Examining the factors obstructing startups and small businesses' success: An empirical study concerned with the Egyptian business environment

Bassant Badr El-Din El-Sharawy

PhD in Accounting

(Cairo University, Egypt)

Walid Aboubakr Abouzeid

PhD in Business Management

(International Academy of Engineering and media Sciences, Egypt)

Abstract:

There is no more ambiguous or better studied issue in the field of small businesses than what contributes to their failure. Given the critical role that the small businesses play in the economy, the economic consequences of their failure can be disastrous. However, there is no definitive answer to the reasons beyond the small businesses failure. This study attempts to examine and analyze the catalysts of small businesses failure in general, and in the Egyptian market in specific.

Success in business is never guaranteed. It is not based on luck. It depends primarily on the owner's foresight and on the organization performance. Even though, it still cannot be assured. In order to avoid business failure, it is necessary to understand the factors leading to this failure and how to successfully overcome them. The most common factors causing small businesses' failure may include: lack of funding, mismanagement of resources, lack of qualified personnel, faulty business model and wrong feasibility study.

Keywords: Small Business, Failure, Economic Consequences, Business Model, Funding

1. Introduction:

Many attempts were made to define small businesses; however, no specific definition for small businesses could be taken as a reference by all researchers. A small business may be defined as an independently owned and operated company that is limited in size and revenues depending on the industry. A small business is a privately owned and operated business with relatively small staff, typically seen as constituting part of a specific commercial or economic sector, (Berisha and Pula, 2015).

In 2008, the World Bank, uses three quantitative criteria for defining small businesses: number of employees (less than 50 employees) and total assets (more than $100,000 and less than or equal to $3,000,000) or annual sales of the business (more than $100,000 and less than or equal to $3,000,000). The dollar amount sated will differ from country to the other. A business must meet the quantitative criteria of number of employees and at least one financial criterion to be categorized as a small business.

In order to be able to comprehend the small businesses failure phenomenon, it is essential to define the concept of small business failure. There are many different interpretations of the concept of "business failure", indicating that there is no single agreed upon definition of "business success" or "business failure" (Rogoff et al., 2004).

Before reviewing failure definitions that have been used or suggested, in the literature, it is useful to consider some guidelines that a definition should possess to be useful in measuring and analyzing business failure (Watson and Everett, 1993). These guidelines are classified into four criteria: (1) Objectivity, in choosing a definition of failure it is important to select a measure that is objective as possible. Data availability is important to be objective in measuring the business failure. (2) Relevance, if the measure is irrelevant then conclusions drawn from the results will be misleading. (3) Reliability, in other words, measures selected should be free from bias. (4) Simplicity, as simple measures are less prone to errors than complex measures. The following paragraphs will state some of the definitions stated in the literature for business failure. Also, the definitions identified are examined against the above mentioned guidelines, thus, selecting an appropriate measure for business failure.

Fredland and Morris (1976), argued that business turnover (discontinuance for any reason) is a proxy for failure. They mentioned that turnover means that resources have been shifted to more profitable opportunities. However, Garrod and Miklius (1990), stated that it is an extremely broad definition of failure that includes as failed businesses, those businesses that are sold to make a profit or because the owner wishes to retire for age or health reasons. Using discontinuance as a measure of failure has the advantage that it is a relatively objective and simple measure, although, it may be a biased measure.

Dun and Bradstreet (1979) defined business failure as, "businesses that go into bankruptcy or cease operations with resulting losses to creditors". The implications are that continuing businesses and businesses that cease without loss to creditors (with losses to owners only) are regarded as non-failed. Bankruptcy as a measure of failure has the advantage of being objective and simple; moreover, it is a relevant measure for credit providers. However, this definition lacks relevance as there may be a large number of businesses that have ceased trading with losses to the owner but without losses to creditors.

Ulmer and Nielsen (1947), defined failure as: "firms that were disposed of (either sold or liquidated) with losses to prevent losses". They further elaborated that losses include the owner's capital and therefore a business could be regarded as having failed even though there may have been no losses to creditors. Defining failure to include businesses that were sold or ceased to prevent further losses appears more relevant than using a measure based on either turnover or bankruptcy. However, it is not simple nor objective as it will not be reported in the financial statements of these businesses. This definition is based on the opinion of someone associated with the business.

