & Sud (2008:123).

Chapter 4 then applied the principles enunciated in Chapter 3 to collect and analyse the data required to address the objectives of the research. Chapter 5 analysed the collected data and applied the five criteria under the realist causality principle to obtain the causes or root causes (not symptoms) of the business failures.

Since the one theme running through Chapters 1 to 5 is the idea that adherence to business management principles on the part of the business owner is a primary determinant of business failure or success (Beaver & Jennings 2005:9; Neuman 2006:52; Nieman 2006b:19; Hofstee 2009:88), the central theme in Chapter 6 relates to empowering the owners of businesses by recommending training and a change of mindset on the basic business management principles or rules. Empowering the owner-managers of businesses through a change of mindset is an important hallmark of the critical realist approach as discussed in previous chapters.

## **6.2 OBJECTIVES REVISITED**

The objectives of this research were to:

1. Undertake a literature review on the theories on the causes of failure in SMMEs in other countries and South Africa in general as a backdrop to this research (Chapter 2);
2. Obtain empirical information from the respondents in this research about the causes of their SMME failures (Chapter 4);
3. Use the information obtained to produce an explanatory or causal model on the SMME failures (Chapter 5); and
4. Make recommendations based on the findings (Chapter 6).

### 6.3 REVISITING THE LITERATURE REVIEW

Under the Literature Review in Chapter 2, the theories on the causes of the failures used were initially classified into three themes:

- “Resources and opportunities” as a perspective for explaining small business failure,
- Business management expertise classified metaphorically into “liabilities” and “venture life cycle” as a perspective for explaining small business failure, and
- “Multiple origins/causes of failure” as a perspective for explaining small business failure.

In the perspective of resources and opportunities, the theory revealed that absence of resources and opportunities individually or combined leads to failure of small businesses.

The perspective on the metaphors of the venture life cycle theorised that there are critical hurdle points during the life cycle of any venture, that is, at each of these critical survival points, the possibility of death deterministically exists because of a lack of small business management skills which results in inefficiencies. The more the inefficiencies within the venture, the more predisposed to failure the small business is. The perspective on the liability of failure revealed that inherently small businesses face a liability of death by virtue of their size and age (the younger the age and the smaller the venture size, the more vulnerable the venture to failure).

In summary, the foregoing views on inefficiencies support Daubie & Meskens (2001:46) who assert that the earliest symptoms of failure and the starting point of the failure process is an insufficiency of revenue and poor profitability. When the availability of share capital is limited, firms are forced to become more indebted (first with long-term loans and then with short-term loans). This is the beginning of a vicious cycle that ends in bankruptcy. This increasing indebtedness leads to poor solvency, creditors become suspicious and liquidity problems arise.

Kuratko & Hodgetts (2001:366) are also supported by this thinking on inefficiencies when they assert: “the failure process was characterised by too much initial indebtedness and too little revenue financing”.

In the multiple origins as a perspective of small business failure, it was revealed that the failure of small businesses emanates from multiple of causes and not a single cause of failure. In this perspective, the causes of failure that combine to overwhelm the small business are the owner-managers' non-adherence to the small business management principles, external environmental complexities and internal organisational poor management. Furthermore, Anderson & Tushman (2001:675) conclude: "The greater the environmental uncertainty, the higher the exit rate". Therefore, according to this theory, the imbalance between the external environment and the internal environment results in the overall depletion of the slack resources needed to retain the opportunity responsible for yielding the revenue and the rents needed for venture refinancing and survival.

A perspective incorporating human value judgements was introduced (Section 2.7) to provide a broader perspective about the multiplicity of factors which influence business failures. The critical realist conceptual framework indicated that the fate of the business in surviving or failing is related to the broader situation regarding the SMME business management principles, as well as the perceptions of the owner-managers, giving some renewed hope that, after all, small businesses are not always born to die.

In answering, "So what?", it is clear that Chapter 2 has exposed as many descriptive causes of failure as is possible but, by so doing, only addressing part of the research title, that is, successfully answering: "What are the causes of small business failure?". This approach does not address "How?" and "Why?" or root causes of small businesses failure as called for by the title of the research. The title sought to unearth the root causes through understanding the mechanisms of failure rather than by describing the causes of failure. Chapter 2 does not present a complete picture, therefore an approach that explains failure causes through use of causality becomes necessary. This approach – which supersedes the conventional approaches – is therefore introduced towards the close of Chapter 2 in the form of a critical realist approach. Without the introduction of this approach the research would have been incomplete.

## 6.4 REVISITING THE PROPOSITIONS

The propositions which were advanced in Section 4.2.4.1 are now revisited in this section as:

- P<sub>1</sub>** Monitoring and control contributes to failure in small businesses.
- P<sub>2</sub>** Experience and planning in finance and marketing contributes to failure in small businesses.
- P<sub>3</sub>** Income constraints contribute to failure in small businesses.
- P<sub>4</sub>** Cash control contributes to failure in small business.

