Poor Management in Small Firms: Three Typical Failure Patterns

Nathalie CRUTZEN

PhD in Economics and Management
Assistant Professor

Accenture Chair in Sustainable Strategy
HEC-Management School of the University of Liege (Belgium-

Paris, 13 October 2011

INTRODUCTION

- The “poor management” of the (small) firm = the most common failure cause (Argenti, 1976; Wichman, 1983; Thornhill and Amit, 2003, Crutzen, 2009…)
- Nevertheless, “poor management” is a vague concept: Wide array of management competences or problems (Sheldon, 1994)
  - Strategy
  - Marketing
  - Finance
  - Operations
  - Control
  - Etc

INTRODUCTION

- In a business failure prevention,
- It is necessary to clarify which kind of poor management can be at the origins of small business failure and, in particular, to distinguish between the main categories of managerial problems small firms can be faced to
- In order to:
  - Better anticipate their failure
  - Propose adequate remedies to failing or distressed firms
- Indeed, only (anticipative) remedies to the fundamental failure problems could lead to a efficient anticipation or recovery of the firm (Argenti, 1976)

RESEARCH OBJECTIVE

- In this context,
- On the basis of a sample of 91 small Belgian distressed firms which entered a failure process because of a poor management (Crutzen, 2009),
- Via two complementary statistical analyses,

- This study aims at distinguishing between several failure patterns amongst "poorly-managed small firms"

STRUCTURE

I. Clarification of key concepts

II. Methodology

III. Results : Three Typical Failure Patterns for Small Firms

IV. Discussion

Conclusion

STRUCTURE

I. Clarification of key concepts
II. Methodology
III. Results : Three Typical Failure Patterns for Small Firms
IV. Discussion
Conclusion

1. Small firm

- Definition of the European Commission (2003)
  - **<u>Less than 50 workers</u>**
  - Turnover <= 10 million Euros

    OR Balance Sheet <= 10 million Euros
- Specific characteristics (Julien, 2005)
  - Small size : small resource set
  - Preponderant influence of ONE entrepreneur
  - Simpler (less formalized) organization/structure
    - Hierarchy, organization
    - Strategy
    - Information systems
  - Strong dependence towards the external environment

2. Business failure

- No clear and generally-accepted definition in the literature
- Often, narrow financial definition :

“A firm that can not (more) face its financial obligations”

“Solvency and liquidity problems” (// Bankruptcy)

- In a preventive perspective to failure, a broader definition, which includes why (causes) and how (process) firms do fail is necessary → dynamic and fundamental view
- In order to prevent/anticipate problems as early as possible
- In order to recover before the firm's situation would be too much deteriorated

2. Business failure

- *Failure occurs when there is a misalignment of the firm to the environment's realities and when, under these circumstances, the firm can not create or sustain a viable strategic position (Greenhalgh, 1983; Weitzel and Jonsson, 1989)*

- *Once entered in a failure process,if no corrective actions are taken, the failing firm evolves in a downward spiral (Hambrick and D'Aveni, 1988) : its organizational, and later its financial, situation deteriorates more and more*

3. Failure patterns

- <u>Business failure patterns</u>

As the failure process may vary from one firm to another, distinctive failure patterns may be distinguished

"Homogeneous sets of traits, acts, tendencies or characteristics which significantly portray firms along the failure process"

  - Static **versus** dynamic failure patterns
  - Explanatory **versus** subsequent failure patterns

- <u>Explanatory business failure patterns</u>

"Homogeneous sets of characteristics, traits or factors that fundamentally <u>explain</u> the failure of firms"

STRUCTURE

I. Clarification of key concepts

II. Methodology

III. Results : Three Typical Failure Patterns for Small Firms

IV. Discussion

Conclusion

STRUCTURE

I. Clarification of key concepts

II. Methodology

III. Results : Three Typical Failure Patterns for Small Firms

IV. Discussion

Conclusion

Methodology – Inductive reasoning

- Sample
  - 91 small distressed firms investigated by the Court of Commerce of Liège
  - Commercial Inquiry, Legal Reorganization, Bankruptcy
  - Origins of failure : Poor management (Crutzen, 2009)

- Data Collection
  - Firms' characteristics : age, size, industry, etc.
  - Fundamental managerial problems at the origins of their failure, on the basis of a validated conceptual model (Crutzen and Van Caillie, 2009)

Methodology – Inductive reasoning

- Data analysis

  Two complementary statistical analyses (Bouroche and Saporta, 2005) :

1. Cluster analysis of cases (Everitt, 1974) in order to identify homogenous groups of firms according to the managerial problems which explain their failure
2. Correspondence analysis (Benzécri, 1973) in order to explain the various groups/clusters identified in Step 1.

