

SUCCESS AND FAILURE STORIES OF SMEs DURING THE ECONOMIC CRISIS: TWO CASE STUDIES AND THEIR IMPLICATIONS

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“An Entrepreneur is the kind of person who will work 16 hours a day just to avoid having to work 8 hours a day for someone else” (Anonymous)

Abstract

Small and Medium-sized Enterprises (SMEs) have been recognised as catalysts to spur the economic prosperity of a nation. In many parts of the world, special focus has been given to the well-being of these SMEs in recognition of the important role they play in the development of the country. Everyone seems to believe that growth in small business enterprises will be the solution for saving the welfare society. Several studies show that the small business sector has a great importance for the national economy, the employment and the innovative climate of a country (for example Storey 1994).

Despite the encouragement and support given to the SMEs, success stories are seldom heard, compared with stories of failure. It appears that companies and entrepreneurs in this category managed to sail through, even in times of economic recession and crisis, but were not able to excel during times of economic growth and prosperity.

The study will adopt the case study approach (Yin, 1994) and a pair of successful and failed examples of SMEs have been selected to explore the common characteristics of success and failure patterns of SMEs within crisis situations.

SMEs and Entrepreneurship

Small and Medium-sized Enterprises (SMEs) have been recognised as catalysts to spur the economic prosperity of a nation. In many part of the world, special focus has been given to the well-being of these SMEs in recognition of the important role they play in the development of the country (Henkinson et al, 1997). Everyone seems to believe that growth in small business enterprises will be

the solution for saving the welfare society. Several studies show that the small business sector has a great importance for the national economy, the employment and the innovative climate (for example Storey 1994). A body of literature has considered the nature of small business related to entrepreneurial skills and has been directed mainly at manufacturing firms (Glancey et al, 1998).

Despite the encouragement and support given to the SMEs, success stories are seldom heard, compared to failure. It appears that companies and entrepreneurs in this category managed to sail through, even in times of economic recession and crisis, but were not able to excel during times of economic growth and prosperity. The majority of these enterprises were able to sustain productivity and profitability, but not in terms of rate of growth.

Hisrich and Peters's (1995:10) definition of entrepreneurship is as follows: "*Entrepreneurship* is the process of creating something different with value by devoting the necessary time and effort, assuming the accompanying financial, psychic and social risks, and receiving the resulting rewards of monetary and personal satisfaction and independence".

As can be evidenced by many different definitions, the term entrepreneurship means different things to different people and can be viewed from different conceptual perspectives. For example entrepreneurship for economists may be different (Hamilton and Harper, 1994) to entrepreneurship for cultural studies (Morrison, 2000). However, in spite of the differences, there are some common aspects: (1) initiative taking; (2) the organising and reorganising of social and economic mechanisms to turn resources and situations to practical account; and (3) the acceptance of risk or failure. In other words, entrepreneurs are seen as people attaining some characteristic features such as innovation, organisation, creativity, wealth (reward), independence and risk taking.

There are both 'pushing' and 'pulling' influences (Glancey et al, 1998:252) active in the decision to leave a present career: the 'push' of job dissatisfaction or even layoff, and the 'pull' toward entrepreneurship by seeing an unfilled need in the marketplace.

Successful SMEs

Under normal conditions, every business is characterised by controllable variables that determine the relative success of market participants. Key success factors come in a variety of patterns depending

on the industry. In other words, these factors are relationships between a controllable variable (e.g. plant size, advertising expenditure, product packaging) and a critical factor influencing the firm's ability to compete in the market. Many of these sources of competitive advantages are based on cost factors such as manufacturing cost per unit and distribution cost per unit. Some are less tangible and less obvious, but are just as important such as product quality, services offered, store location and customer credit.

The primary factor in the success of any small business is the existence of a real business opportunity. Most successful entrepreneurs possess the following characteristics as indicated by Hodgetts and Kuratko (1995:31): technical competence, mental ability, opportunity orientation, initiative and responsibility, integrity and reliability, tolerance for failure, internal locus of control, human relations skills, high achievement drive, creativity. Miles and Snow (1994) drew their attention to the concept of 'fit' for companies' success or failures. Similarly, Osborne (1995) indicates that the essence of entrepreneurial success lies in the strategies that link the company and its environment.

There have been different key fundamentals according to different authors for establishing a highly effective small business in the literature. Most of the studies tend to give a check list for ensuring the success of SMEs. Normally, a SME can be called 'successful' if it's profit is above the industrial average, above average profitability and/or productivity or if it is increasing it's market share. However, the definition of business success used in this study is *business survival* for the SMEs in the province, following a natural disaster and in a crisis economy.