## 6.5 RESEARCH CONTRIBUTIONS

The research has illustrated the relevance of the retrospective and the critical realist approach in terms of:

- Demonstrating that basic business management principles are crucial as an overarching framework in any analysis of business failures and that the principles could be conceptualised as rules for interpretation by the owners of businesses;
- Demonstrating the importance of the retrospective method in conjunction with the critical realist approach as a research paradigm in addressing the problem of small business failure;
- Advertising the relevance of the retrospective method to the business failure research community;
- Demonstrating how lack of access to certain resources essential for business successes could contribute to the failure of certain businesses as confirmed by anecdotal evidence in Chapter 5;
- Demonstrating how the negative perceptions/lack of coping mechanisms of owners of businesses could contribute to the closure of their businesses;
- Demonstrating how the critical realist approach could be used as a framework to contribute to a change in mindsets which could then lead to the reactivation of the small businesses to contribute to job creation, poverty alleviation, and income generation in South Africa;

- Mobilising the relevant stakeholders or supportive environmental elements to provide the necessary knowledge and other forms of assistance to the SMME sector to enable them to make their maximum contributions to the development of South Africa; and
- Five criteria of causality used in the understanding of failure in small businesses.

## **6.6 RESEARCH LIMITATIONS**

“Potential limitations are often numerous even in the most carefully planned research study” (Fouché 2006:118).

Following from the above quotation, this section outlines how limitations that may have impacted on the research have been reduced.

### **6.6.1 Limitations on the research methodology**

The retrospective methodology research design as an open system or non-experimental method does not require the use of an experimental sample control normally used by closed systems. This fundamental difference between experimental and non-experimental methodologies involving the use of a sample control is perceived as a weakness in determining causality by those researchers who conduct experiments under closed systems. However, this research saw no handicaps in the methodology as it had been deliberately chosen to suit the data. Scientific experimental sample control is unnecessary since, at the time of sampling, the event of failure in the small businesses had already taken place. One cannot recreate the sample treatment where the experiment has already gone to conclusion. Furthermore, by considering the perceptions of the owners of failed small businesses, an accurate explanation or account of the events was attained. Consequently, the more owners of failed small businesses interviewed in this research, the more factual reasons for failure were given. In this type of research, this retrospective methodology was the best under the circumstances: that is, for obtaining facts first hand.

At times during the instrument design phase and during actual interviews it was tempting to include those owners of successful small businesses that were still in operation to enhance perceptions from a slightly different angle. The assumptions made in Section 1.10 are that owners of successful small business have remained in business because they adhered to the classical and conventional business “rules” (Beaver & Jennings, 2005:9; Neuman 2006:52; Hofstee 2009:88). The factors that were identified empirically as contributing to the failed small businesses serve to confirm that the owners of failed small businesses in this research did not adhere to the classical business “rules” as identified. Based on these cited assumptions, there was therefore no need to specifically interview successful small business owners for their perceptions about the failure phenomenon.

In this research, by making use of the random systematic sampling procedure in Chapter 4, followed by the snowball sampling method, the retrospective method managed to show that the sample was representative of the population, and hence any inference therefrom is credible and generalisable to the rest of South Africa.

### **6.6.2 Limitations of the research instrument**

The questionnaire used was initially intended to be structured, but, by so doing, the owner-managers who wanted to explain more about why their ventures failed were partially restricted from further explanations. However, this difficulty was overcome by including an unstructured, open-ended question at the end of the questionnaire asking the owner-managers of the failed businesses to elaborate on what they perceived in hindsight had caused the failure of their small businesses. The answers were collected and collated as hindsight and anecdotal findings which were reported and explained in Chapter 5. The anecdotal evidence strengthened the research findings.

Furthermore, the supposed weaknesses in the structured questionnaires were reduced by taking additional notes during the interview process. Another strength of the interview system emanated from the interviewer who took time to explain and clarify any misunderstandings. This approach was important on account of the widely differing educational backgrounds of the respondents.

A structured questionnaire can be a handicap in a developing country if respondents are educationally disadvantaged. This is one of the reasons face-to-face interviews were used to reduce misunderstandings and enhance accuracy of the responses. Chapter 4 was dedicated to improving the credibility of the research. This was achieved by concentrating on the validity and reliability precautions normally followed when using a retrospective methodology.

As testimony of the present researcher's interventions, Chapter 5 reported high Cronbach alpha values (0.80 to 0.98) in Table 5.10. A "goodness of fit", being a measure of how well a research model being used had the best fit to the test scores, that is, any statistically significant difference is not by chance, was reported in Section 5.3.3 as testifying that the model being used had a best fit to the test scores. For the fit, the data collected for the research yielded a chi-squared distribution ( $\chi^2$ ) = 2317.189 with a highly significant statistical p-value of 0.000, for an  $\alpha = 0.05$  level of significance. Ultimately, there was strong evidence that the instrument used in this research was appropriate and made the study credible.

## **6.7 RECOMMENDATIONS**

The literature review revealed a dearth of journal articles, publications and accessible information available regarding failed small businesses in the South African context. Therefore additional focus needs to be given to this important aspect of accessible information on small business failure via an appropriate government department and the research community at large.

Given the importance of successful small businesses to a nation's economic growth, and also the role that small businesses play in poverty reduction, it is postulated that an understanding of the problems negatively affecting small businesses in South Africa is a vital first step in managing and avoiding the massive failure of these small businesses as Okpara & Wynn (2007:25) note for Nigeria.

