

CHAPTER 1
BACKGROUND AND PROBLEM ORIENTATION

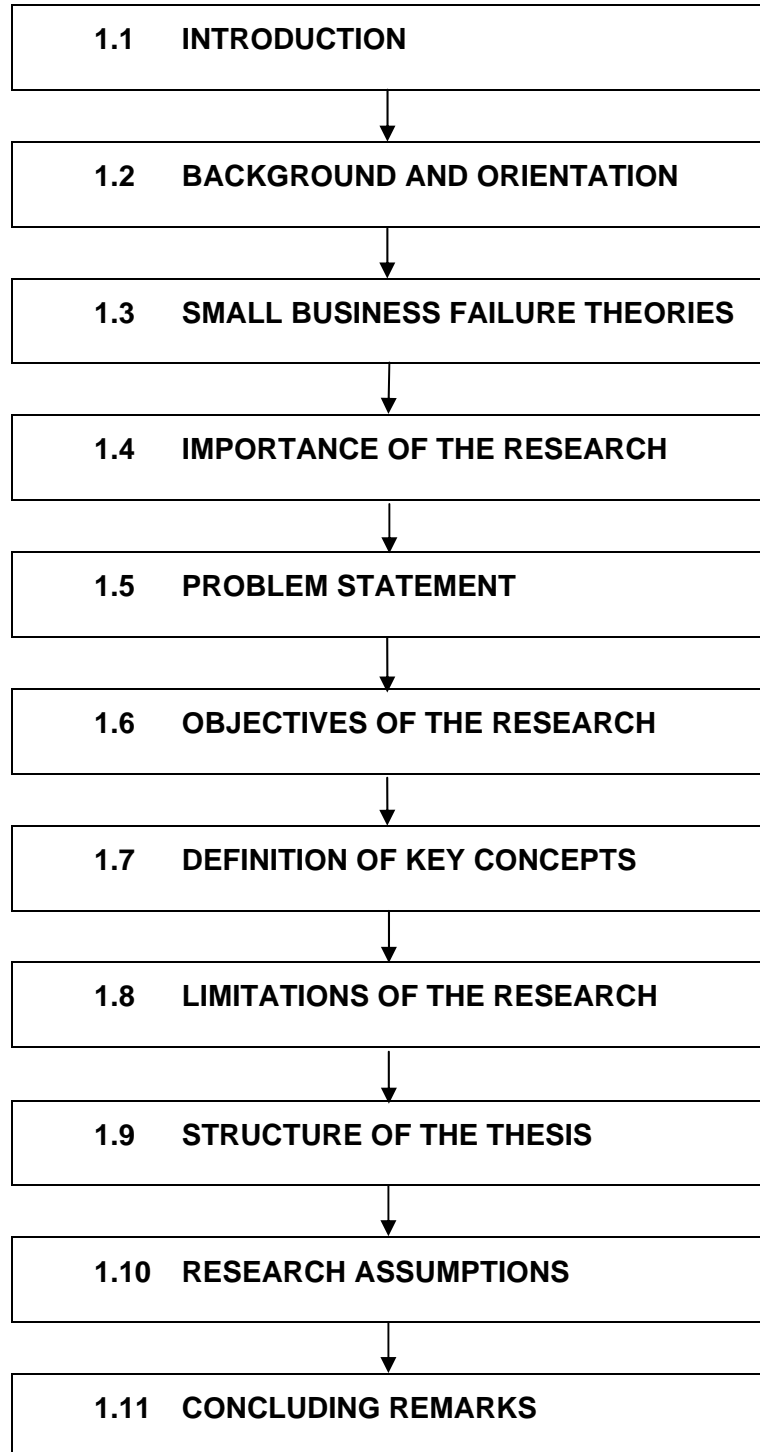


Figure 1.1: Layout of Chapter 1

CHAPTER 1

BACKGROUND AND PROBLEM ORIENTATION

1.1 INTRODUCTION

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

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

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

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

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

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

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

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

Table 1.1: Small business failure rates in the developed world

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

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

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

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

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

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

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

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

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

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

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

1.2 BACKGROUND AND ORIENTATION

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

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

1.2.1 United States of America

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

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

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

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

1.2.2 Japan

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

1.2.3 Britain

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

1.2.4 Denmark

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

1.2.5 Hungary

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

1.2.6 Sweden

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

1.2.7 Africa

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

Mfaume & Leonard (2004:1) note:

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

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

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

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

1.2.8 South Africa

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

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

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

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

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

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

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

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

1.3 SMALL BUSINESS FAILURE THEORIES

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

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

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

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

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

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

1.4 IMPORTANCE OF THE RESEARCH

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1.4.1 Advantages of explanatory research

