INTERNATIONAL JOURNAL OF
INNOVATIVE RESEARCH AND KNOWLEDGE
ISSN-2213-1356 www.ijirk.com

# A Review of Literature of Venture Growth and Decline: Explanations of Factors Relating to Small and Medium Scale Industry

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***Abstract***

*This review examines the literature in relation to the research topic; a review of literature of venture growth and decline: explanations of factors relating to small and medium scale industry. The structure of the review is as follows. First, the concept of venture growth and organizational life will be examined briefly. Secondly, problems faced by small businesses and thirdly small business success and failure will be reviewed. Finally, the causes of small business success and failure will be examined. The literature review will be connected to the research issue at the end of this paper. The following general conclusions emerged from the literature on business failure. Growth of an organization does not occur at ones; it grows after passing through series of stages in its life cycle. It can be identified that there are internal and external problems in small businesses and if necessary, steps have not been taken to overcome them by the business, those problems may ultimately end up with a failure of a business. There is no uniform definition for the success or failure of a small business and the failure rate of a certain industry depends upon the definition used to define failure. Small business Success and failure are two sides in the same coin. There is a similarity between causes of failure and causes of success. Factors, which affect the failure of business, affect the business adversely to the business where as factors which affect to the success of a business affect the business favorably to the organization. Most important factors, which affect the business failure or success, are micro level factors. Basically, personal characteristics of the owner and managerial deficiencies are critical.*

***Keywords:*** *Success, Failure, Small business, Life cycle*

## 1. Introduction

This review examines the literature in relation to the research topic; explore factors affecting the growth and failure of small-scale enterprises. The structure of the review is as follows. First, the concept of venture growth and organizational life will be examined briefly. Secondly, problems faced by small businesses and thirdly small business success and failure will be reviewed. Finally, the causes of small business success and failure will be examined. The literature review will be connected to the research issue at the end.

## 2. Venture Growth and Organizational Lifecycle

Merz, Weber and Laetz (1994) states that small firm growth is often of two main types. The most common type concerns cross sectional studies examining the relationship between certain firm characteristics and firm growth as a performance measure, and the organizational life cycle hypothesis and is usually concerned with advancing a new model or examining the characteristics of firms in various predetermined stages of growth. Hoy, McDougall, and Dsouza (1992) report that a variety of growth measures have been used ranging from increases in venture capital market share, to growth revenues, return on investment, or number of customers. Dewhurst and Burns (1993) point out many theories have proposed that the growth of the firm can be classified into various stages when predictably similar problems will encountered. The firm has to deal with these problems in order to pass to the next stage of growth. Steinmetz (1969) argues that these phases are critical, because failure to live through them will result in the death of the business, either because the business must be liquated or sold to another company because continued operations would be unprofitable. Greiner (1998) further argues that it can be identified a series of developmental phase through which companies tend to pass as they grow. Each phase begins with a period of evolution, with steady growth and stability, and ends with a revolutionary period of substantial organizational turmoil and change. Dewhurst and Burns (1993) argue that the models depict the firm as a behavioral entity whose focus of activity changes in systematic and predictable ways. However, it is clear that all the models are too simplistic and firms do not progress through the stages in a linear manner.

According to Hicks and Gullett (1984) an organization grows similar to a human being and it has four-stage life cycle. The four stages are introductory phase, growth phase, maturity phase and decline phase. All four phases shows how an organization grows by means of time.

Steinmetz (1969) introduces a small business growth curve, which shows three stages of a firm’s growth and their critical phases. Three critical areas are Stage 1, which occurs in the direct supervision stage of growth; Stage 2, which occurs in the supervised supervision stage; and Stage 3, which occurs in the indirect control stage.

Greiner (1998) introduces a five-stage life cycle for an organization, which consist of five growth stages along with five crisis stages. This characterizes the firm as growing though a series of evolutions and revolutions precipitated by various crises. Each evolutionary phase is dominated by a particular management style used to achieve growth, and during each revolutionary period a dominant managerial problem has to be overcome.

