

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

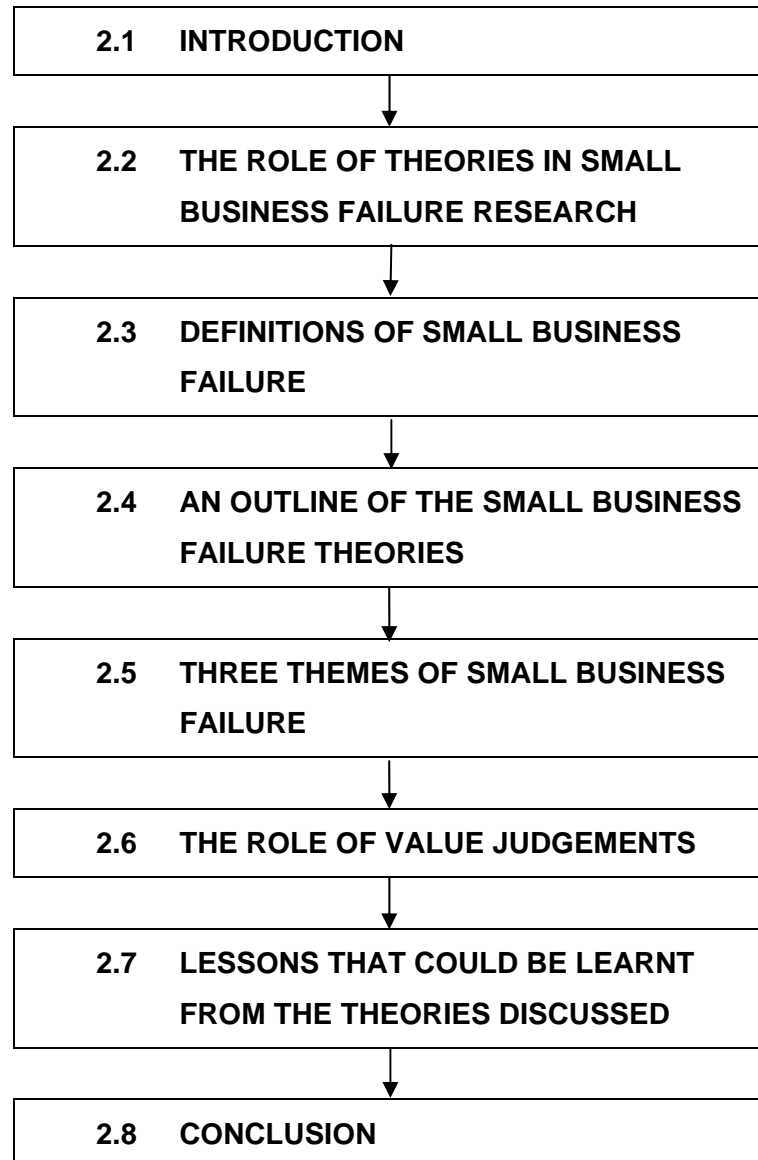


Figure 2.1: Layout of Chapter 2

## 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***

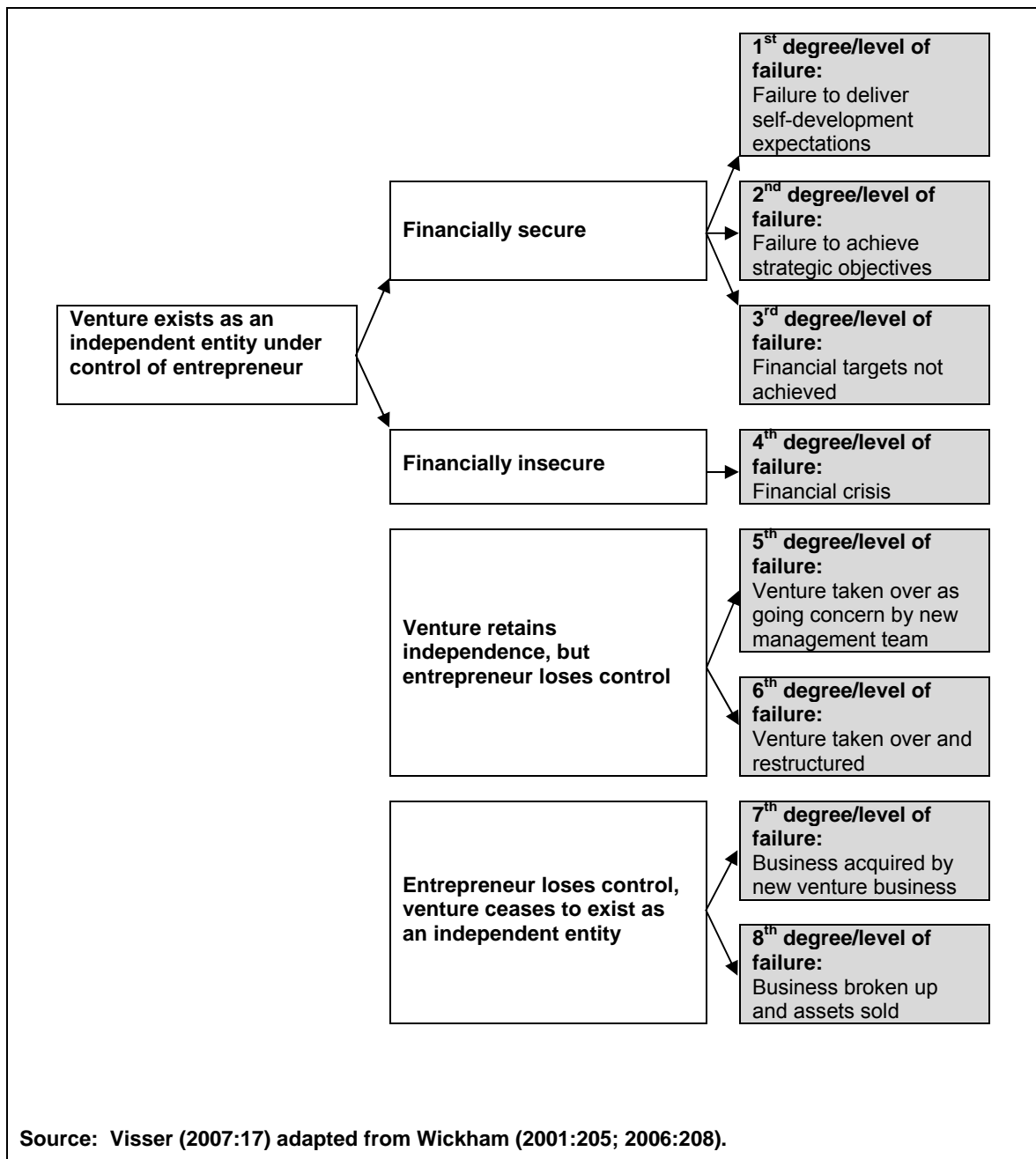
Definitions of failure can also be approached from a generic point of view. Many researchers have different perspectives on failure (Table 2.2), especially in the South African context there are those who hold the generic view or perspective, whilst others have the view of levels or degrees of failure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

