1. Introduction

1.0 BACKGROUND AND MOTIVATION

I first became interested in the small and medium enterprise (SME) sector in 1989 as the result of a visit to my local branch of the Institute of Chartered Accountants in Australia. While waiting in the reception area, a brochure encouraging SME owners to seek the advice of a chartered accountant caught my eye. The brochure argued that SME owners could maximize their chances of success (reduce their chances of failure)\(^1\) by seeking the advice of a properly qualified professional. The brochure also pointed to the extremely high mortality rate for SMEs, as noted in the following quote by the then National President of the Institute of Chartered Accountants in Australia:

The statistics on the longevity and mortality of small business in Australia show a very disturbing picture. Nearly half go into receivership within three years of commencement, and about 80 percent are out of business within ten years. (Cohen 1987, p.6)

I had two problems with this quote and its use to promote the services of chartered accountants. First, the extremely high failure rate referred to did not seem to reflect the experiences of SME owners within my local community. For example, I was aware of a number of SME owners who had run very successful businesses over many years and who had eventually closed their businesses only when they felt it was time to retire. Were these owners failures because they eventually retired and closed their businesses? I think not! Second, I was particularly concerned that such a highly regarded professional body, of which I was a member, might have either knowingly or unknowingly been using misleading statements to promote the services of its members. While I strongly believe that SME owners can benefit from obtaining professional advice, I do not believe the services of chartered accountants (or any other service provider) should be promoted on the basis of misleading statements.

Coincidentally, I also happened to be searching for a PhD topic at that time, and therefore decided that an examination of SME failure rates could potentially make a significant contribution to knowledge. As
the first step down the PhD trail I undertook a literature review and it soon became clear that the high mortality rate for SMEs referred to in the Institute of Chartered Accountant’s brochure was simply reflecting the consensus opinion at that time. The following quotes illustrate those views: ‘The odds are well stacked against success, since in the United States about 50 per cent of new ventures fail in the first two years and only a tiny minority last ten years’ (Bannock 1981, p.34); ‘There is a lot of statistical information in the literature on small business failures. The consensus of opinion seems to be that between 50 and 60 per cent of such ventures fail within three years of starting’ (Leslie, Magdulski and Champion 1985, p.27); ‘Four out of five new firms fail within the first five years’ (Phillips and Kirchoff 1989, p.65); ‘the literature . . . suggests that between one-third and a half of new firms cease trading in their early years’ (Cromie 1991, p.44); and ‘Every year more than 100,000 new businesses open their doors. The hazards, however, are so great that 95 percent eventually fail’ (Thankappan and Hammer 1980, p.1).²

However, I found much of the available literature confusing because of the variety of definitions (or proxies) used to describe SME failure or success. As a result, and in the absence of any contrary evidence, I felt that dubious statistics suggesting very high failure rates for SMEs might have become part of the folklore and received wisdom on this subject. It was also common at that time (and, unfortunately, still occurs occasionally today) for SME conference speakers to begin their presentations with a justification of the importance of their topic based on the very high failure rates prevalent within the sector.

The following quote further helped to convince me that an examination of SME failure rates could make a useful contribution to our knowledge concerning SME performance and the risks involved for the would-be entrepreneur:

Like the weather, small business failure is the subject of much discussion . . . But unlike the weather . . . there is . . . a dearth of timely, reliable, and relevant information on small business failure rates. (Cochran 1981, p.50)

Therefore, while much had been written about SMEs, and in particular about SME failure rates, reliable statistics on small business failure were scarce and, as will be seen later, had typically been produced or inferred from databases designed for other purposes.³ As stated by Scott and Lewis (1984, p.49) ‘the absence of good statistical evidence leads to the growth of myths and half truths’ and, as noted by Stanworth (1995, p.59), these myths get ‘reported by the media, perpetuated by spokespeople for the industry and subsequently accepted by the wider public’. Without reliable
information on the subject, these perceptions are permitted to continue unchallenged, and the ‘danger is that believers, acting in the faith, may take actions which have unintended consequences in the real world’ (Scott 1982, p.239). Further, policy decisions by governments and others with an interest in the small business sector based on such perceptions are likely to be suspect. For instance, the assumed high risk of small business failure has been cited as justification for the high rates of return demanded from this sector by bankers and venture capitalists (Phillips and Kirchoff 1989).

This is not to say that the mortality rate for small business could not be lowered ‘if the proper help is available and accepted’ (Said and Hughey 1977, p.37). Also, the Wilson Committee’s interim report (1979, p.35) stated that ‘the major source of financial advice to small businesses is their accountant . . . But in practice this advice appears often to be confined to questions of audit and taxation’. The Committee recommended that ‘the accountancy bodies should take steps to ensure that their members are both equipped and encouraged to take a more active role in providing adequate advice to their smaller business clients’. Indeed Reynolds (1987) found that a major factor related to small firm survival was the amount of attention given to financial matters. Similarly, Potts (1977, p.93) found that ‘successful companies rely more heavily on accountants’ information and advice than do unsuccessful companies’.

My PhD, therefore, had three primary objectives (Watson 1995). First, I wanted to get a better understanding of what might constitute failure or success within the SME sector, that is, what definition(s) of failure and success might be the most appropriate. Having decided on the most appropriate definition(s), the next step would be to measure prevailing failure rates within the Australian SME sector. Finally, I hoped to demonstrate that failure rates could be reduced, and performance improved, if SME owners sought (and acted on) appropriate advice from professional groups such as accountants. So started my journey down the path of trying to better understand and measure SME performance and, in so doing, to expose as a myth the belief that SMEs experience failure rates considerably higher than that experienced by large organizations.