Churchill and Lewis (1983) argue that there are five stages in small business growth. They are existence, survival, success, take off and resource maturity. This framework has developed based on the some assumptions. They are, a company must grow and pass through all stages of development or die in the attempt, models fail to capture the important early stages in a company’s origin and growth, and framework characterizes company size largely in terms of annual sales.

## 3. Problems Faced by Small Businesses

Wijewardena et al. (2000) point out that the success of manufacturing enterprises in Sri Lanka is constrained by various obstacles. Bandaranayke and Fernando (1989) states that small and medium scale industry (SMI) sector is a subject of industry and business in general and many factors, which obstruct the growth and successful performance of the SMI sector, are common to industry and business in general. Small and Medium Enterprise Sector Development Programme (2002) suggests that several surveys have been undertaken to investigate the problems facing small and medium scale enterprises (SMEs).

Central Bank of Sri Lanka (1998:152) states that inadequate capital, inadequate institutional credit facilities, usage of outdated technology, improper accounting techniques, inadequate sales promotion competencies and inattentiveness of the small businesses are the main problems faced by small and cottage industries in Sri Lanka. Bandaranayke and Fernando (1989) point out that societal attitudes, inadequate management education, low level of technology, uncoordinated policy, shortcomings in project formulation skills on the part of SMI investors, inadequate development of entrepreneurs, shortcomings in marketing skills on the part of small industrialists, shortcomings in the World Bank funded SMI loan scheme operation. Anyway these problems may ultimately hinder the growth of a small business.

Small and Medium Enterprise Sector Development Programme (2002) suggests policy inertia, high interest rates and the emphasis on collaterals, low level of technology and absence of technical and managerial skills, lack of market information and marketing skills, lack of adequate infrastructure, current labor legislation, competition from low prices sub-standard goods, regulatory role of the government are the problems faced by the small business sector. Wijewardena et al. (2000) also discuss 13 constraints, which block the success of manufacturing firms in Sri Lanka. Further, the tax burden, high interest rates of loans; lack of bank loans and other facilities are perceived to be more severe obstacles for SMEs than large firms. Gamage (2003) states that the shortage of capital, management skills, obsolete or inappropriate technology, lack of SME policies and institutional support to protect are the major problems in the Sri Lankan SME sector. Karunanayake (1999) suggests that the biggest problem faced by small-scale industrialists is the high cost of finance.

## 4. Small Business Success and Failure

Watson and Everett (1996) suggest that much have been written about the small businesses and in particular about small business failure rates. Lussier (1996) sates that there are many studies to better understand success versus failure.

According to Johnson (1976) success in business requires many things, but above all a burning commitment to succeed. To make it, a manager has to get the best he can out of his people, for employees are the staff of which success is made. Ibrahim and Goodwin (1986) point out that the success in business is defined in terms of rate of return on sales and age longevity of the firm. In other words, successful firms have an above average rate of return and have been in business for five or more years. Steiner and Solem (1988) argue that the successful businesses must seek a balance between the ends to which the organization aspires and the ways and means available to achieve them. Luk (1996) believes that the owner's satisfaction with the performance of the given small business should be one of the most important indicators of success. They define the success of small business as a level of performance equal to or exceeding the expectations of the firm's owner.

Bruno and Leidecker (1988) state that no two experts agree on a definition of business failure. Some conclude that failure only occurs when a firm files for some from of bankruptcy. Others contend that there are numerous forms of organizational death, including bankruptcy, merger, or acquisition. Still others argue that failure occurs if the

firm fails to meet its responsibilities to the stakeholders of the organization, including employees, suppliers, the community as a whole, and customers, as well as the owners. Lussier (1996) states that, there are many questions still to be resolved and justify with additional explanation. Previous studies do not provide a comprehensive or unified explanation for small firm failure.