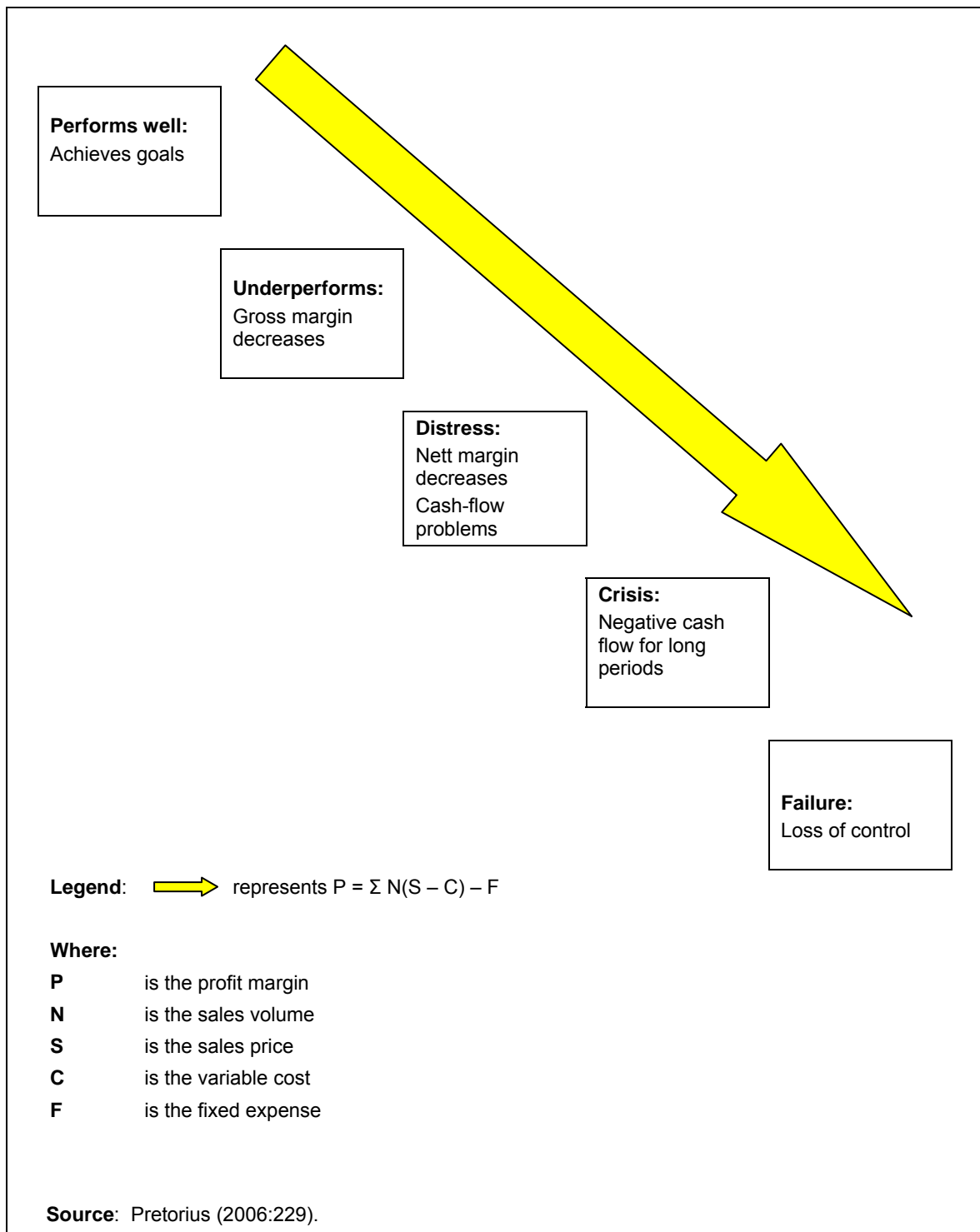
Failure definition	Category/key definition construct	Source
Failure can be defined in different ways, but most people automatically think of absolute failure as evidenced by bankruptcy	Bankruptcy	McLeary (1995:288)
An SMME failure can be seen as a venture that one must get rid of (whether by selling 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**

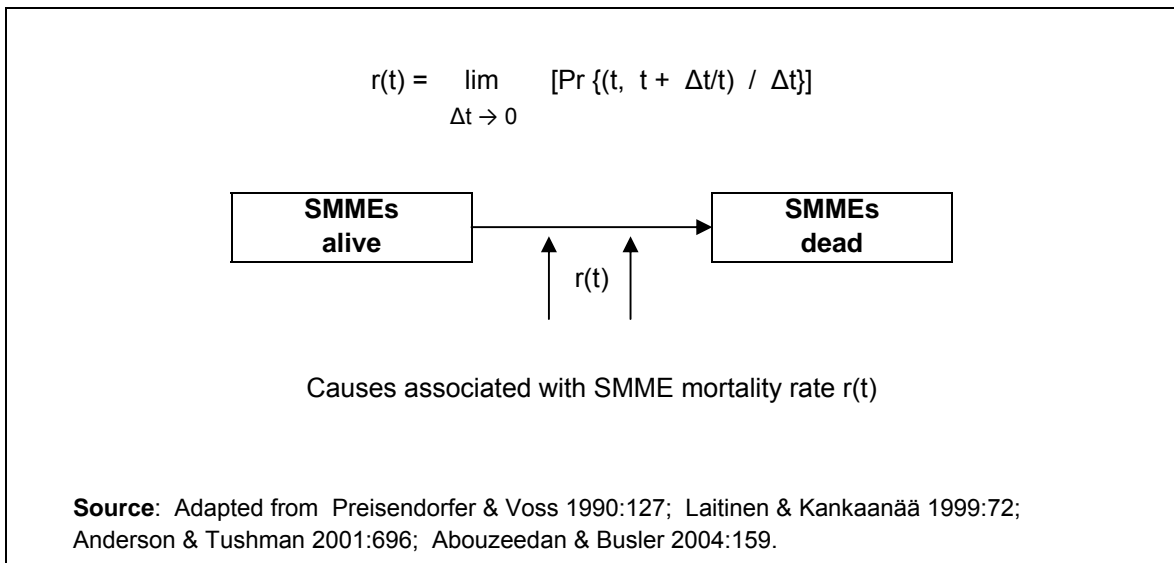
Before an in-depth review of small business failure is conducted, attention is first given to the conceptualisation of “hazard rate” in the small business failure process. This concept is being introduced to set the stage for a deeper review of small business failure theories. According to Abouzeedan & 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.