With such evidence, it is clear that researchers of the failure phenomenon situation of small businesses in South Africa need to focus on the failures and locate their

recommendations in the framework of radical positive change (Rogerson 2000:687).

The aim of this section is to present, and justify, the measures that may be considered to address the four causes of failure among small businesses discussed in Chapter 5 and also to look at other broader contextual issues. The recommendations are based on the idea that business failure problems, or any other social realities for that matter, do not exist as external objects whose function is only to overwhelm the owners of businesses until their businesses close down. Instead the problems need to be seen as being defined by the human mind and thoughts which can be changed to introduce progress in the lives of those concerned (Fleetwood & Ackroyd 2004:56).

The recommendations made here examine the possibilities of changing the existing situation through increased understanding and self-awareness to enable the owners of small businesses to renew their confidence to become self-conscious agents for their future prosperity. The recommendations made are thus specific to the four problems and also general to relate to the broader South African context as discussed under the conceptual framework in Chapter 3.

The recommendations are based on the four causes/causal factors which have been identified by the research as:

- Monitoring and control (factor 1)
- Experience and planning in finance and marketing (factor 2)
- Income constraints (factor 3)
- Cash control (factor 4).

### **6.7.1 Recommendations based on “monitoring and control” (factor 1)**

#### **6.7.1.1 RESOURCES AND OPPORTUNITIES**

As it is generally accepted that a venture is a bundle of resources (Bruton & Rubanik 2002:553) gathered to capture an opportunity, it is therefore imperative for the South African small business owner to be conversant with sound methods of resource deployment as well as to be able to have an internally and externally

balanced small business. A method that can assist the small business owner achieve this is already in place but the method is hardly being used by small businesses who are intimidated by its complexities. This method is known as the “balanced scorecard” introduced into the business landscape by Robert Kaplan and David Norton in 1992 (Kaplan & Norton 2000:65). Many owners of small businesses in South Africa seem to be intimidated by the name and the method remains largely practised by large firms where it has found wide usage. In creating a balanced small business, the method uses its four components which are: financial indicator, customer’s perspective, internal business processes, and learning and growth perspective (Kaplan & Norton 2000:65; Appiah-Adu *et al* 2001:18; Crutzen & van Caillie 2007:20). Organisations such as Khula and Seda need to be brought closer to the owners of small businesses to enable them to know about basic business management practices associated with the balanced scorecard, for example.

#### **6.7.1.2 PREVENTION OF FAILURE**

It is clear that to monitor and control a small business, the owner needs to be aware of the symptoms that lead to failure. These symptoms adapted from past researchers (Koksal & Arditi 2004:9; Rasheed 2005:239) include: insufficient profits; heavy operating expenses; inadequate sales; burdening debt, and cash shortage. There need to be training programmes for the owners of small businesses on the aforementioned aspects (Yanchus *et al* 2003:2). These programmes could be organised by numerous government and non-government organisations in South Africa.

#### **6.7.1.3 POOR SYSTEMS OF CONTROL**

It is generally accepted that no person starts a new venture preparing it for failure. Checks and monitoring can help owners of South African small businesses manage organisational activities towards survival and success. A lack of proper control on internal activities can eventually lead to business failure from inefficiency of slack resources. Corrections can be instituted if the systems are in place. Therefore owners of small businesses need training programmes on how to

put their internal controlling systems in place. This assertion supports Sheth & Sisodia (2005:22).

## **6.7.2 Recommendations based on “experience and planning in finance and marketing” (factor 2)**

### **6.7.2.1 OWNER-MANAGERS’ EASY ACCESS TO SELF-HELP SERVICES**

Much of the research into marketing in small businesses concludes that it is frequently underutilised and misunderstood by small business owner-managers (Hogarth-Scott *et al* 1996:6; Mazzarol 2000:2; Mboniyane 2006:26; Shepherd & De Tienne 2005:91).

To be able to increase sales demand, owners of small businesses in South Africa need access to up-to-date marketing information about consumer behaviour, competitive forces and best industry practices, for example, which could be provided via internet services, especially in remote areas (de Klerk & Kroon 2008:25). With a lack of industry specialists in remote localities, trouble-shooting is another key area that may be addressed through the provision of self-help centres.

### **6.7.2.2 THE OWNER-MANAGER’S TRAINING**

As discussed in Section 1.1 and Section 5.2.2, the lack of training is a major handicap to the survival chances of South African small businesses (Westhead & Storey 2001:14). In addition to training constraints, the findings of this research have demonstrated that the lack of marketing and finance and basic business management skills are major factors contributing to the failure of the small businesses concerned. Present small business and entrepreneurship training interventions in South Africa tend to put more emphasis on theory (classroom) rather than practical (hands-on) business skills which the owners of small businesses need to be able to run their ventures successfully (Alstete 2008:584). The increased number of small businesses in the South African economy – like for Botswana – should not be equated with the development of entrepreneurship in the country. These are two different concepts. It is the development of entrepreneurship that leads to an increasing number of viable small firms not vice versa (Temtime & Pansiri 2004:25).