Fredland and Morris (1976) state that failure occurs when firm's earning return on investment (ROI) less than opportunity cost of capital. Ulmer and Nielsen (1947) point out that failure is termination to avoid losses. Dun and Bradsheet (1967,1981) argue that the failure is termination with losses to creditors and shareholders and termination due to bankruptcy. Watson and Everett (1996) group the studies carried out in small business failure according to the four definitions of failure such as discontinuance of a business for any reason, bankruptcy/loss of creditors, disposed of to prevent further losses and failing to "make a go of it". Bruno and Leidecker (1988) point out that the problem from a research investigation point of view is that the definition of failure used can significantly affect the compositions of databases. Watson and Everett (1996) state that clearly reported failure rates are influenced by the definition of failure used. Broad definitions of failure lead to higher failure rates than would be reported using a narrow definition of failure.

## 5. Causes of Small Business Success and Failure

Bruno and Leidecker (1988) point out managers should aware of factors that can make their firms successful, it might be more useful to know the factors that can lead to firms' failure. Lussier (1996) argues that it appears critical for researchers and business owners and managers to better understand the factors contributing to the failure of small business. Success versus failure research benefits entrepreneurs, those who assist, train and advise them, those who provide capital for their ventures, suppliers, and public policy makers. Wijewardena and Tibbits (1999) also state that it is important to identify the causes of failures and discontinuances as well as the factors contributing to the success or growth of small enterprises.

Wijewardena and Tibbits (1999) argue that the causes of failure and factors of success may vary from county to country, depending on the economic, geographical, and cultural differences. Huck and McEwen (1991) noted that success or failure factors in one country might not work in another because cultural and governmental differences may require a different approach.

Peterson, Kozmetsky and Ridgway (1988) point out even though the number of failure among small businesses is increasing; relatively little empirical research has addressed the general causes of small business failure. Yusuf (1995) states that there are also virtually no empirical data identifying critical success factors for small business success. Luk (1996) points out that business success is the result of a web of factors. Lussier (1996) points out that there is no generally accepted list of variables distinguishing business success from failure. Prior researchers have created disagreement within the literature by reporting different variables as contributing factors to success or failure. Baum, Locke and Smith (2001) suggest that entrepreneurs should recognize that multiple personal dimensions affect venture success. Explaining venture success is a complex process, influenced by a variety of interrelated micro and macro domains.

According to Steiner and Solem (1988) successful small manufacturing business is likely to have following characteristics.

- An owner/manager with experience in the business
- Specialized knowledge of manufacturing processes or product knowledge
- Previous supervisory or management experience
- Access to adequate financial resources

- Competitive advantage based on costs, product specialization, customer specialization, or various forms of price/quality specialization
- A well-developed strategy development through a formal or informal process

Wijewardena and Tibbits (1999) point out that the previous research on factors contributing to the success or growth of small firms has focused primarily on the entrepreneurial, managerial, or other personality attributes of owner-manager. An International note (1995) states that the four most critical success factors were perceived to be good management, access to financing, personal qualities, and satisfactory government support.

Huck and McEwen (1991) argue that more specifically, the researchers identified entrepreneurs' competencies in management, planning and budgeting, and marketing as most crucial for the successful operation of a small business. Wijewardena and Cooray (1995) point out that good customer relations, high quality of products, efficiency of management, and the owner's knowledge and experience were perceived to be highly correlated with small firm success. Huck and McEwen (1991) argue that 12 competency areas such as starting a business, planning and budgeting, management, marketing/selling, advertising and sales promotion, merchandising, finance and accounting, personnel relations, purchasing, production, facilities and equipments, and controlling risks are needed for small business success. Ibrahim and Goodwin (1986) identify a set of variables associated with successful small businesses. They further state that entrepreneurial behavior and material skills were identified as key success factors in small business. Duchesneau and Gartner (1990) identified three categories of factors that are thought to influence the likelihood of small business success: entrepreneurial characteristics, start up behavior, and the firm's strategy. Zimmerer and Scarborough, 1996:6) states that twelve characteristics which are shared varying degrees by successful entrepreneurs. They are commitment and determination, desire for responsibility, opportunity obsession, tolerance for risk, ambiguity, and uncertainty, self confidence, creativity and flexibility, desire for immediate feedback, high level of energy, motivation to excel, orientation for future, willingness to learn from failure, leadership ability. Bolton and Thomson (2000:16) suggest, "Successful entrepreneurs are often acknowledged that circumstances did combine to give them a great opportunity and they were the ones who seized that opportunity and made it happen". Luk (1996) identifies four categories, which affect the success of a firm. They are personal factors, management factors, company factors, and product and market factors. Following were the most significant success factors under each category.