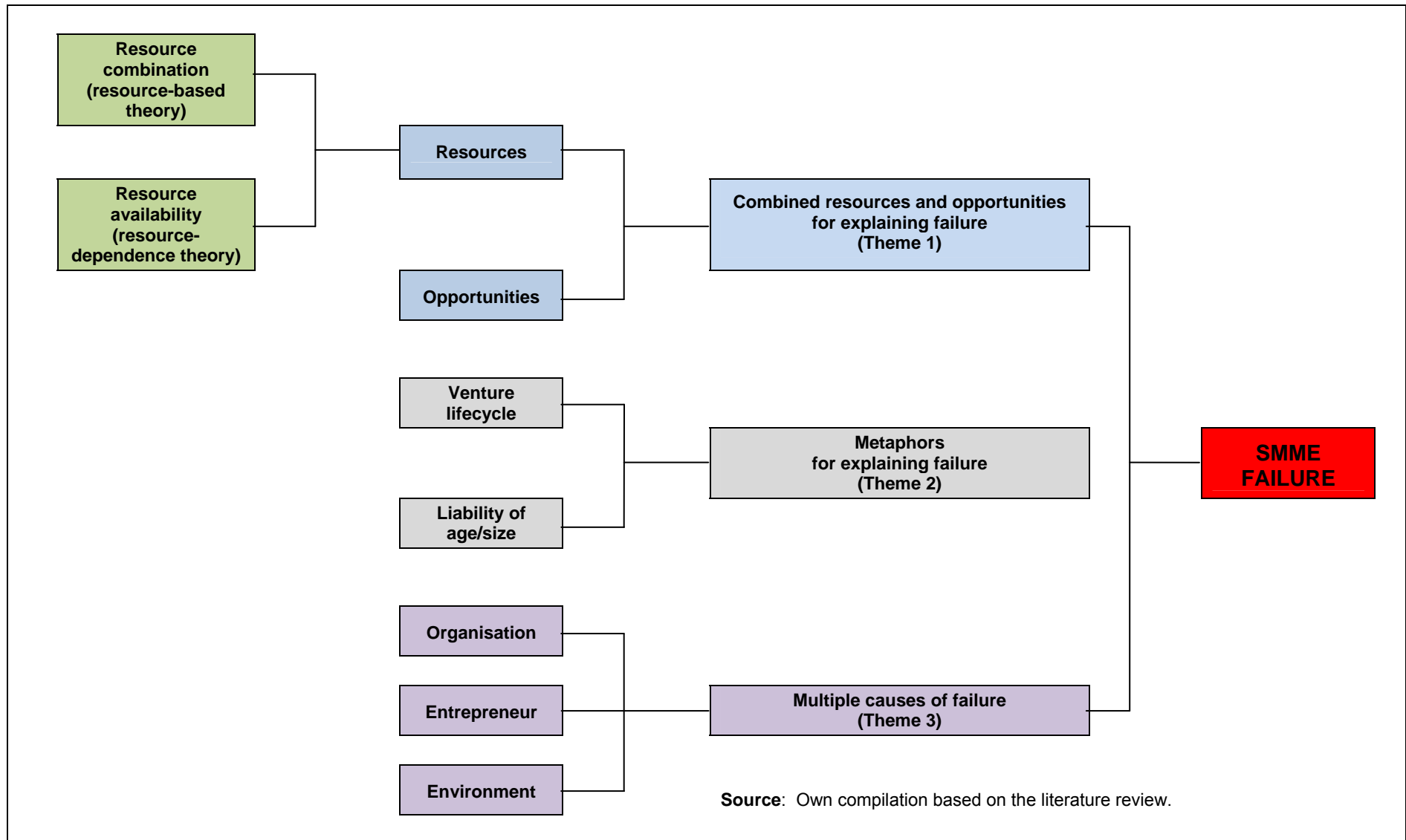


Figure 2.5: Proposed tree diagram of small business failure themes

### **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.

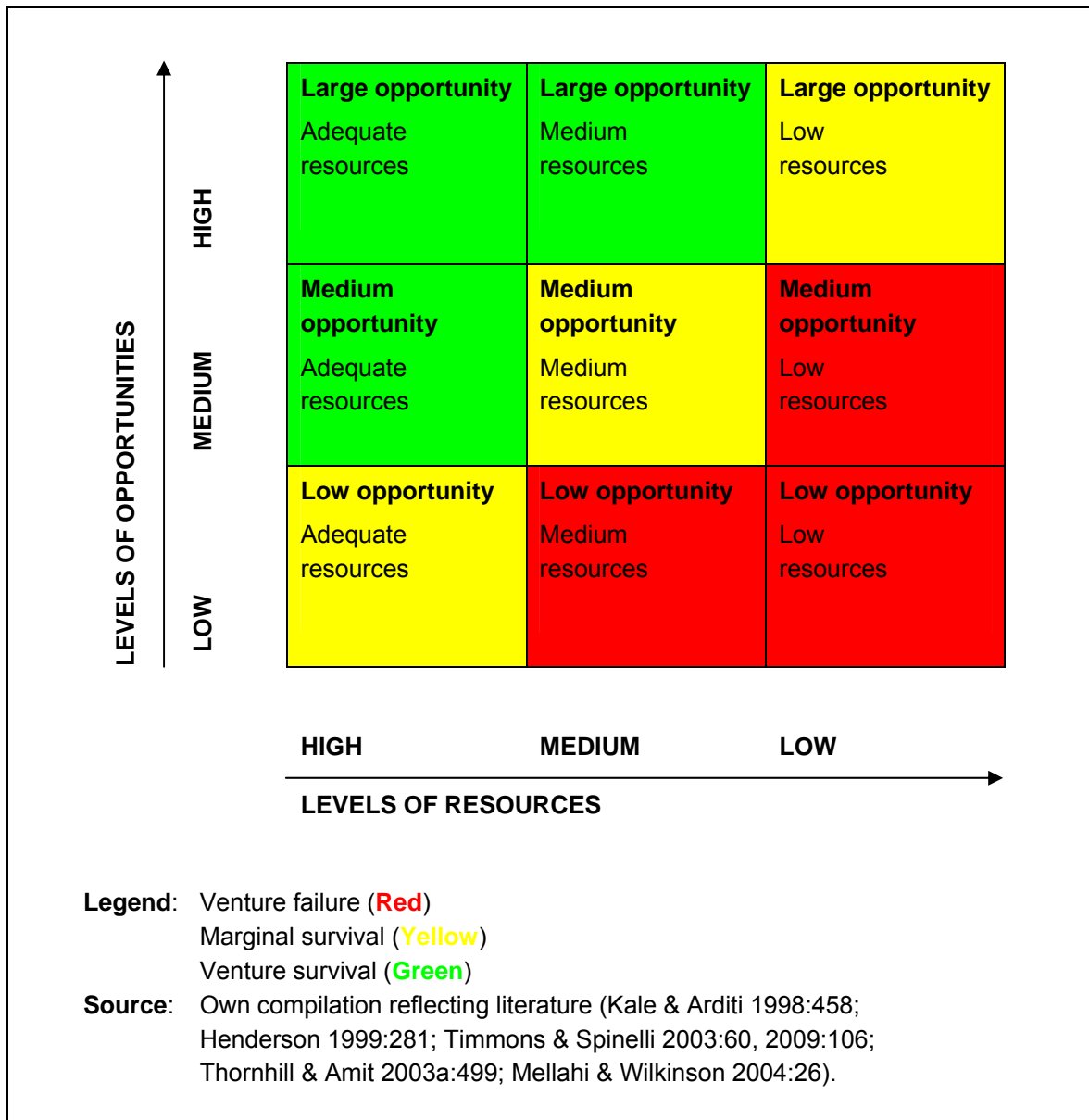
In Figure 2.6, the resource and opportunity combinations concept has been used to explain that at each point during the venture life stages, there are combinations between resources and opportunities which define whether a venture remains in existence or ceases (Timmons & Spinelli 2003:56; 2009:555). 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**