### **6.7.2.3 CONDUCTING THE FEASIBILITY STUDY**

Before someone is employed, many large firms/corporates screen potential employees in order to recruit the correct candidates. But screening is seldom practised within South African small businesses. Few owners of businesses are screened for suitability for their new ventures. The owners of businesses do not often conduct feasibility studies into their newly ventured industry, business environment and other issues. Remedies for the foregoing can reduce the high failure rates in small businesses. A correct fit between resources, opportunity and the owner should form part of the screening processes (Timmons 1999:38, 2009:101; Rwigema 2005a:25).

### **6.7.2.4 ACQUISITION AND DEPLOYMENT OF RESOURCES**

The South African small business owner needs to be trained to become conversant with the management of finances and be able to raise capital where necessary for refinancing the venture. The owners of businesses need to be aware of the importance of finance and marketing and not take them for granted. Declining ventures (once they have reached a point beyond turnaround strategies) can often no longer attract debt, as they can no longer convince financiers that they still have the capacity to repay their debt. At this point, when resources are depleted, they may no longer be capable of supplying services creating the opportunity. It is therefore critical that the owners of businesses build the capability for acquiring finance and for retaining marketing opportunities. Resource acquisition and deployment is at the heart of a balanced small business (Kraatz & Zajac 2001:635; Crutzen & van Caillie 2007:9) as illustrated in Figure 3.3.

### **6.7.2.5 ENTREPRENEURIAL MENTORS**

Effective interventions should assist South African small business entrepreneurs to learn rather than simply impose prescribed solutions, as is the case through the provision of “expert” consultancy (Sullivan 2005:164). A feature of owners of successful small businesses is that they learn from failure (Minniti & Bygrave 2001:9). Successful managers in the corporate world depend on the guidance of their elders. This practice (known as mentoring) is hardly in place within the South African small business industry, although theoretically it forms the fulcrum around

which small business practices revolve, needing someone who has walked a similar path to guide others the same way. Mentoring has not gained much ground within the South African small business sector, despite its wide use within the corporate world. Mentoring could benefit South African small business entrepreneurs by imparting expert knowledge from subject matter specialists (Sullivan 2005:162; van Emmerik *et al* 2005:310).

#### **6.7.2.6 NETWORKING**

The statement that “no man is an island” is very applicable in small businesses. The critical use of networking lies in the mobilisation of resources, often resulting in bulk purchases that can be shared by all involved small businesses. This then impacts favourably on the small business costs for a successful venture. Networking has many benefits such as sharing of small business skills and best practices, for example. However, this crucial business practice is barely practised by many South African small businesses. This is perhaps one of the reasons that small businesses in South Africa are unable to mobilise resources effectively. They have not formed networks (Johannisson & Mønsted 1997:109; de Klerk & Kroon 2008:25). Small businesses need to create self-help networks or be associated with dedicated small business structures with low interest rates so that owners of businesses can afford loan repayments.

#### **6.7.3 Recommendations based on “income constraints” (factor 3)**

Given that the process of creating a new business is market driven, that identifying a good opportunity is difficult but critically important, and that success is dependent on a strong customer focus, one would expect owners of South African small businesses to have a need for, and be highly receptive to, marketing (Grünhagen & Mishra 2008:1).

Success cannot happen without an opportunity (Rwigema 2005b:61). The identification of new opportunities is a process often fraught with difficulties within the small business sector, partly because not all small businesses are innovative. Reflecting on the venture life-cycle concept, at the very beginning and towards venture decline, innovation can often be the answer to the problems of failure and

decline. It is imperative that the owners of South African small businesses are trained in innovation and creativity to enhance the probability of small business survival.

#### **6.7.4 Recommendations based on “cash control” (factor 4)**

Theory of the firm as generally understood stresses the need for ventures to learn over time how to adjust their cost structures to become financially efficient and profitable. Success in large firms is often attributed to the thinking that large firms have mastered cost management whilst small businesses have not. At the heart of financial efficiency is the ability for cash control. Small businesses need to excel at cost leadership. Respondents answering the questionnaire to this research agreed that they had inadequate records in place, indicating the need for operational efficiency to impact the day-to-day business. There was a lack of cash-flow budgeting and small business management experience. The need for cash control training and experience for the owners of South African small businesses can therefore not be overemphasised. The South African government needs to establish dedicated small business structures to educate and make resources available to small businesses at affordable rates.

The above recommendations indicate that there is much to be done to address the problems of the failed businesses in particular and SMMEs in general. The overall condition of the purchasing power of the population; the unemployment situation; the attitudes of the general public towards the quality of the products of SMMEs; and the commitment of organisations (such as Khula and Seda) in giving assistance to SMMEs will, to a large extent, depend on the framework laid by government to position SMMEs as a key sector in the development of South Africa. Each stakeholder in the SMME sector has a specialised role to play. Whether as consumers of SMME products, providers of SMME raw materials, or ambassadors for educating the public about the difference that SMMEs can make in the lives of South Africans, SMME businesses rely on the support of the broader South African public to succeed. The government, therefore, needs to implement the enabling environment posited in the National Small Business Act, Act 102 of

1996 of the Republic of South Africa (RSA) (RSA 1996) for all stakeholders associated with SMMEs.