STRUCTURE

I. Clarification of key concepts

II. Methodology

III. Results : Three Typical Failure Patterns for Small Firms

IV. Discussion

Conclusion

STRUCTURE

I. Clarification of key concepts

II. Methodology

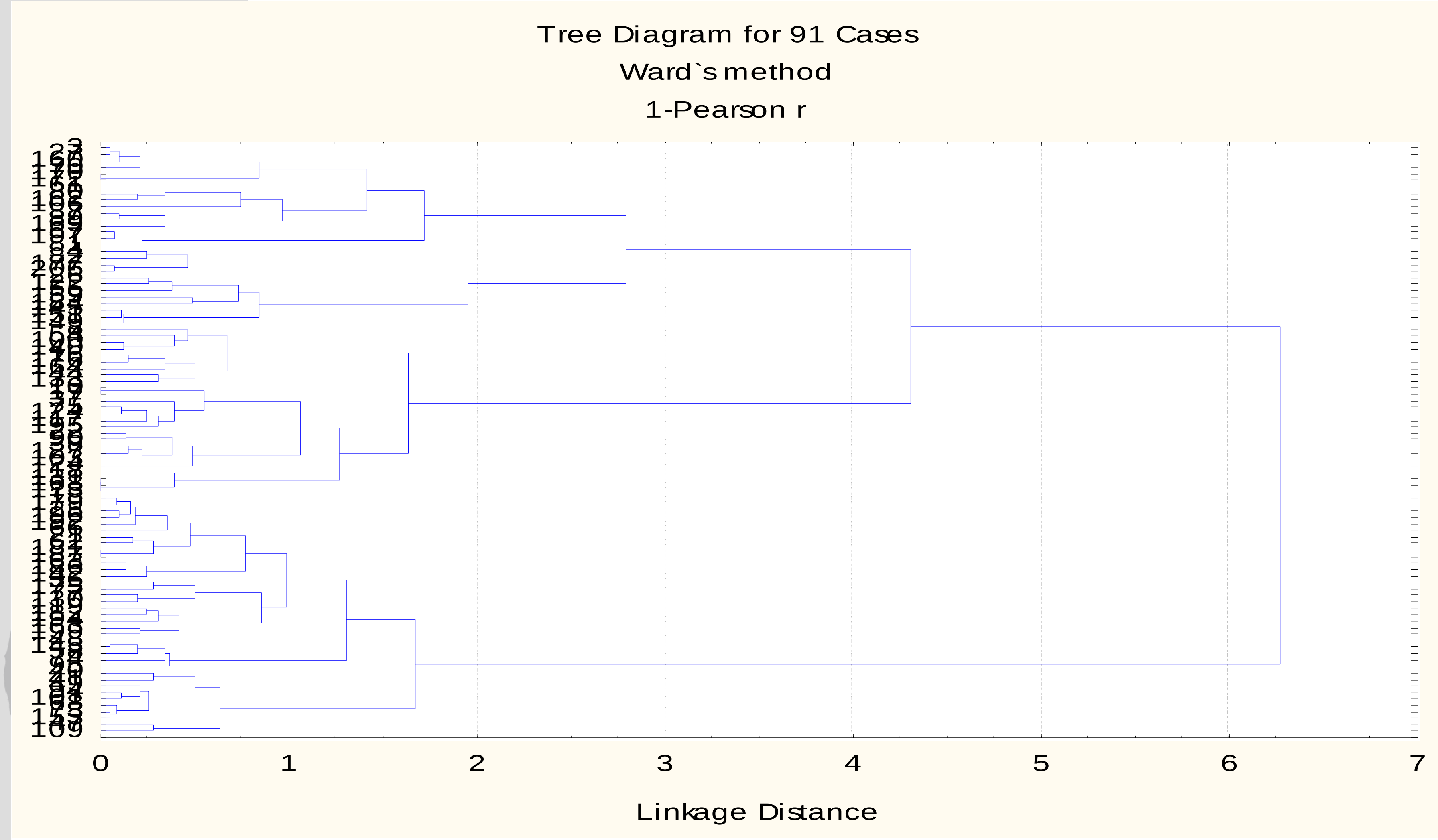
III. Results : Three Typical Failure Patterns for Small Firms

