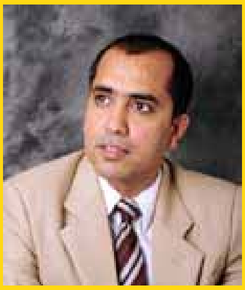

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What matters for business success or failure?

Abstract

This article examines, based on literature review, the specific reasons which cause business failure among the SMEs. It explores the fundamental question on why some businesses succeed while others fail in a similar economic condition. First, the article discusses the role of SMEs in Sri Lanka and then it moves on to discuss the reasons why entrepreneurs start businesses. It recognises that the need for achievement and social intimacy as the prime motives to start a business. Finally, the results show that businesses fail due to many reasons. Some reasons are fundamental; some are unique to the business. This article, hence recognize integrity, and business policies (policies as disciplines) as the fundamental causes of business failure.

Introduction

Business crisis is a painful circumstance that affects everyone, directly or indirectly. Many SMEs fail in early stage of their life cycle. In Australia, 7.5% of businesses in SME sector fail (Bickerdyke, I., Lattomore, R., & Madge, A. 2000). Similarly, in the UK, between 350,000 and 400,000 closures are recorded annually representing 10% of their business operations (Pratten, 2004). In Canada, almost half of the firms become bankrupt not because of exogenous factors, but due to internal deficiencies (Baldwin, J., Gray, T.,Johnson, J., Proctor,J., Rafiquzzaman,M.,& Sabourin, D. 1997). However, we do not have accurate information to measure the rate of business failure in Sri Lanka; it could be a significant percentage. In Sri Lanka, during January to August 2012, 4846 new firms have been registered as limited liability companies (Sunday Times, 2012). This number is in addition to sole proprietors and partnerships. However, Sri Lanka has not felt the crisis of business failure due to the lack of direct knowledge on failed companies. Nevertheless, the recent Golden Key company crash has urged Sri Lankans, to consider the seriousness of business failure. Although the exact quantum is unknown, business crashes among SMEs in Sri Lanka is plenty and it has affected stakeholders as well as the entire economy.

It would be a wow factor, if all businesses initiated in Sri Lanka prosper. If so, Sri Lanka could have been in a better position in its development process. Why does, all these businesses not succeed? Why do we still have a very handful of listed companies? Policy makers should address this macroeconomic matter.

The important role that SME sector businesses play in the Sri Lankan economy suggests that an understanding of why firms fail is crucial to the stability and health of our economy. It is important to know why many SME sector companies exit. The contribution to the GDP and to the government revenue (in the form of taxes), and employment generation to the citizens are the key direct benefits of SMEs. Many factors such as business inexperience, lack of managerial skills, lack of accounting and improper internal control systems, poor financial management, corruption, inadequate capital, lack of education, gender discrimination, lack of business planning, lack of marketing skills, incorrect financial structure, lack of integrity, and business disciplines (policies), and exogenous factors like economic recessions and poor infrastructure, affect business success. Business failure is not an overnight incident. It is a long process of declining business which creates grave impact for many people (stakeholders).

Various scholars have defined business failure in various ways for the purpose of their analysis. Therefore, reasons for business failure may vary from one definition to another. Nevertheless, this article defines business failure under three categories such as (1) the exit of existing business due to cash flow problems and continuous losses (2) continuing business which faces severe financial problems and seems unable to continue its operations, and (3) business with continuous losses for more than three years and whose performance is far below the industry norms.

Causes of Business Success or Failure

The focal point in this article is to discuss about two main causes of business failure which are the lack of integrity and business policies. However, these causes are not much easily identifiable and quantifiable. Researchers have paid less attention to these two causes, but this article contends that these two causes contribute significantly to business failure.