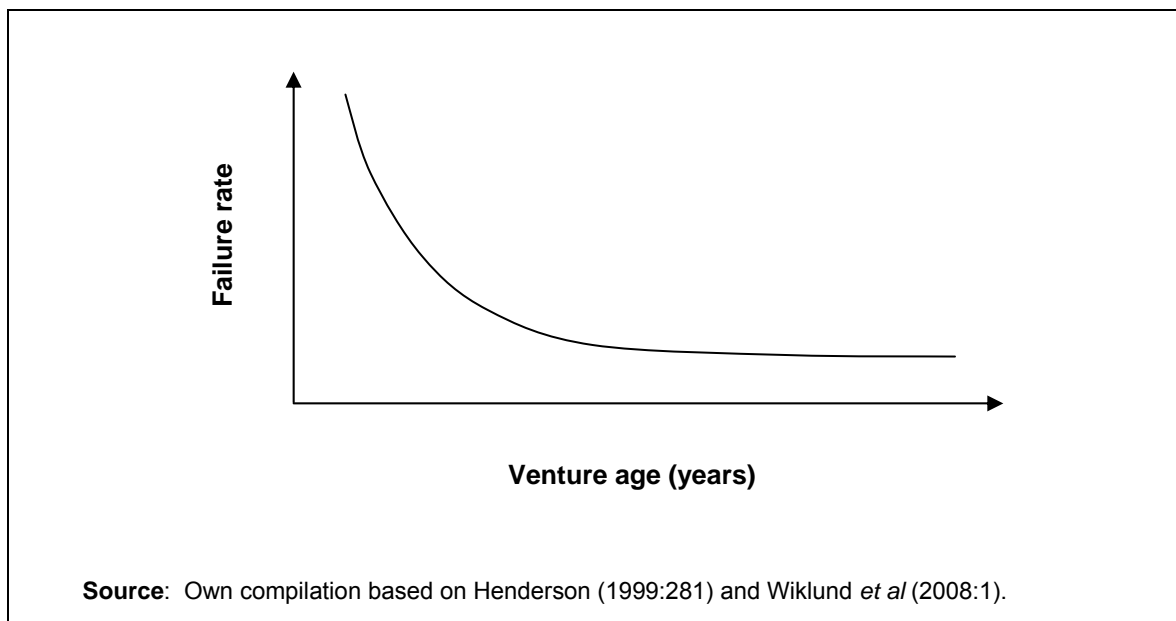
Stokes & Blackburn (2002:19) and Cressy (2006:113) contend that the age-dependency failure rates are highest in the early years after venture start-up, and decline as the business ages. They contend that younger firms tend to close at a higher rate than older ones. This metaphorical phenomenon is well 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.