- Personal Factors: Good decision making skills, sufficient relevant work experience prior to starting own business, interpersonal skills.
- Management Factors: Good marketing techniques, good personal selling techniques, good production management skills, ability to take advantage of the china factors, and ability to motivate employees and enjoy low turnover rate.
- Product market and company factors: Company image, a close company customer relationship.

Steiner and Solem (1988) point out that the management characteristics; operating characteristics and competitive strategy are very important factors for the success of a firm. Theng and Boon (1996) suggest that endogenous and exogenous factors are the factors, which influence the failure of SMEs. The following is a description of those factors.

i. **Exogenous Factors:** Economy in recession, high inflation, high labor cost, tight labor market, high interest rate, strict government regulations, high taxes, competition from public sector, competition from foreign MNCs

**ii. Endogenous Factors**

- **Personal shortcomings of the owner(s):** Lack of entrepreneurial judgment, lack of self-confidence, lack of managerial experience and skill, lack of knowledge of the company's product(s), resistance to stress and pressure, lack of vitality and enthusiasm, short sighted view of future, lack of planning, lack of initiative, lack of formal education
- **Financial and operation shortcomings:** Lack of inventory control, lack of accounting records, lack of cash flow analysis, lack of trained accountant, lack of control over cash, lack of working capital analysis, lack of budgets or forecasts, lack of capital, inefficient management of receivables, excessive fixed assets, high operating expenses, low labor productivity, lack of automation/computerization in operation, inappropriate marketing strategy.

Larson and Clute (1979) suggest that the small businesses may fail due to the managerial deficiencies, financial shortcomings and the personal characteristics. They further define what are the managerial deficiencies and the personal characteristics in their research, and those are started below.

- **Personal Characteristics:** Exaggerated opinion of business competency based upon knowledge of some skill, limited formal education, inflexible to change and not innovative, uses own personal taste and opinion as the standard to follow, decisions based on intuition, emotion and non-objective factors, past not future orientation, little reading in literature associated with business, resistant to advice from qualified sources but, paradoxically, accept it from the least qualified.
- **Managerial Deficiencies:** Cannot target market or customers, connote delineate trading area, cannot delegate, believes advertising is an expense not an investment, immature understanding of distribution channels, no planning, cannot motivate, believes the problems is somebody else's fault and loan would solve everything.
- **Financial Shortcomings:** Has little or no control over inventory, accounting records are either incomplete or nonexistent, poor understanding of the significance of cash flow and working capital analysis, does not know how to assess the ability of those who keep his accounting records, does not use accounting statements to plan for the future, does not have adequate control over cash receipts and cash disbursements, and does not understand accounting language.

Peterson, Kozmetsky and Ridgway (1983) identified lack of management expertise, high interest rates, and recession economy/inflation/ unemployment, under capitalization/overcapitalization, taxes, competition, cash flow, federal regulations, high overheads and others as the primary causes of small business failure. Lussier (1996) identifies 10 factors that affect small business failure. Those factors are, under capitalization and high fixed costs, slow economic activity/recession, creditor problem, slow accounts receivable, tax problems, loss of a major customer, poor management, partners, over expansion, theft. Long (1983) sates that some important personality traits which affect the success or failure of small businesses are intuition, extroversion, risk taking, creativity, flexibility to change, sense of independence, effective time management, self confidence, good health, and emotional stability.