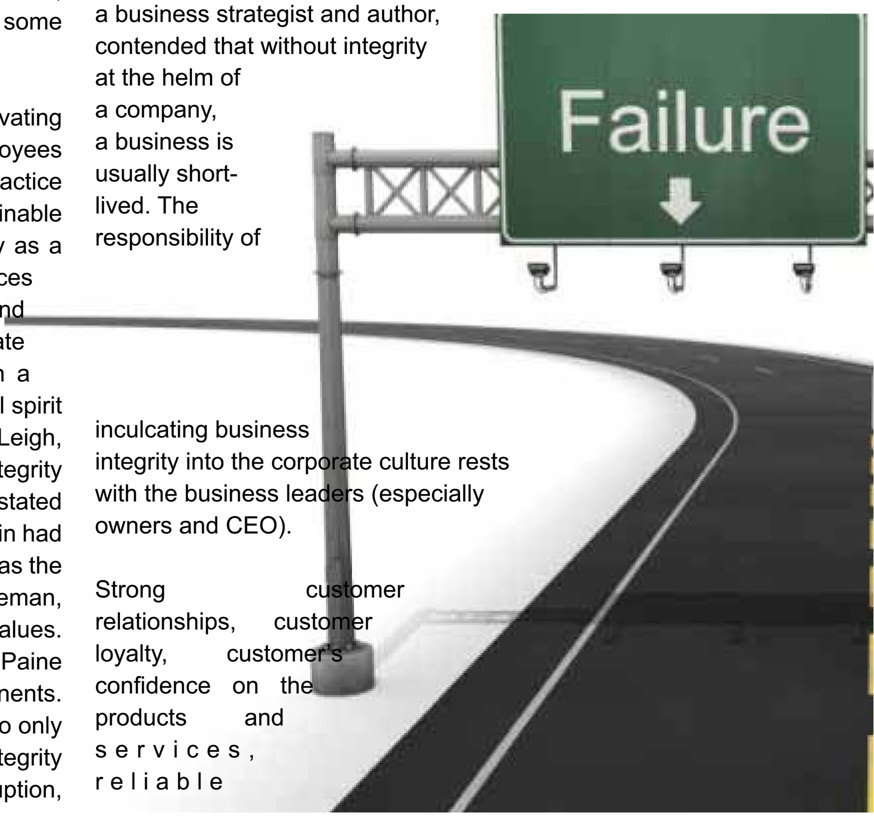
It is no doubt; anyone can start a new business. An entrepreneur may start a business due to a unique reason or due to common reasons explored by scholars. However, this article categorizes all these motives into one phenomenon. That is the "Need for Achievement". (Gamage, H.R., Cameron, D., & Woods, E. 2003). The motivational factor of an entrepreneur is a social psychological drive among the people that leads to economic development. In the need for achievement, we can see why someone wants to starts a business. It may be due to unemployment, the need for power and affiliation, prestige, security, financial self-sufficiency, self-confidence and self-actualization. Social intimacy also plays a major role in business start up. The need for social power, social relations and collectivism are elements of social intimacy. Someone can think that success of a business is purely a matter of capital investment and availability of a market. However, the world has witnessed that even with those basic ingredients, businesses still fail. Why? It indicates to us that there are some other reasons that result in business success or failure.

Integrity is a basic element of business success. Cultivating business integrity among the business leaders and employees builds a trust-based culture. Therefore, businesses should practice integrity as a business strategy in order to achieve sustainable business development. If business leaders apply integrity as a strategy in the business place that will restrain illegal practices and unethical conducts, and will create a better human bond between people and company which finally builds corporate reputation. What is integrity? It cannot be explained in a word. No doubt, it is beyond honesty. Integrity is the moral spirit of human being to practice disciplines in society. Andrew Leigh, stated in one of his articles "apart from staying honest, integrity is clearly about morality". Small and Dickie (1999) have stated as stated by Paine (1996) that Cicero and Benjamin Franklin had written about integrity, both of them arguing that integrity was the cornerstone of worldly success (cited in Werhane and Freeman, 1997, pp. 335-36). Integrity is a matter of an individual's values. Small and Dickie (1999) has suggested as stated by Paine (1996), that integrity could be broken into several components. First is moral conscientiousness. It means, you desire to do only what is right. Therefore, you can measure someone's integrity based on his or her trustworthiness, resistance to corruption, fairness in his or her dealings and obedience to rules. The moral accountability is the second category of integrity. It deals with high degree of self-control and self-awareness. In other words, it is a higher degree of personal accountability. Third category of integrity is commitments of individual for their respective causes. Fourth category that Paine stated was consistency. It is a best practice for an individual to be consistent in words and deeds, and commitments and moral judgments.

Integrity is a fundamental principle of business ethics and it begins with Board of Directors, CEO/ Managing Director, and goes down to all other employees. If you build integrity in the corporate culture, beginning from business leaders, it will then flow to your customers automatically through products and services. Business leaders should practice integrity at two levels. First is the application of integrity internally (systems and procedures, employees). Second is the application of integrity externally (in dealing with stakeholders, especially customers and suppliers). Applying integrity internally creates a corporate culture that enables employees to maintain integrity resulting in satisfied customers. Satisfaction of customers builds strong corporate relationships. Such strong reliable relationships would generate customer loyalty. That customer loyalty will pass on from one generation to another assuring the sustainability of the business.

It is important to ensure whether integrity is built in a company's vision, mission and its values, whether high ethical standards are built into processes and systems of controls etc., as they are important to build integrity in corporate culture.

Business integrity is a key element of business success. If business leaders do not possess and practice the business integrity, there will be a greater chance of leading the business towards failure. Moment (2004), a business strategist and author, contended that without integrity at the helm of a company, a business is usually short-lived. The responsibility of inculcating business integrity into the corporate culture rests with the business leaders (especially owners and CEO).



Strong customer relationships, customer loyalty, customer's confidence on the products and services, reliable business information (accurate financial information) are the true sense of business integrity. Insider trading/dealings, firms's overbilling clients, non-disclosure of required information, transactions not occurring at arm's length basis, false advertisements, and bid rigging are few examples for integrity not being practiced.