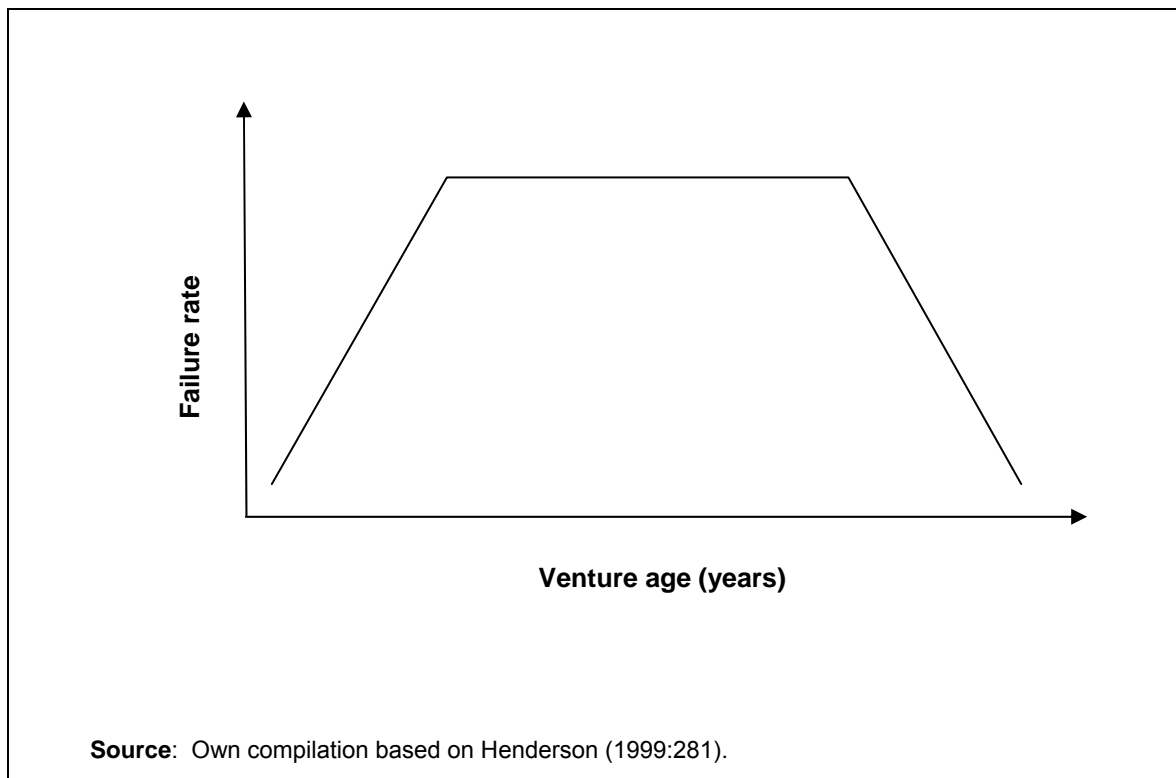
**Figure 2.7: Proposed failure rate versus liability of newness in years**

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**

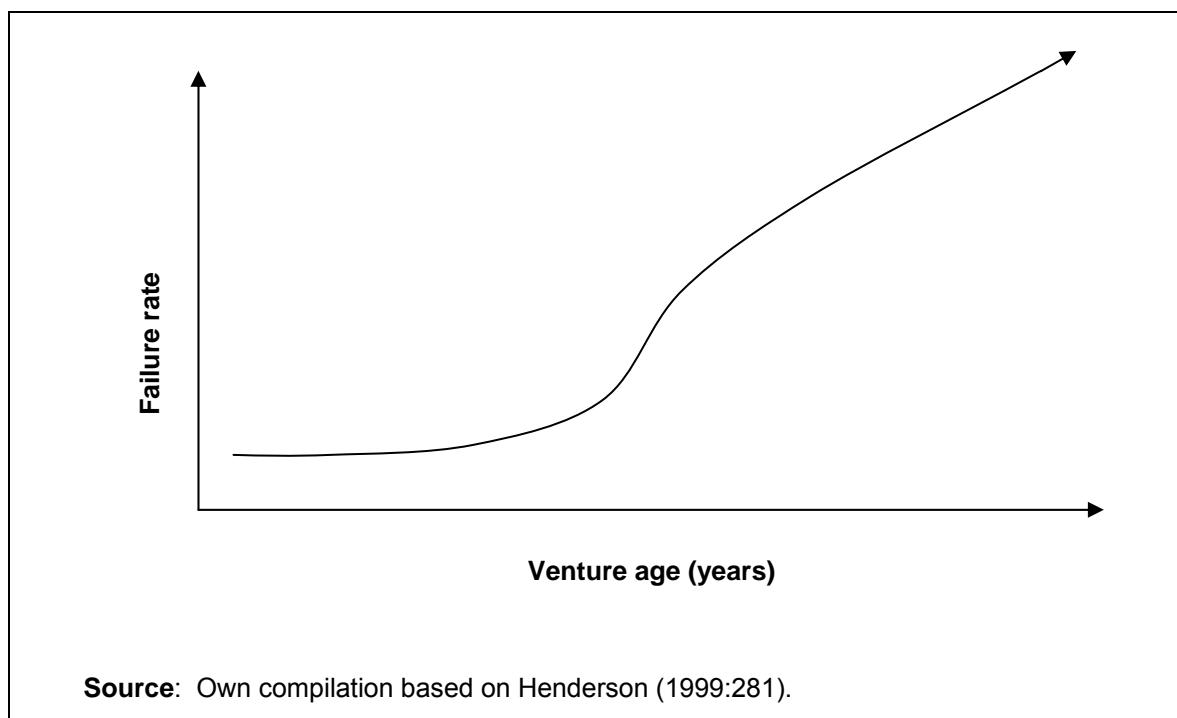
Figure 2.8 supports Bruderl & Schussler (1990:23), Fichman & Levithal (1991:15) and Cressy (2006:130) who opine that the liability of adolescence claims that the risk of failure increases for a certain period at the beginning of the life of an