Another definition of business failure is the one suggested by Cochran (1981), "failure should mean inability to "make a go of it", whether losses entail one's own capital or someone else's, or indeed any capital". This definition is wider than that suggested by Ulmer and Nielsen (1947) as it includes any businesses that were not earning any adequate return. However, many businesses may continue operating even though they would be classified as having failed under this definition. In addition, an adequate return is hard to define as many small business owners may be willing to accept low financial returns as the cost of independence.

Business failure has been defined from a number of perspectives, all of which ultimately point to the inability of the venture to satisfy a certain set goals. The inability to satisfy the goals in variably translates into the position occupied by the firm along a continuum characterized by success at one pole and failure at the other. Moreover, it can be stated that business failure refers to a company ceasing operations as a result of its inability to make a profit or to bring in enough revenue to cover its expenses. A profitable business can fail if it does not generate adequate cash flow to meet expenses.

For the purpose of this research, business failure definition is limited to only businesses that are either placed into bankruptcy or cease with losses to creditors are considered to have failed. The reason for this is that it includes the minimum guidelines that were mentioned above. The simplicity, objectivity and reliability are included in this definition. In addition to the ease of obtaining the required information for the study.

The following literature attempts to highlight the possible factors present in the Egyptian market that may contribute to the closure or cessation of small businesses operations. The research also utilizes empirical methods to evaluate the elements causing startups and small businesses failure in the Egyptian business environment.

2. Literature Review:

Small business failure, from a financial perspective, could be elaborated as firms earning a return on investment which is less than the opportunity cost of capital (Fredland and Morris, 1976). Moreover, business failure is a situation in which the business is unable to meet its liabilities. In the literature, many categories were illustrated under which businesses might fail including: discontinuance of operation, failing to achieve specific financial goals and filing for bankruptcy. Pfeifer and Lussier (2001) mentioned that any small business unable to gain profits for three years or more is recording a business failure. Since there is no agreement on the definition of businesses failure, therefore, the causes or the reasons of a phenomenon cannot be fully defined (Ucbasaran et al., 2001).

In a small business, one or two persons are required to make all the critical management decisions, finance, accounting, personnel, purchasing, transactions processing, marketing and selling with specific knowledge of one or two areas at most. Successful business owners must possess the ability to mitigate the business risks while simultaneously bringing a product or service to market at a price point that meets consumer demand levels. Without the proper tools in place to achieve the small businesses owners' objectives, small businesses are on a path to failure. To safeguard a newly established business from falling, it is necessary to understand what can lead to business failure. The most common reasons for small businesses failure include lack of capital or funding, retaining an inadequate management and other external factors.

A survey of approximately 1,000 small business owners and managers was conducted to investigate the perceived causes of small business failure. In addition the survey participants were asked for suggestions for reducing the number of small business failures. The major causes of small business failures according to the survey are the lack of management expertise. Consequently, the survey participants' primary suggestion for decreasing small business failures was to improve management education. The survey also indicated other perceived causes closely related to the lack of management expertise as under capitalization, high overhead expenses, insufficient cash flow, which are related to inadequacy of management practices. Other uncontrollable or external factors such as high interest rates, taxes and recession in the economy collectively lead to businesses failure (Perterson et al., 1983).

Temtime and Pansiri (2004) find that factors related to marketing such as lack of market research, ineffective demand forecasting and analysis, bad customer service, and lack of training for sales staff are the most significant factors leading to the failure of small businesses. Bad business planning easily leads to failure. The investment analysis and working capital management factor is rated second. Customer relationship is rated third. Managerial action and external environmental factors are rated fourth. Phaladi and Thwala (2008) conclude that lack of effective management, financial management, entrepreneurial skills, proper training, resources, technical skills, contractual and managerial skills and inability to get credit from banks and suppliers are critical failure factors of small businesses.

Fatoki (2014), conducted a study on South Africa searching for the reasons beyond small business failure. The study revealed that the causes of the failure of small businesses are both internal and external. Internal factors include lack of management experience, lack of functional skills and poor staff training and development and poor attitudes towards customers. External factors include non-availability of a logistics chain and a high cost of distribution, competition, rising costs of doing business, lack of finance and crime.