## 6.8 FURTHER RESEARCH AREAS

There is a need to undertake further research on:

- the programmes in place to train the owners of SMMEs and the impact of such programmes. As indicated in Chapter 3, the institutions (for example, Khula and Seda) are not making much impact on the activities of the SMMEs as confirmed by the interviewed owners of failed small businesses. There is the need to establish the necessary framework for these organisations to provide various forms of support to small businesses.
- the provincial and municipal distribution of failed SMMEs, indicating their sectoral, gender and rural urban dimensions.
- the impact of the closed/failed small businesses on the overall economic development of South Africa (for example, impacts on the formal/first economy).
- the possible impacts (economic, environmental, and social) of small business failure in South Africa.
- the prospects of the retrospective and critical realist research paradigms on SMMEs in South Africa.
- comparing failure rates in different Southern African Development Community (SADC) countries.
- comparing failure origins in different Southern African Development Community (SADC) countries.
- the fact that if small business failure originates largely from non-adherence to business management principles, then failure should be preventable by adherence to business management principles. Thus it needs to be ascertained what is preventing owner-managers from adhering strictly to business management principles.
- developing a “grand theory of failure of small businesses”. There is still no “grand theory of failure” or “uniform failure knowledge”. To arrive at a grand theory, more ground empirical studies are needed to

build middle-range theories on which consensus can be reached to arrive at a grand theory.

## 6.9 CONCLUDING REMARKS

Research on the failure of SMMEs in South Africa can make tremendous contributions by providing detailed information on the causes behind the failed businesses (as outlined by the small business owners themselves) by utilising multivariate techniques (such as factor analysis) to build the necessary explanatory models, and by engaging the various communities in identifying workable strategies for the development of the small businesses.

This research has sought to make a contribution to the body of knowledge concerning the failures of small businesses in South Africa by emphasising that the “dead” firms also need to be studied, and reactivated wherever possible. Just as medical science would be unlikely to progress by researching only healthy individuals, small business management science may be limited in the knowledge obtainable only from the study of successful firms (Thornhill & Amit 2003a:506). McGrath (1999:28) and Rwigema (2005c:117) noted that there are benefits to be gained from the study of failures. By carefully analysing small business failures, instead of focusing only on small business successes, scholars can begin to make systematic progress on better analytical models of entrepreneurial value creation by learning from failure, as emphasised by Coelho & McClure (2005:13), McKenzie & Sud (2008:123) and Rwigema (2005c:118). Coelho & McClure (2005:13) summarise the situation succinctly: “without death there is no life, similarly without failure there is no success”.

Unless researchers and policy makers begin to take interest in the failed South African small businesses, our understanding of the failure issues of SMMEs can never be complete. For example, the National Small Business Act, 102 of 1996, Micro-economic reform strategy, Broad-based Black Economic Empowerment Strategy, National Youth Enterprise Strategy, Draft Strategy Framework for Forestry Enterprise, and the National Industrial Policy Framework (NIPF) have all underlined the importance of accelerating small business creation, growth and development. However, as shown in Chapter 3, the statistics indicate that very

little has been done to address the plight of the failed South African small businesses. This inattention to failed ventures, may have contributed to the failure rate continuing to escalate to an average of 80 % (Mohanlall 2008:26).

The results of this research demonstrate that the retrospective approach, coupled with the critical realist approach, made a substantial contribution to the knowledge available on SMMEs by disclosing information which otherwise would remain hidden. Consequently, one of the past propositions of this research, which states that the perceptions of the owners of small businesses are important determinants in explaining the failure of SMMEs, is supported (Clover & Darroch 2005:238). This proposition implies that the owner-managers of failed small businesses know best why their ventures folded.

This research has demonstrated that the retrospective approach requires much patience, since the owners of small businesses are often silent because of the lack of interest shown in them. By systematically going into the field to garner all the information obtained, this research has shown the merit of the retrospective method. As noted in previous chapters, Beaver & Jennings (2005:15) opine that only those persons immediately affected by organisational failure, or near failure, have sufficient knowledge of the precise circumstances to be able to suggest cause-effect relationships.

This research has raised awareness about the contributions that the critical realist approach can make to provide key information for decision making. The critical realist approach is based on the idea that prevention is better than cure. By providing information on what caused the deaths of the small businesses studied, this research gives the caveat that to prevent more business closures, action should be taken now. Lussier & Pfeifer (2001:228) emphasise that the would-be business owner's prime concern is his/her future chances of survival and that these can only be known if equipped with the information on the causes and the rates of businesses failure before actually venturing into the business (conducting a feasibility study).

Unlike human beings, small businesses do not have to undergo extinction. They can be turned around if the causes of the failures are identified early enough and

preventative action taken. This would have an enormous positive impact on the South African economy around issues of growth, reduction in unemployment, and poverty alleviation, if the high failure rate – standing at an average of 70 % to 80 % (before seven years after birth) – were to be reversed to the benchmark levels of between 4 % to 8 % in Australia each year (Craig *et al* 2007:9) (Chapter 1). It was encouraging to hear owners of the failed small businesses state that, if given further training and finance, they would be willing to continue contributing to the national economy.