According to Athwela Business Magazine (1999) causes of small business failure are conflicts among partners, very high greediness and no control over the business activities. Karunanayake (1999) points out that in a gloomy business environment where even the biggest business houses in the country are finding it difficult to maintain the momentum of growth, the collapse of smaller business is not surprising and the biggest problem faced by the small-scale industrialists for the growth of their business is the highest cost of finance. Premarathne (2002) argues that entrepreneur or manager use different methods to from their personal networks. There are few empirical

studies available on the impact of network formation on the growth. However, he further suggests that entrepreneurial networks are always regarded as advantageous for small business success. Dun and Bradsheet (1981) point out that 92% of the business failures are due to bad management. That 92% includes incompetence, lack of managerial experience, unbalance experience, inexperience in line. Other that them neglect, fraud and disaster and unknown factors also have an influence on the success. Main management related factors which affect success and failure are, according to Lussier (1996) the two most commonly stated causes of failure are capital and management experience. According to Peterson, Kozmetsky and Ridgway (1983) the major cause of small business failure is lack of management expertise.

Fredland and Morris (1976) argue that pinpointing the causes of a failure is largely a matter of definition. There are two extremes in the definitions. They are the causes of failure may always be said to be a lack of funds and at the other extreme, the cause of failure may always be said to be poor management. Sandberg (1986) argues that the entrepreneur experience and the entrepreneur psychology are the most important factors for the success of a small business. Theng and Boon (1996) clearly state that the endogenous factors as significantly important than exogenous factors in influencing SME failure. Peterson, Kozmetsky and Ridgway (1983) suggest that the primary causes of business failure are internal problems within the firm. Sexton and Bowman (1983) provided empirical evidence that certain personality traits of small business owner or manager tend to affect the success or failure of such businesses. Steiner and Solem (1988) suggested that small manufacturing firms tend to more successful when they are well managed in the areas of personnel supervision, manufacturing processes, and marketing and product knowledge. Larson and Clute (1979) stated that most businessmen who have failed or who are likely to fail have certain personnel characteristics they share in common. Peterson, Kozmetsky and Ridgway (1983) stated that the reasons cited by survey participants for small business failure can be categorized into internal or managerially controllable causes and external or non-controllable causes. Five out of 10 individuals interviewed cited internal problems as the primary cause of small business failure, with the most frequently cited cause being a lack of management experience. Wijewardena and Tibbs (1999) suggested that entrepreneurial behavior and managerial skills of owner-manager are key success factors in small business. Dewhurst and Burns (1993) state that it is easy to see from the stage theories of growth how firms fail because of the interaction of the personal characteristics of the owner/manager with the managerial problems they face in their business. Baum, Locke and Smith (2001) point out that "there is a relatively low impact of the environmental domain on venture growth, with the other, more macro dimensions, is surprising; at least in our study, this finding suggests that CEOs of small firms may have more control of their venture's growth than some macro theories suggest".

## 6. Conclusion

The following general conclusions emerged from the literature on business failure. Growth of an organization does not occur at ones; it grows after passing through series of stages in its life cycle. It can be identified that there are internal and external problems in small businesses and if necessary, steps have not been taken to overcome them by the business, those problems may ultimately end up with a failure of a business. There is no uniform definition for the success of the failure of a small business and the failure rate of a certain industry depends upon the failure definition used. Small business Success and failure are two sides in the same coin. There is a similarity between causes of failure and causes of success. Factors, which affect the failure of business, affect the business adversely to the business where as factors which affect to the success of a business affect the business favorably to the organization. Most important factors, which affect the business failure or success, are micro level factors. Basically, personal characteristics of the owner and managerial deficiencies are critical.

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