Having undertaken an extensive literature review, the next step in the process was to gain access to appropriate data that would allow me to answer the questions I had identified. The problem I confronted, however, was the almost total absence of any data that could be used for this purpose. The only body that regularly obtained information (particularly financial information) from the SME sector in Australia was the Taxation Department and, because of confidentiality concerns, its data could not be accessed. As can sometimes happen, one night I awoke from a deep sleep
with an idea! I would try to access information on SMEs from managed shopping centres. My logic was that the owners of these centres were big businesses and, as such, were almost certain to keep records concerning their tenants. The managers in charge of a managed shopping centre were also likely to know the reasons surrounding the demise of any of their clients. Indeed, I later discovered that managers were routinely required to write reports, normally monthly, on each of their tenants. Further, given that the success of a managed shopping centre depends largely on the success of the tenants, I felt that shopping centre managers were likely to expend considerable effort screening new tenants and providing them with ongoing support and advice. Subsequent discussions with a number of shopping centre managers confirmed this belief. Therefore, I would suggest that the role played by shopping centre managers is similar, in many respects, to the role that an external accountant (business adviser) might play. For this reason I expected the failure rates for businesses located within managed shopping centres to be lower than those applying to the wider population of SMEs. If this expectation could be confirmed, it would provide support for the notion that accessing (and acting on) appropriate advice increases the probability of SME survival.

I should also note that during the course of completing my PhD I became aware of a growing body of literature expressing the view that female-controlled SMEs underperformed male-controlled SMEs. Unfortunately, my PhD was not designed to examine this issue. However, shortly after completing my PhD the Australian Federal Government commissioned a substantial longitudinal (four-year) study into the performance of Australian businesses. The SME data collected in that study were subsequently made available to researchers (in a confidentialized form), thereby permitting many interesting questions concerning SME performance (such as gender effects and the role of networking) to be explored in a way that had not previously been possible. Results from analysing that data have allowed me, at least for Australian SMEs, to expose as a myth the belief that female-controlled SMEs underperform male-controlled SMEs and also to clarify a number of other issues, such as the benefits of networking and the relationship between growth and the availability of external funding.

In summary, I hope the material contained in this book will help to dispel a number of myths related to SME performance. In particular, I hope to convince the reader that: SMEs do not suffer from excessively high failure rates; female-owned SMEs do not underperform male-owned SMEs (when appropriate adjustments and controls are incorporated into the analysis); SME growth is not limited by a lack of external funding; female SME owners do not find it more difficult than male SME
owners to access external funding; and female SME owners are not dis-
advantaged, relative to male SME owners, in terms of their networking
activities.

It should be noted, at the outset, that the focus of this book is on the
individual SME owner and, therefore, implicit in this book is the notion
that ‘failure’ is ‘bad’ and that reducing ‘failure’ rates is ‘good’. However,
from a societal perspective it can be argued that some level of ‘failure’
is ‘good’ because it allows inefficient operators to be replaced by more
efficient operators (Schumpeter 1942). Indeed Knott and Posen (2005,
p.638) found that, within the banking sector, ‘Excess entry and subse-
quently failure increase aggregate industry efficiency.’ Similarly, using real
options reasoning, McGrath (1999, p.16) noted that ‘A high failure rate
can even be positive, provided that the cost of failing is bounded.’

1.1 OUTLINE OF THE REMAINING CHAPTERS

Having provided the background and motivation for this book, Part II
outlines the various issues that need to be considered if we want to get
a better understanding of: what constitutes failure; the rate of failure
within the SME sector (Chapter 2); and how economic and other factors
(such as age of business) are likely to impact reported SME failure rates
under alternative definitions of failure (Chapter 3). Part III compares
male- and female-controlled SMEs on a number of dimensions, such as:
business closure rates (Chapter 4); return on assets (Chapter 5); and risk-
adjusted returns (Chapter 6). Part IV examines the relationship between
external funding and firm growth using both a qualitative (Chapter 7)
and a quantitative approach (Chapter 8). This is followed in Part V by
an examination of the association between networking and firm perform-
ance (Chapter 9) and the differences in networking activities for male and
female SME owners (Chapter 10). Finally, Part VI (Chapter 11) concludes
the book with a summary of the key findings from the earlier chapters and
with some suggestions for future research.

I trust that the material provided in this book will help clarify a
number of important misconceptions relating to SME performance to
ensure that policy decisions by governments, bankers, service provid-
ers and any other groups with an interest in the SME sector are based
on reliable statistical analysis and not on unsubstantiated myths that
have been permitted to flourish in the absence of such evidence. Indeed,
anyone with an interest in SMEs should find the material presented in
the remainder of this book essential to a proper understanding of SME
performance.
NOTES

1. It should be noted that in the literature (particularly the early literature) it is generally assumed that firms that have not failed are successful. More recently some researchers have moved away from a dichotomous definition of success/failure (such as bankrupt/not bankrupt) to more continuous measures (for example, percentage growth in sales or return on assets).

2. Further examples of similar comments can be found in Massel (1978) and Scott (1982).

3. Excellent literature reviews are provided by Berryman (1983) and Cochran (1981).