The information provided through the retrospective method (using the critical realist approach) as evidenced by Figure 3.3 and Figure 5.6 should, therefore, be a means to take radical steps to revive those businesses which show potential for successful resuscitation and also businesses which show signs of failure. The research has generated the conceptual framework in Figure 3.3 and its process of failure model in Figure 5.6 for a better understanding of the causes associated with small business failure. This answers the third problem statement in Chapter 1: “Can a model for a better understanding of the causes of business failures be created?”. The information presented in this research should enable better policies and programmes to be put in place for removing the current anxieties about small business failures and answers the fourth problem statement in Chapter 1: “What are the implications of the information emanating from this research?”. It is senseless to expend energy and resources to create businesses that are allowed to die in large numbers.

The four failure factors identified in Chapter 5 are specific to this research. Research elsewhere may unearth factors unique to the firms concerned, since the small business failure process is not context-free. These contexts differ from country to country and locality to locality. The four failure factors need to be viewed as a challenge that needs urgent attention from policy makers and local SMME support agencies. The identified four failure factors constitute an integral part of South Africa’s political economy of development and underdevelopment. It is within this critical realist context that the findings of this research need to be evaluated in terms of the theories of failure of SMMEs.

Importantly, if small business failure emanates largely from non-adherence to business management principles, attention needs to be turned to the possibility that small business success could be enhanced by adhering to business management principles. It might be beneficial to undertake a pilot study on small businesses that are adhering to business management principles as a step towards the enactment of policies on adherence to business management principles.

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**APPENDIX A**

**LETTER TO SMME OWNER-MANAGERS AND  
QUESTIONNAIRE TO SMMES IN THE RESEARCH AREAS TO  
EXPLORE THE CAUSES OF FAILURE IN SOUTH AFRICAN  
SMALL BUSINESSES: 2007**

**A.1 LETTER TO SMME OWNER-MANAGERS**

Dear Respondent

This questionnaire investigates the causes of failure of your small business. The main objective of the research is to establish “How?” and “Why?” your small business failed in order to inform policy formulation to reduce the high failure rates of South African small businesses.

It would be appreciated if you would answer the questions as thoroughly as possible. All information will be treated as confidential and will be used for academic purposes only. It is hoped that the research will provide input towards policy formulation aimed at understanding and reducing small business failures.

Thank you in anticipation.

Sincerely

P P Nemaenzhe

Doctoral Student

Department of Business Management  
University of Pretoria  
Tel: 082 461 1190

**Instructions for completion:**

1. Please answer all questions as honestly as possible.
2. When asked for comment, please keep it as short as possible.
3. Mark a cross in the space provided on the right side of the question.
4. Answer all questions, if possible, as this will enable an accurate analysis and interpretation of data, and thus lead to more effective recommendations and conclusions.

**A.2 QUANTITATIVE QUESTIONNAIRE TO SMME OWNER-MANAGERS  
EXPLORING CAUSES THAT WOULD HELP ENTREPRENEURS TO  
SUCCEED**

**A.2.1 Demographic information**

Name of owner-manager: ...MR / MS .....

Name of business:  
.....

Address of business:  
.....  
.....

		<i>For office use only</i>																
Respondent number:		<table border="1" style="display: inline-table; border-collapse: collapse;"> <tr> <td style="width: 20px;">V0</td> <td style="width: 20px;"></td> <td style="width: 20px;"></td> <td style="width: 20px;"></td> <td style="width: 20px;">1-3</td> </tr> </table>	V0				1-3											
V0				1-3														
<p><b>1. Please mark type of business ownership you had with an “X”</b></p>																		
<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: left;">Type of ownership</th> <th style="width: 40px;"></th> </tr> </thead> <tbody> <tr> <td style="width: 20px; text-align: center;">1</td> <td>Owner only (someone else manages the business)</td> <td style="width: 40px;"></td> </tr> <tr> <td style="text-align: center;">2</td> <td>Manager only (someone else owns the business)</td> <td></td> </tr> <tr> <td style="text-align: center;">3</td> <td>Both owner &amp; manager (you own and manage the business)</td> <td></td> </tr> </tbody> </table>		Type of ownership			1	Owner only (someone else manages the business)		2	Manager only (someone else owns the business)		3	Both owner & manager (you own and manage the business)		<table border="1" style="display: inline-table; border-collapse: collapse;"> <tr> <td style="width: 20px;">V1</td> <td style="width: 20px;"></td> <td style="width: 20px;"></td> <td style="width: 20px;">4</td> </tr> </table>	V1			4
Type of ownership																		
1	Owner only (someone else manages the business)																	
2	Manager only (someone else owns the business)																	
3	Both owner & manager (you own and manage the business)																	
V1			4															



		<i>For office use only</i>	
<b>2. How long have you been the owner-manager of the venture? Please fill in the number of:</b>			
<b>Years</b>		<b>V2</b>	5-6
<b>Or</b>			
<b>Months</b>		<b>V3</b>	7-8
<b>3. Do you have business ownership-management experience? Please mark with an "X"</b>			
<b>1</b>	Yes		<b>V4</b> <b>9</b>
<b>2</b>	No		
If you answered "Yes" to the above question, please provide details of your experience			
.....			
.....			
.....			
.....			
<b>4. Please indicate the nature of your business with an "X"</b>			
<b>1</b>	Retailer		<b>V5</b> <b>10</b>
<b>2</b>	Wholesaler		
<b>3</b>	Transport		
<b>4</b>	Manufacturing		
<b>5</b>	Service industry		
<b>6</b>	Tourism		
<b>7</b>	A combination of the above options		
<b>8</b>	Other, please specify: ..... .....		