In 2011, another study was conducted in Zimbabwe. The study sought to establish the major causes of small business failure in Zimbabwe. Data were gathered through formal and informal interviews, questionnaires and focus group discussions with small businesses which were randomly selected from different clusters representing different industries. Results showed that lack of general knowledge on business management, unavailability of credit, import competition and high cost of raw materials are the major causes of small business failure in Zimbabwe (Mudavanhu et al., 2011).

The following paragraphs are summarizing the main reasons beyond the small businesses failure.

Financial inadequacy and lack of capital. A large number of small businesses that fail each year stated a lack of funding or working capital. In most situations, a small business owner is aware of how much money is needed to keep operations running on a day to day basis, including funding payroll, fixed and variable expenses and ensuring outside creditors are paid on time. However, owners of failing companies are less in tune with how much revenue is generated by sale of products or services. This disconnect leads to funding shortfalls that put a small business out of operations. In addition, small business owners miss the mark on pricing products and services. To beat out the competition, in a highly competitive market, companies may price a product or service far lower than similar companies offering the same product or service trying to attract more customers. While the strategy is successful in some cases, businesses that end up closing their doors are those that keep the price of a product or service too low for too long. When costs for production, marketing and delivery outweigh the revenue generated from new sales, small businesses have to close operations. The other end of the situation takes place also with small businesses. Better explained, the small business price the products too high compared to the rivals, thus, being unable to attract customers, no revenues are achieved to cover the expenses, resulting in the discontinuance of the business.

Small companies in the startup phase, also face challenges in terms of obtaining financing to bring new products to market, to fund an expansion, or to pay for new marketing campaigns. While bank loans, especially in the Egyptian market nowadays with the support provided by the government for the small businesses, represents a source of financing which requires businesses to achieve a revenue stream to secure this type of financing. To protect small businesses from the financing problems, business owners should be able to establish a realistic budget for the startup of the business and for the company operations. Unawareness of the small business owners with the accounting and finance, inability to establish a well feasibility study and preparing annual budgets leads to financial inadequacy.

Poor or inadequate management skills: Another common reason for small business failure, mentioned in the literature, involves the lack of management expertise held the management team and the owner of the business. A small business owner, in most of the situations, is the only senior level within a company, especially when a business is in its first year or two of operation. While a business owner may have the skills necessary to create and sell a product or service, he is often lacking the attributes of a successful manager and the time required to successfully manage the employees. In other terms, a business owner might mismanage certain aspects of the business, whether marketing, administration, human resources aspects and many other aspects of management.

Successful small business owners outsource the activities they do not perform well or have less time to efficiently carry out. Even though outsourcing will add extra expenses on the burden of small businesses which could not be afforded during the first year of operations.

A strong management team is one of the main reasons for the success of small businesses and the continuation of operations. It is important for the small business owners to be knowledgeable of the different aspects of the business management.

Small businesses understand the significance of effective business planning prior opening their doors. A sound business plan should include, at a minimum, a clear description of the business, current and future employees, and management needs, opportunities and threats within the market, capital needs including projected cash flow and budgets, marketing initiatives and competitors analysis. Business owners who fail to address the needs of the business within a well laid out plan before operations begin are setting their businesses for serious challenges.

Some other factors could cause a small business failure. These factors are external factors which are not controllable by small business' owners. Among these factors are: legal problems, changing interest rates, failure to comply with laws and taxes. Another important factor is uncontrolled growth, in other words, too much business can destroy small businesses. Overdependence on a single customer or a single supplier is also an important factor. Overgeneralization, which means trying to do everything for everyone is a sure road to ruin. Specialization and quality are very important dimensions for small businesses success. Last but not lease, failure to acquaint with technology is very important.

3. Research objectives:

The main aim of the research is to examine the factors leading to the failure or cessation of businesses in the Egyptian market. The Egyptian market, nowadays, witnesses a growing market in small businesses. Small businesses are encouraged by the government and many facilities are presented to them. These facilities include ease of startup, low interest loans, taxes and many other facilities thus encouraging investment in small businesses. However, many small businesses record failure within years from their operation.