Business Failures for SMEs

Every year many millions of Euros are spent in starting new enterprises. Many of these newly established businesses vanish within a year or two; only a small percentage are successful. Most studies have found that the factors underlying the failure of new ventures are, in most cases, within the control of the entrepreneur. The major reasons for the failure of new ventures can be extracted from the literature. For example Bruno et al. (1987) examined 250 high-tech firms and found three major categories of causes for failure: (1) product/market problems; (2) financial difficulties; and (3) managerial problems. The failure reasons for the Turkish case were examined by Karakaya and Kobu (1994) and all three categories were found to be influential.

One of the major areas for identifying the failure reasons of the new ventures is *start-up* period (Smallbone, 1990). It seems to be true for most of the SMEs that they tend to choose to fail or to sail through within the first year of their business. A study conducted by Terpstra and Olson (1993) systematically classified the first-year problems of new business ventures: (1) obtaining external financing; (2) internal financial management; (3) sales/marketing; (4) product development; (5) production/operations management; (6) general management; (7) HRM problems; (8) economic environment; (9) regulatory environment. It is important for entrepreneurs to recognise these problem areas at the outset because they remain challenges to the venture as it grows. Another study of 645 entrepreneurs focused on the classification of start up and growth problems that were experienced internally versus externally (Dodge et al, 1994). *Internal problems* included adequate capital, cash flow, inventory control, human resources, leadership and organisation structure. *External problems* included customer contact, market knowledge, marketing planning, location, pricing, competitors and expansion. The researchers found that 'intensity of competition' rather than life-cycle stages was more dominant in changing the relative importance of the problem areas. Thus, entrepreneurs need to recognise not only that start-up problems remain with the venture but also that the increasing competition will adjust the relative importance of the problems.

For the small business failures, Scarborough and Zimmerer (1996:pp.37-40) explored the circumstances for small business ventures: (1) management incompetence: In most small businesses, management inexperience or poor decision-making ability is central to business failures. (2) lack of experience: the prospective entrepreneur should have adequate technical ability; the power to visualise, co-ordinate and integrate the various operations of the business. (3) poor financial control: Two financial pitfalls are common in small business: under-capitalisation and lax customer credit policies. (4) lack of strategic planning: Without a clearly defined strategy a business has no sustainable basis for creating and maintaining a competitive edge in the marketplace. (5) uncontrolled growth: Growth is natural, healthy and desirable for any business enterprise, but it must be planned and controlled. (6) inappropriate location: For any business, choosing the right location is partly an art and partly a science. (7) lack of inventory control: Although inventory control should be the core of any business, it is one of the most neglected managerial responsibilities. (8) inability to make the 'entrepreneurial transition': A successful start-up does not guarantee healthy and balanced growth.

Richardson et al (1994) represented the exploration of these issues concerning business failures using metaphorical representation.

In the light of the literature, failure encompasses some actions taken by a SME including in loss situation, bankruptcy (Berryman, 1983), insolvencies, closure, ceasing to trade, deregistering, selling out, exit and death. In this study, business failure will be used as a means of *closure* of the small business venture.

SME Entrepreneurship in Turkey

Entrepreneurship is a multidimensional concept as it encompasses different activities and types of behaviour. Measuring entrepreneurship in a country requires the use of different proxies and indicators to fully capture its scope. One way of examining the level of entrepreneurship in a country is studying the size distribution of firms. The SMEs within the Turkish Economy constitute 98.8% of the total firms. Moreover, entrepreneurship is valued by a large part of the population as a career option as a means of secure jobs and avoiding layoffs.

Turkey has always been characterised by a long history of commercial orientation and a developing enterprise culture. Today entrepreneurship should be at the centre of attention of economic policy as it is seen as: (a) a source of flexibility and renewal; (b) an engine behind job creation; (c) a means for individual self-realisation; and (d) a means to stimulate emancipation and integration.

However, in practice, there have been some constraints placed upon SME entrepreneurs in Turkey. Governments have always used a variety of barriers to block free trade among nations in an attempt to protect businesses within their own borders. Sometimes the biggest barriers for potential exporters are *domestic barriers* regarding the attitude of going international, information and financing. Perhaps the biggest barrier to small businesses exporting is the "I am too small to export" attitude. Another reason for entrepreneurs to neglect international markets is a lack of information about how to get started. Financing is another significant obstacle for SMEs to expand their business through export policies. There are also *international barriers* that export-minded entrepreneurs must overcome. They are mainly tariff and non-tariff barriers. Political barriers are another type of obstacle for entrepreneurs wishing to export. Especially in Turkey, the obstacles that exporters face are many and difficult to

overcome. For instance, *bureaucracy*, that is common within the country, is a significant source of obstacle to setting up a business or to exporting. If an entrepreneur of a SME wants to export his/her products, there are 78 signatures and approvals to be obtained and this situation makes most entrepreneurs reluctant to focus on exporting and thus expanding their business.