IV. Discussion

Conclusion

Ecole de Gestion de l'Université de Liège

Results



Results

- Three typical failure patterns for badly-managed small firms

1. Firms with deficiencies in strategic management

2. Firms with deficiencies in operational management
(or in business administration)

3. Totally badly-managed firms

1. Firms with deficiencies in strategic management

- Small firms confronted to strategic management problems.
- Failure can be related to deficiencies in the *management of the interrelation between the firm and its environment (external orientation)*
- These deficiencies may include :
  - An inability to analyze the environment of the firm (strategic, technological, competitive awareness/intelligence, etc.)
  - An inability to anticipate the future of the firm and the evolution of its environment.
  - An inability to adapt the firm adequately to predictable or unpredictable changes.
  - More globally, an inability to elaborate a strategy (strategic planning, strategic and operational objectives, etc.)

2. Firms with deficiencies in operational management

- Small firms confronted to operational management problems
- Failure can be related to deficiencies in the *administration of the firm* (how it deploys its strategy) *(internal orientation)*
- Several kinds of problems can be observed in :
  - The financial management of the firm (methods of financing, etc.)
  - The accounting management of the firm (calculation of cost prices, regular accounting monitoring, budgeting, etc.)
  - The administrative management of the firm (follow-up and ordering of administrative documents, payment delays, etc.)
  - The operational and day-to-day management of the firm (organization/planning of work, monitoring, human resource management, etc.)

3. Totally badly-managed firms

- Small firms which <u>cumulate patterns 1 and 2</u>

Deficiencies in strategic management

AND

Deficiencies in operational management

Two categories of managerial deficiencies at the origins of small business failure

		Strategic Management	
		Non problematic	Problematic
Operational Management	Non problematic	X	<u>**EBFP 1**</u> Firms with deficiencies in strategic management
	Problematic	<u>**EBFP 2**</u> Firms with deficiencies in business administration	<u>**EBFP 3**</u> Totally badly-managed firms

STRUCTURE

I. Clarification of key concepts

II. Methodology

III. Results : Three Typical Failure Patterns for Small Firms

IV. Discussion

Conclusion

STRUCTURE

I. Clarification of key concepts

II. Methodology

III. Results : Three Typical Failure Patterns for Small Firms

IV. Discussion

Conclusion

Discussion

- Results consistent with previous literature (Sheldon, 1994)

- Some relationships between the patterns and the intrinsic characteristics of the sampled small firms
  - Industry
  - Exit of the failure process

CONCLUSION

- Thanks to statistical analyses,
- On the basis of a sample of 91 small distressed firms,
- Identification of three typical patterns explaining the failure of small “badly-managed” firms
  - Firms with deficiencies in strategic management
  - Firms with deficiencies in operational management
  - Totally badly-managed firms

- <u>Scientific interest</u>
  - “Original” failure patterns
  - First step towards a clarification of the poor managerial problems at the origins of (small) business failure

CONCLUSION

- Managerial interest

  Better practical prevention of small business failure

  - The identification of the fundamental causes of failure = THE key to the prevention of this phenomenon
  - The identification of these patterns gives the opportunity (to the entrepreneur or to other interested parties) :
    - To anticipate the pitfalls in which the firm could fall

      (ANTICIPATION of Business Failure)
    - If the firm is already engaged in a failure process, to determine, in function of its pattern, if it still has a potential on its market and, if yes, which adequate remedies can be implemented in order to recover

      (RECOVERY)

Ecole de Gestion de l'Université de Liège

Thank you for your attention

References

- ALTMAN, E.I., 1968, “Financial Ratios, Discriminant Analysis and the Prediction of Corporate Bankruptcy”, *Journal of Finance*, 23, 589-609.
- ARGENTI, J. , 1976, “Corporate Collapse : the causes and symptoms”, Holsted Press, McGraw-Hill, London.
- CRUTZEN, N., 2009, Essays on the Prevention of Small Business Failure : Taxonomy and Validation of Five Explanatory Business Failure Patterns, Editions de l'ULg, Liège, Belgique.
- CRUTZEN, N. and VAN CAILLIE, D., 2009, “Vers une taxonomie des profils d'entrée dans un processus de défaillance : un focus sur les micros et petites entreprises en difficulté”, *Revue Internationale PME*, 22 (1).
- SHELDON, D., 1994, “Recognizing Failure Factors Helps Small-Business Turnarounds”, *National Productivity Review*, Autumn, 531-541.
- THORNHILL, S. and AMIT, R., 2003, “Learning about Failure : Bankruptcy, Firm Age and the Resource-Based View”, *Organization Science*, 15, 497-509.