The main objective of the research is determining and analyzing the factors that lead to the failure of these small businesses. Is the failure of the small businesses related to financial inadequacy, management inadequacy or the external factors which affect these small businesses?

4. Research Hypotheses:

The hypotheses of the research are examining the main factors that lead to small businesses obstruction in the Egyptian market.

H_1: Financial inadequacy is the main reason for the small businesses failure in the Egyptian market.

H_2: Management inadequacy is the main reason for the small businesses failure in the Egyptian market.

H_3: External factors represent the main reason for the small businesses failure in the Egyptian market.

The hypotheses of the research are summarized in a research model demonstrated in figure (1).

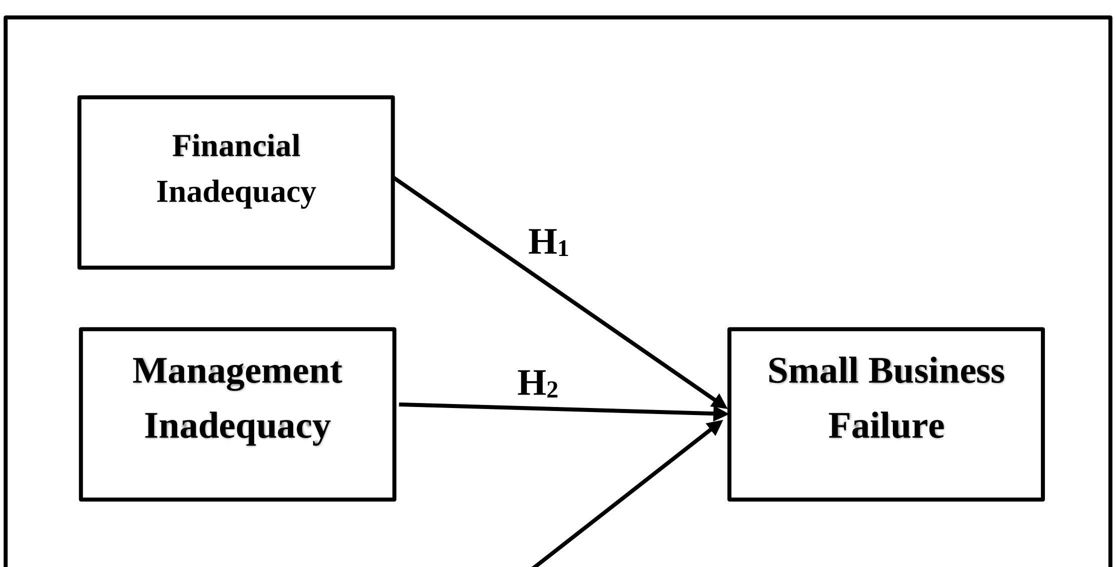

Figure (1)
The research model

5. Methodology and Data Collection:

Data collection was based on semi structured interviews conducted with seventy five ex-owners of small businesses in different disciplines (six shopping malls). The small business were selected based on the criteria of world bank for small businesses, which means number of employees is less than 50 and the capital of the business is less than L.E. 3,000,000. The main areas, the interview was tackling, were the main reasons beyond the business failure. The questions were targeting the financial aspects, the managerial aspects and other external factors that may affect the business. These are the independent variables of the study.

Another factor which was included into the interview is the number of months the business operated before it was shut down. The number of months is an indicator for the effect of each independent variable on the business failure, which is the dependent variable.

6. Data analysis:

From the interviews, the main reasons for the small businesses failure were: inadequate financing, over borrowing, lack of planning, poor cash flow management, unexpected growth, failure to innovate, poor location, absence of performance monitoring, inexperienced management, insufficient capital, personal use of funds and poorly trained employees. Some of the ex- business owners that were interviewed mentioned did not mention only one reason for the business failure but they listed that a group of factors lead to the business failure.

The researchers allocated the reasons mentioned in the interviews into the three independent variables of the study; managerial inadequacy, financial inadequacy and the external factors. Table (1) illustrates the reasons listed under each independent variable.