The rate and type of taxation in a country can have impact on entrepreneurship. Higher income tax rates can diminish the returns on entrepreneurship. This may inhibit entrepreneurs from starting new ventures and make failure of established businesses more likely as it erodes the financial basis of the enterprise. Also VAT tax rates are quite high in Turkey which makes setting up and carrying out a business difficult and relatively undesirable for potential entrepreneurs.

Research Objectives

In this study, two cases (one failure and one success story) has been selected to explore the common characteristics of success and failure stories of the SMEs within the region. The study will attempt to answer the following questions:

- Is there any typology that can be explored for the key factors for success and the failure cases for SMEs,
- What is the specific case for a region which has recently experienced a natural disaster followed by an economic crisis situation?
- What are the possible difficulties and obstacles faced by SMEs in a developing country?
- In the light of the case study findings what are the possible future prospects for SMEs and their survival and success paths?

Research Setting

This study aims to identify critical factors in the success and failure cases of SMEs. The setting of the study seems to be interesting and complex. The Eastern Marmara Region of Turkey, where an earthquake occurred on 17th August 1999, has been greatly affected by the earthquake and the present economic crisis. The earthquake losses in economic terms were huge and remained a potential problem for the Turkish economy. The great contribution of the region to the Turkish

Economy especially in the heavy industry, automotive industry and other main industry groups has been apparent. Thus, the region always has had a leading role within the national economy.

Alongside other technical (or normal) reasons for business venture failures, some of the authors also consider “disasters” (act of God) as conditions that can not be foreseen and in most cases can not be controlled (for example Hodgetts and Kuratko, 1995). In this study, natural disasters as well as economic crisis situations are taken as two key variables for the analysis.

Research Methodology

The study adopts the case study approach (Yin, 1994) and a pair of successful and failed examples of SMEs within the region were presented. To provide a balanced overview of the success and failure stories of SMEs within the region, the examples of SMEs were selected from the province of Adapazari which was the main location affected by the earthquake disaster. The empirical data was collected through in-depth interviews with managers. An interview ‘agenda’ was derived from the key elements of the model and was used in unstructured interviews with entrepreneurs. The advantage of such a research strategy is that the researchers were able to guide their subjects unobtrusively to provide the relevant information. The data was then analysed using content analysis (Holsti, 1969). To ensure the consistency of the comparisons, the cases were selected within the same industry (manufacturing).

Case Studies

The type of organisational crisis has been an enduring feature of our modern industrial world. Today’s trading conditions in Turkey, make the job of creating and maintaining organisational success even more difficult than it has been in the past. The consequences of business failure crises are mainly financial shortfalls which threaten their very survival. These crises also damage the quality of life for the different groups of people associated with the organisation. The consequences of this type of organisational failure aggregate at the national level, too. The two case studies illustrated in this study are expected to give us some clues to the success and failure conditions of SMEs in crisis situations.

Case A: The Power of Innovation

The Entrepreneurship A is located in Adapazari. He founded the business 30 years ago as a family business. A father and three sons with 10 employees in total have been manufacturing small machines for timber businesses. When they founded the business, there was little technology to be used for their processes, but in recent years they switched to more technological products to manufacture their machines. As Case Study A is a family-owned business there is no differentiation for departments and business functions. However, the eldest son has a leading role with his innovative ideas. The job requires pure technical skills and all the employees are trained by the father with his old-fashioned and classical techniques. They were producing some ready-made and designed-outside tools for some big industrial companies.

The company was more profitable before the economic crisis which has been affecting Turkey since February 2001. After the crisis the company had to take some measures basically to survive. Just after the earthquake of 1999, the company had to slow down its business activities. After that, they were moving into process of a growth period as they were building a new site which was in the middle of the major trade centre and was 20 times bigger than the present space for manufacturing. When the crisis started, they postponed this investment and took a decision to stick to their small but less costly manufacturing site.

The company A decided strategically to focus on what they neglected before: innovativeness and the creativity of the eldest son's ideas. He has a unique skill for designing different machines with multiple purposes. He started drawing new models which they produced and then branded. At the beginning, they provided full after-sales-service for their customers. They helped their customers to set up the machines, even if they were distantly located and gave them consulting aid when they needed it. They also put computer-controlled devices (provided from big manufacturers in Istanbul) onto the machines. Their machines started to be known by different customer groups. Despite most of the companies had to choose downsizing or at least stopping expansion, they managed to survive and even increase their market share. As a result of this successful strategy there have been no layoffs during the economic crisis period. In the future, they are planning to expand their business and go more internationally. They already have some customers from the Balkans and they are likely to be successful when the economic crisis diminishes.