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**

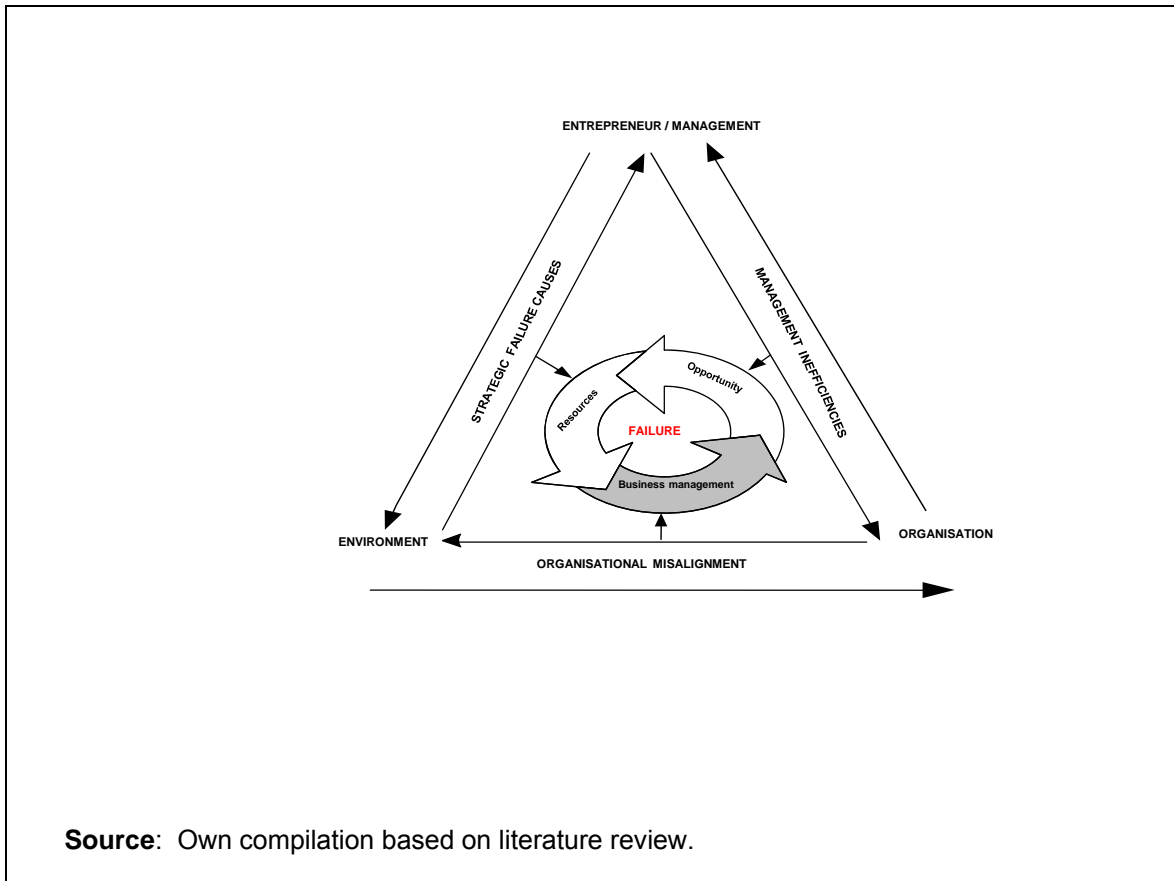
As the metaphors explain failure by analogy which conveys meaning from one thing to another, the danger is that the owners of small businesses may take them literally without questioning their meanings. Danermark *et al* (2006:123) alert the reader to risk in the use of metaphors by noting:

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.