Managerial Inadequacy	**Financial Inadequacy**	**External Factors**
Lack of planning	Inadequate financing	Unexpected growth
Poor cash flow of management	Over borrowing	Poor location
Absence of performance monitoring	Insufficient capital	Failure to innovate
Inexperienced management	Inadequate use of funds	Untrained employees

Table (1)
The reasons listed under each independent variable

The total number of business reporting that the managerial inadequacy was the main reason for their failure is nine out of the fifteen businesses interviewed. Four out of the seventy five businesses interviewed mentioned that financial inadequacy was the main reason beyond failure, while two out of the fifteen interviewed businesses that other factors were the main reason for their obstruction. Tables (2), (3) and (4) are breaking down the information collected from the conducted interviews listing the reasons under each variable and the number of small businesses that were affected. The last column in each table is showing the average number of months for each business to cease operations.

Managerial Inadequacy	Number of small businesses affected (total:45)	Average survival period
Lack of Planning	15	20
Absence of performance monitoring	10	18
Lack of experience	5	15
Poor cash flow management	15	22

Table (2)
Managerial inadequacy reasons, number of businesses affected and the survival period

Financial Inadequacy	Number of small businesses affected (total:20)	Average survival period
Insufficient capital	5	13
Over borrowing	10	24
Personal use of business funds	5	21

Table (3)
Financial inadequacy reasons, number of businesses affected and the survival period

Other/external factors	Number of small businesses affected (total: 10)	Average survival period
Poor location	5	38
Failure to innovate	5	46

Table (4)
Other factors reasons, number of businesses affected and the survival period

After the Pearson Correlation Coefficient test was conducted, the researchers were able to observe the following:

Pearson Correlation Formula:

$$r = \frac{\sum XY - \frac{(\sum X)(\sum Y)}{n}}{\sqrt{\left(\sum X^2 - \frac{(\sum X)^2}{n}\right)\left(\sum Y^2 - \frac{(\sum Y)^2}{n}\right)}}$$

The following are the results obtained after conducting the Pearson Correlation Coefficient test on the sample

Linear Regression

y= ax+b

a= 3

b= 12

r^2= 0.9252336449

r= 0.9618906616

The results above indicates a very strong correlation/ association between the two variables. In other words, there is a very strong relationship between managerial inadequacy and the average number of months it takes for a firm to cease operations.

In order to support the research's hypothesis, the coefficient of determination $\mathbf{r^2}$ was also calculated.

Coefficient of Determination value interpretation ($\mathbf{r^2}$):

Value	**Strength of association**
$r^2 = 0$	No correlation
$0 < r^2 < 0.25$	Very weak correlation
$0.25 \le r^2 < 0.50$	Weak correlation
$0.50 \le r^2 < 0.75$	Moderate correlation

$0.75 \leq r^2 < 0.90$	Strong correlation
$0.90 \leq r^2 < 1$	Very strong correlation
$r^2 = 1$	Perfect correlation

According to the previous table, the coefficient of determination indicates a very strong correlation between managerial inadequacy and the time it takes for a small business to fail. The results also indicate that managerial inadequacy affects the businesses significantly and causes it to fail quicker than the two other variables; financial inadequacy and other external factors. Therefore, business owners and shareholders must take into consideration the fact that managerial inadequacy must be avoided in order for the business to succeed and survive longer. In addition, they must ensure that they invest a decent amount of the company's capital in developing and sufficiently training the human resources as it is the most vital aspect for business success.

7. Conclusion:

According to the data analysis, the research's hypothesis has been affirmed that managerial inadequacy is the most common cause of small business failure in the Egyptian market. Moreover, businesses failure is the result of mediocre management skills, decisions, and lack of expertise and proper capitalization. Many of the small businesses owners encounter their financial problems with the management inadequacy.

Another crucial aspect that needs to be taken into consideration is that; in developing countries (including Egypt), external causes of failure involve a lack of vigilance by the owner-manager over the external environmental factors or changes (Mambula, 2002, Kiggundu, 2002, Van Eeden et al. 2003, Maas and Herrington, 2006, Okpara and Wynn 2007 and Van Scheers and Radipere, 2007).

The external causes of failure elements are discussed under infrastructure issues, economic issues, corruption, disasters, new technology, and low demand or sales. In this model, small business failure stems from the entrepreneur's inability to overcome internal weaknesses when faced with rapid environmental changes or turbulences that cause uncertainties.

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