					<i>For office use only</i>									
<b>5. Have you ever worked in a business environment where you had exposure to a successful role model/mentor? Please mark with an "X"</b>														
1	Yes				<table border="1"> <tr> <td>V6</td> <td></td> <td>11</td> </tr> </table>	V6		11						
V6		11												
2	No													
If you answered "Yes" to the above question, what business skills did you acquire?														
.....														
.....														
.....														
.....														
.....														
<b>6. What was your annual turnover for 2001, 2002 and 2003? Please mark with an "X"</b>														
	<b>Turnover</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>										
1	Less than R150 000				<table border="1"> <tr> <td>V7</td> <td></td> <td>12</td> </tr> <tr> <td>V8</td> <td></td> <td>13</td> </tr> <tr> <td>V9</td> <td></td> <td>14</td> </tr> </table>	V7		12	V8		13	V9		14
V7		12												
V8		13												
V9		14												
2	R150 001 to R500 000													
3	R500 001 to R1 000 000													
4	R1 000 001 to R5 000 000													
<b>7. Please indicate the total number of employees in the failed venture other than the owner.</b>														
1	Fewer than 10 employees				<table border="1"> <tr> <td>V10</td> <td></td> <td>15</td> </tr> </table>	V10		15						
V10		15												
2	More than 10 employees													
<b>8. Please mark with an "X" how often the failed venture did planning</b>														
	Frequency				<table border="1"> <tr> <td>V11</td> <td></td> <td>16</td> </tr> </table>	V11		16						
V11		16												
1	Not done at all													
2	0 to 6 months													
3	6 to 12 months													
4	12 to 18 months													
5	18 to 24 months													



			<i>For office use only</i>		
<b>9. Please mark with an "X" how often the failed venture did cash-flow budgeting</b>					
	Frequency				
1	Not done at all		V12		17
2	0 to 6 months				
3	6 to 12 months				
4	12 to 18 months				

## A.2.2 Factors responsible for failure of SMMEs

### 10. Entrepreneur's business management skills

Please think about the failed venture and then mark the best possible answer with an "X"

Statement	1	2	3	4	For office use only		
	Strongly disagree	Disagree	Agree	Strongly agree			
1. More venture start-up experience would have halted failure in the venture					V13		18
2. More experience within the industry would have halted failure in the venture					V14		19
3. More planning would have halted failure in the venture					V15		20
4. A proper opportunity analysis before starting would have identified possible issues					V16		21
5. Previous experience as an owner-manager would have halted failure in the venture					V17		22
6. More managerial experience to manage workers would have increased success of the failed venture					V18		23
7. Managing the venture under the guidance of a successful mentor would have helped me steer the venture to success					V19		24
8. Obtaining expert advice would have saved the venture from failure					V20		25

Statement	1	2	3	4	For office use only
	Strongly disagree	Disagree	Agree	Strongly agree	
<b>11. Income (revenue) / product demand / sales</b> <b>Please think about the failed venture and then mark the best possible answer with an "X"</b>					

Statement	1	2	3	4	For office use only		
	Strongly disagree	Disagree	Agree	Strongly agree			
1. Declining customer traffic is an important reason for the failure that was experienced					V21		26
2. Ignoring price competition was an important contributory factor to the failure that was experienced					V22		27
3. Comparatively too expensive prices of goods contributed to failure					V23		28
4. Ignoring customers complaints significantly influenced the venture failure					V24		29
5. Lack of product advertising fuelled venture failure					V25		30
6. Bypassing newly constructed toll road diverted consumer traffic from the failed venture					V26		31

Statement	1	2	3	4	For office use only		
	Strongly disagree	Disagree	Agree	Strongly agree			
7. Losing sales during recessionary times contributed heavily to failure					V27		32
<b>12. Cash-flow monitoring and control</b> <b>Please think about the failed venture and then mark the best possible answer with an “X”</b>							

Statement	1	2	3	4	For office use only		
	Strongly disagree	Disagree	Agree	Strongly agree			
1. Regular cash shortages were typical of the venture before failure					V28		33
2. Fluctuations in sales made it difficult to control cash flow in the venture before failure					V29		34
3. Slow-paying customers contributed to the venture not being able to pay its monthly bills					V30		35
4. Bad debts resulted in the venture running out of cash before failure					V31		36
5. Slow conversion of goods into cash contributed to					V32		37



Statement	1	2	3	4	<i>For office use only</i>		
	Strongly disagree	Disagree	Agree	Strongly agree			
failure							
6. Inadequate initial financing contributed heavily to failure					V33		38

Statement	1	2	3	4	<i>For office use only</i>		
	Strongly disagree	Disagree	Agree	Strongly agree			
7. Excessive cash withdrawal for personal use drained money from the business before failure					V34		39
8. "Dipping of fingers" into company cash registers was one of the contributory factors to failure					V35		40
9. Banking both personal and business monies in one business account contributed to failure					V36		41
10. Delays in debt collection reduced the venture's cash levels before failure					V38		42
11. Difficulties in paying monthly bills were typical of the venture before failure					V39		43
12. An increase in uncontrolled expenses was typical of the venture before failure					V39		44
13. Failing to pay government company taxes was typical of the failed venture					V40		45