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

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

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

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

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

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

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

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

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

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

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

Table 1.4: Percentage of small business failure by age

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

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

1.4.2 Consequences of small business failures

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

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

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

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

1.4.2.1 FINANCIAL CONSEQUENCES

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

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

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

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

1.4.2.2 EMPLOYMENT LOSS CONSEQUENCES

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

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

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

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

1.4.2.3 PSYCHOLOGICAL EFFECTS OF BUSINESS FAILURES

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

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

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

Table 1.6: South African overall unemployment rate by province

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

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

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

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

From the above, certain pertinent issues emerge:

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

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

1.5 PROBLEM STATEMENT

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

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

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

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

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

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

1.6 OBJECTIVES AND PROPOSITIONS OF THE RESEARCH

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

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

The research proposition are:

- P₁** Monitoring and control contributes to failure in small businesses.
- P₂** Experience and planning in finance and marketing contributes to failure in small businesses.
- P₃** Income constraints contribute to failure in small businesses.
- P₄** Cash control contributes to failure in small business.

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

1.7 DEFINITION OF KEY CONCEPTS

BUSINESS MANAGEMENT PRINCIPLES OR KEY SUCCESS FACTORS

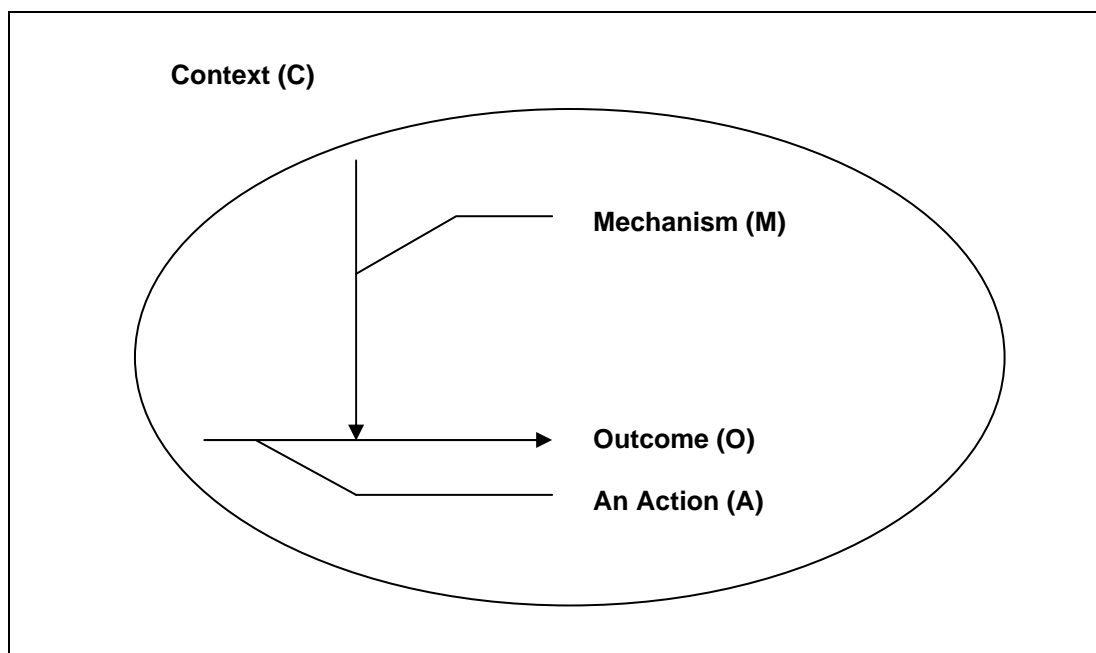
“Business management principles” or “key success factors” are the set of conditions/rules that need to be satisfied to enable businesses to survive and grow with time (Beaver & Jennings 2005:9; Wickham 2006:205).

BUSINESS FAILURE DEFINITION ADOPTED FOR THIS RESEARCH

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

CAUSAL MODELS

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



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

Figure 1.2: Elements of causal modelling

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

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

CAUSE

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

DEVELOPING CAUSAL MODELS IN REALIST RESEARCH

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

HAZARD RATE

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

HERMENEUTICS

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

MECHANISMS

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

OPPORTUNITY

Several definitions of “opportunity” apply to this research:

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

REALIST STRATIFICATION MODEL

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

RESOURCES

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

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

RESOURCE BUNDLES

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

RESOURCE AND OPPORTUNITY HALF-LIFE

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

SMALL BUSINESS VENTURE OR DOMAIN

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

THEORY IN CRITICAL REALISM

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

MECHANISMS AT THE REAL LEVEL OF THE REALIST APPROACH

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

VENTURE DECLINE

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

Engelbrecht (2005:463) takes the position:

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

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

1.8 LIMITATIONS OF THE RESEARCH

The following limitations are applicable to this research:

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

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

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

1.9 STRUCTURE OF THE THESIS

CHAPTER 1: INTRODUCTION AND PROBLEM ORIENTATION

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

CHAPTER 2: LITERATURE REVIEW: SMALL BUSINESS FAILURE THEORIES

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

CHAPTER 3: CONCEPTUAL FRAMEWORK FOR THE RESEARCH

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

CHAPTER 4: RESEARCH METHODOLOGY

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

CHAPTER 5: FINDINGS AND ANALYSIS

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

CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS

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

1.10 RESEARCH ASSUMPTIONS

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

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

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

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

1.11 CONCLUDING REMARKS

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

Retrospective analysis of failure causes in South African small businesses

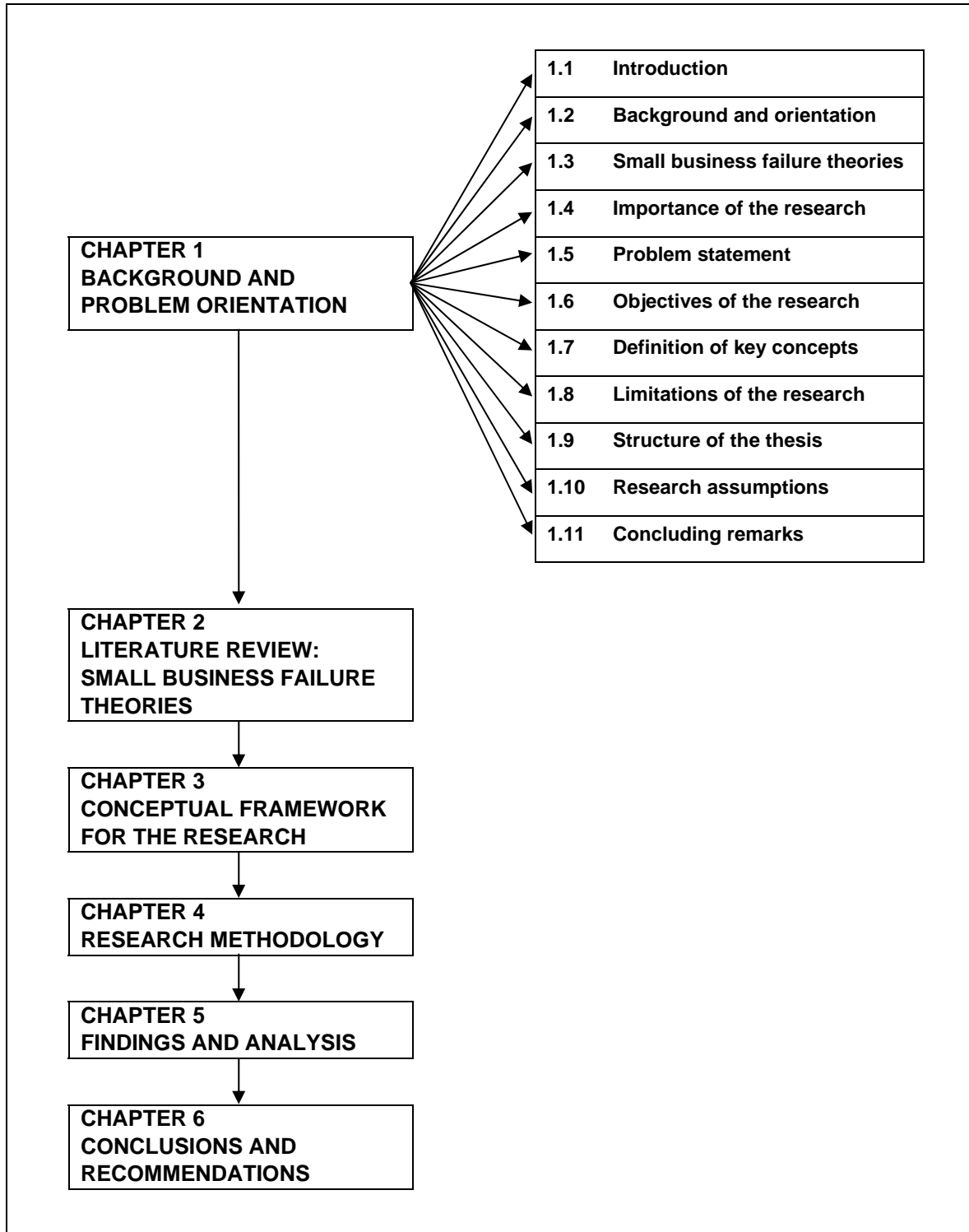


Figure 1.3: Organisation of the research and layout of the thesis