Similarly, business disciplines are equally as important as integrity. The introduction and implementation of business policies does discipline the business operation. Thus, this article categorizes disciplines into three main areas for better understanding. They are, operational (non-financial), financial and behavioral disciplines. In order to maintain the proper disciplinary environment, we must introduce and practice appropriate business policies. Policies bring fairness, order and results. Hence, it is worth noting that the policies of a company are part of company discipline.

Business policies could be narrow as well as broad. Firms/ businesses do have policies as a whole, under each business unit, department, and even under a a transaction. A business policy is simply what is or not done. Not having steady business policies and non-consistent application can harm sustainability. Business policy could be a leading principle to develop procedures, system and controls. It describes what to do and what not to do. It gives guidelines for decision making process enabling subordinates to take decisions without depending on top management. And also top management can take fearless decisions. Policies can be introduced to the overall company or under different areas such as sales and marketing, accounting and finance, human resources etc. Therefore, policies do discipline business operations and provide a self-driven facility to run the organization independently. Business policies are blue prints of an organization. It increases the efficiency and effectiveness of routine activities.

Detail analysis in business disciplines shows many SME sector business leaders do not understand the importance of business disciplines. Not every failed business has recognized the importance of having proper accounting records for business development. Recording financial transactions in an accepted manner is a primary business need. It should be a company policy to record every transaction in a proper manner; otherwise, business will have to face serious consequences. In an indiscipline business environment, researchers found that not keeping proper books of accounts, not reviewing financial information on regular basis, lapses in accounting and financial controls and acts of management violating internal controls systems, rules and regulations are causes of business failure. An author, Pratten (2004) has once cited a good example on examining the possible causes of business failure in British public houses. It has proven the importance of having proper controls and financial information. A business has been running in the license trade industry in the UK. It said that the particular licensee, a business owner, has started his business with business experience and financial skills. The business start up was took place with bank borrowing and additional capital for improvement of the business. Eventually the business was declining due to down turn of local and national sales and affected the cash flow. As a result, repayment of bank loans and payments to suppliers were hit badly. The business owner had understood that the bank support for him to recover the business is not potential and he managed to repay the loan and negotiated with creditors for their payments. This was possible because the company was well disciplined in all aspects. The company had proper financial controls and books of accounts and accurate financial information. Finally, the business recovered even though the exogenous factors affected the business. This restructuring would not have been possible in case if the business owner did not know about the true state of affairs of the company. As he knew very well about company's financial position, he was able to implement strategies and take right decisions at the right time. This real life experience proves that business disciplines can even support to face exogenous factors that would affect businesses one day.

Thus, it is understood that accounting and financial indiscipline is a root cause of financial problems of a business. If business leaders do not carry on their businesses within the financial disciplines, there will be a greater chance of business failure even under a very short run. Inculcating accounting and financial disciplines is must. Not recording business transactions in the books of accounts to avoid taxes or any other payment, habit of using the business cash by business owners for private purpose, spending the cash collection from customers without depositing in the bank, over spending than the budgets, issuing postdated cheques to suppliers are bad business practices of SMEs.

Proper structuring of the business organization, adherence to systems and controls, abiding to internal and external rules and regulations are a must in business management. Non-recognition of the importance of control environment by business leaders is a major threat to business success. There are business organizations which do not recognize the importance of the control environment. Not having proper internal controls, not adhering to the internal and external controls, policies, rules and regulations, informal business communications etc. are some examples of such.

Among others, the business Leaders drive to success, should alweys be focused upon. Steady business focus is a behavioral discipline of business leaders. Once the business is started, business leaders should not lose their business focus at any cost. Losing business focus has negative consequences. Scholars state that losing business focus at early stage of business has more tendency of business failure earlier than that of matured businesses. Thus, business leaders should have a steady focus rather that allowing it to change from time to time.

Ahmad and Seet (2009), in a qualitative research on the behavioral aspects of business leaders identified that wrong behaviors might have a negative impact on business success. Among such behaviors is the failure to formulate strategic plans resulting in the lack of business direction. If business runs without a strategic direction, it will lose the focus and will end up doing various unrelated things. If the focus is lost, it creates disputes among the management, employees and other key stakeholders. Possibility of increasing the actual monetary cost and the opportunity cost is higher.

Conclusion

Business crisis is a tragedy. SMEs are an important sector that supports the economic growth and social development. Thus, failure of SME sector companies is an economic and social cost to the economy. There are various causes found by scholars for business failure. These causes differ from country to country, region to region, and business to business, but there are common factors such as lack of managerial skills, lack of or improper accounting, lack of financial controls, lack of internal controls systems, lack of business experience etc. Apart from these mentioned causes, integrity and business policies as disciplines are critical. The lach of these critical factors can bring misfortune to business.

Therefore, you cannot expect business success without practicing integrity and business disciplines. The article discussed various business disciplines and it has been proved that they have direct impact on business failure. Hence it is concluded that a business cannot survive without bringing in integrity and business disciplines to its corporate culture.

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