Statement	1	2	3	4	For office use only
	Strongly disagree	Disagree	Agree	Strongly agree	
<b>13. Owners' decisions and actions to results from control systems</b> <b>Please think about the failed venture and then mark the best possible answer with an "X"</b>					

Statement	1	2	3	4	For office use only		
	Strongly disagree	Disagree	Agree	Strongly agree			
1. Better response to sales records could have contributed to better money flow in the venture					V41		46
2. Monitoring of inventory records would have helped improve sales of slow moving stocks before stock became redundant					V42		47
3. Accurate record keeping would have helped us to take immediate corrective action					V43		48
4. Regular monitoring of cash receipt books would have halted venture failure					V44		49
5. Continuous monitoring of cash payment (disbursement) books would have forewarned me of possible misappropriation/mismanagement of funds					V45		50



Statement	1	2	3	4	<i>For office use only</i>		
	Strongly disagree	Disagree	Agree	Strongly agree			
before venture failed							

Statement	1	2	3	4	<i>For office use only</i>		
	Strongly disagree	Disagree	Agree	Strongly agree			
6. Monitoring of monthly financial statements (results versus budgets) would have helped arrest decline in venture's profits					V46		51
7. Managing weekly cash flow projections/forecasting records would have stopped failed venture from running out of cash					V47		52
8. Monitoring of stock levels (daily records) would have aided me in identifying redundant /slow moving stocks					V48		53
9. Monitoring of stock losses /shrinkage records would have helped to stamp out theft before venture failed					V49		54

**14. Poor business management**

Please think about the failed venture and then mark the best possible answer with an “X”

Statement	1	2	3	4	For office use only		
	Strongly disagree	Disagree	Agree	Strongly agree			
1. Too low prices of goods contributed to the venture's failure					V50		55
2. Too high prices of goods led to lower sales turnover					V51		56
3. Incorrect costing was responsible for poor profits					V52		57
4. Undercapitalisation was one of the fatal reasons for the venture's failure					V53		58
5. Excessive use of credit contributed heavily to the venture's failure					V54		59
6. Too high expenditures overwhelmed the failed venture					V55		60
7. High, uncontrolled running costs contributed to the venture's failure					V56		61

Statement	1	2	3	4	<i>For office use only</i>		
	Strongly disagree	Disagree	Agree	Strongly agree			
8. Acquiring more assets to offset declining sales accelerated the venture's failure					V57		62
9. Financing of the venture's assets using high-interest-bearing, short-term debt, is one of the reasons the venture failed					V58		63
10. Inability to pay interest on debt was typical of the venture before failure					V59		64
11. Evading tax payment was one of the business practices in the venture before failure					V60		65
12. Over-reliance on only one large customer was one of the reasons the venture failed					V61		66
13. Overstocking of products contributed to failure					V62		67
14. Frequent reprocessing due to inferior product quality contributed to the venture's failure					V63		68



**15. Overall rating**  
Please think about the failed venture and then rank the following statements from 1 to 5 (where 1 = least important and 5 = most important) that in your opinion contributed to the venture's failure

Statement	Ranking	For office use only	
<b>1. Better fit between the entrepreneur and the venture would have made the venture successful</b> (for example, better management, vision, skills, know-how, opportunity evaluation)		V64	69
<b>2. Higher product demand would have made the venture successful</b> (for example, more sales would have meant more cash, profits, turnover)		V65	70
<b>3. Improved cash flow would have made the venture successful</b> (for example, cash for stock readily available, cash for operating expenses always available, cash always available to service debts)		V66	71
<b>4. Proper reaction to information from control records/systems would have increased the venture's success</b> (for example, from sales records, income statements, stock control information, stock theft control systems)		V67	72
<b>5. Better venture management practices would have increased the venture's success</b> (for example, avoiding running a business using high, debt-bearing finances, collection of credit on time, constant lowering of expenses, frequently servicing debts).		V68	73



## **APPENDIX B**

### **PILOT STUDY QUALITATIVE QUESTIONNAIRE: 2006**

Please think about the failed venture; study the suggested reasons on the next page that might have caused it to fail; expand on why you believe the venture failed and then mark with a cross (X) to indicate whether you feel it was a “major” or “minor” cause of the failure:

Type of reason	Explanation	Major	Minor
Leadership and experience issues			
Sales issues			
Cash-flow issues			
Recordkeeping systems issues			
Business management			
Marketing issues			
Financial management issues			
Self-management and motivation issues			
Other management and business skills issues			
Trust/relationship issues			

## APPENDIX C

### PRE-PILOT STUDY QUESTIONNAIRE: 2005

During the pre-pilot study in 2005, several issues emerged which were incorporated into the pilot-study questionnaire (Appendix B) to obtain a deeper understanding of the underlying causes of failure and its consequences for business owners.

The following topics were probed:

- The implications which the failure had for the business owner
- How business owners coped during the process of failure
- How the businesses finally failed
- The psychological effects of the failure on the owner and the community at large
- The kinds of jobs the owners-managers are doing after their business failed
- If given a second chance to be in business and an opportunity to raise capital and receive further business management training, what would they recommend to ensure their business would remain successful.