The entrepreneur for case A fall into the *craftsmen entrepreneurs* (Williams and Tse, 1995 & Glancey et al, 1998) category. Craftsmen entrepreneurs usually come from a blue-collar background and have narrow educational and managerial experience. They prefer technical work to administrative work. However, they have a high level of social awareness and communication skills. Craftsmen tend to be content with “making a comfortable living” and measure their success more by customer satisfaction than by high financial rewards.

Case B: To Diversify or not To Diversify?

The entrepreneur B was producing textile products and he set up the business about 10 years ago when he retired after working for many years as a teacher. He and his brother decided to go into a textile business when they saw this profitable business opportunity. He did not know anything about the textile business, but he employed some experts and technical personnel and was successful in the market. After a few years the company started quickly reaching 40 employees working on the production line. They were producing clothes and especially jeans for big companies and their business was quite successful.

When the economic crisis started, the business started declining dramatically as their production was mainly for export. The main reason for this was the unstable condition of the exchange markets. They had to stop the machines and ceased to trade within the 6 months. They also had no choice but to layoff all the employees. As a sign of goodwill, he tried to find jobs for his ex-employees. He says ceasing production was a strategic decision and he told all his employees that they will work together again when the crisis is over. After that, to make a living and with another creative idea, entrepreneur B decided to go into a totally different business area: the sports and recreation business although he had no expertise in this area. He thought of this business as a temporary job and also a diversification of his business into a more profitable area.

The entrepreneur for case B can be labelled in the *opportunistic entrepreneurs* (Williams and Tse, 1995 & Glancey et al, 1998) category. They exhibit high levels of social awareness and have high social movement. They tend to be highly oriented towards the future -following market and economic

trends- and the growth rate of their company. In our case, although he is a typical opportunistic entrepreneur, he was too ambitious and unbalanced in diversifying (expanding) the business.

Discussion and Conclusion

Every year many business firms cease operations. The reason why some business ventures survive while some others fail needs further analysis and explanation. The discussion of two cases may be helpful to answer this question. The fact is that, in recent years -especially after the earthquake and the recent financial crisis- the failure rate for the SMEs within the region has dramatically increased.

For the Case Study A; Starting up a new firm is very much an individual decision, which is why the individuals qualities as an entrepreneur are central to the investigation of entrepreneurship (Littunen, 2000). During the start-up phase of a firm, the important characteristics an entrepreneur must have include *innovativeness* and the will to act. Innovativity means that the entrepreneur must have the ability to produce solutions in new situations. This is presumably linked with the entrepreneur's abilities, attained through training and experience.

Technical competence and good judgement are extremely important in a small manufacturing firm like case study A. Despite the fact that large businesses dominate certain industries, there is a great deal of opportunity for small businesses in the economy. For example, the giant firms in manufacturing depend heavily on smaller firms to serve as subcontractors. Company A had an opportunity to survive and grow in this way.

For the Case Study B; The entrepreneur has tried to diversify in markets where they lack knowledge. They should have focused only on known markets. Because, at the beginning, the goals set by the entrepreneur were unreasonable, it resulted in disappointment because of a lack of understanding of the situation. The company's marketing plan was superficial and lacked detail and substance especially regarding goals and objectives.

Another point is that the entrepreneur had no experience in the planned business. At the time of closing the manufacturing business and opening up the recreation business, the entrepreneur had not made a total commitment to the new business. Two part time business do not make a full time business!. It was also difficult to separate the entrepreneur from the business. SME entrepreneurs put

everything into the company, including worrying about the future of their employees. The entrepreneurs simply did not know how to run the business. They made major mistakes that an experienced, well-trained entrepreneur would quickly see and easily sidestep (Sommers and Koc, 1987).

To conclude, in spite of the chance of failure, there are a number of practical advantages for going into small business. They include independence, financial opportunity, community service, job security, family employment and challenge. Certainly, layoffs and uncertainties that have plagued the corporate world feed entrepreneurial initiatives.

Although this exploratory study has identified some key factors towards a better understanding of success and failure characteristics of the SMEs' in a special context, further research is required in order to gain a fuller appreciation of the subject. In particular, future research could focus on comparisons of SMEs in different locations to differentiate the primary and secondary variables of the entrepreneurial initiatives in different cultural settings.

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