



The potential impact of accessing advice on SME failure rates

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Abstract

It has been suggested that the impact of some of the potential causes of small and medium enterprise failure (SME) might be reduced if business owners accessed appropriate advice. Many countries have established various small business agencies to assist SMEs. Implicit in these initiatives is the premise that SME owners who access the services provided by these and other providers (for example, accountants, bankers and lawyers) will be more successful than those who 'go it alone'. While there has been some evidence to support this premise, it has been very limited to date. This study draws on a large database of Australian SMEs to provide additional empirical evidence to support the proposition that SME owners who access advice are more likely to survive (less likely to fail).



THE POTENTIAL IMPACT OF ACCESSING ADVICE ON SME FAILURE RATES

INTRODUCTION

Many studies have examined the perceived causes of small and medium enterprise (SME) failure. These studies have generally been based on the opinions of one or more of the following three groups: failed owner/managers (Fredland and Morris 1976; Smallbone 1990; Hall and Young 1991; Hall 1992; Gaskill and Van Auken 1993); non-failed owner/managers (Fredland and Morris 1976; Chaganti and Chaganti 1983; Peterson, Kozmetsky et al. 1983); or third parties such as liquidators or official receivers (Hall and Young 1991; Lowe, McKenna et al. 1991; Hall, G. 1992).

The motivation for most of these studies is best described by Abdelsamad and Kindling (1978, p.24) who stated that 'Although failures cannot be completely avoided in a free enterprise system, the failure rate could be reduced if some of its causes are recognized and preventive action is taken'. A similar view was expressed by Larson and Clute (1979, p.36) who stated that 'One realistic approach would be to identify failure symptoms before the business failed. In fact, if deficiencies can be diagnosed early enough, managerial assistance can be given and failure may be averted'.¹

Even though not all failed firms end in bankruptcy, 'most business failures result in heavy personal loss for the entrepreneur' (Bannock 1981, p.35). These personal losses include: financial losses 'from the disposal of remaining stocks of merchandise, adapting equipment to other uses, and finding employment for labor in other enterprises' (Hutchinson, Hutchinson, and Newcomer 1938, p.497); and the degradation and disappointment suffered by the owner and the owner's family (Berryman, 1983, p.47).

Two primary causes of SME failure appear to be a lack of appropriate management skills² and inadequate capital³. Said (1977, p.37) argued that '75 percent of these failures could be avoided if the proper help is available and accepted'. Reynolds (1987, p.239) found that a major factor related to small firm survival was the amount of attention given to financial matters. Duchesneau (1990, p.309) reported that 'Successful firms spent more time planning ... at start-up, were more likely to have used professional advice and had greater amounts of capital at start-up'. Similarly, Potts (1977, p.93) found that 'successful companies rely more heavily on accountants' information and advice than do unsuccessful companies'. In addition, Kent (1994) found that the financial performance of a group of

¹ A somewhat contrary view is expressed by Fredland and Morris (1976, p.7). They argued that (in a full employment economy, and assuming capital markets operate with reasonable efficiency) a business failure indicates a previous misallocation of resources. They also noted that such a misallocation may exist for many firms that remain in business because resources are being under-utilised. Similar sentiments were expressed by Storey (1989, p.178).

² Chaganti and Chaganti (1983) noted that in the period 1977-78, 55% of Canadian small business failures were attributed to poor management. According to Bruno and Leidecker (1988, p.51) Dun and Bradstreet cite incompetent management as responsible for 90% of business failures.

³ See, for example, Hall and Young (1991); and Peterson, Kozmetsky and Ridgway (1983).



small pharmacy businesses was positively related to using external management advisory services.⁴ Conversely, Larson and Clute (1979), using the financial records of over 350 small businesses, found that business owners who had failed were more likely to have accepted advice from non-qualified sources and typically had poor accounting records. Why, therefore, more SME owners do not access advice is puzzling.

Part of the reason may lie in the lack of sufficient compelling evidence of the benefits of obtaining such advice. Pragmatic owner-managers are likely to expect a demonstrable ‘pay-off’ before they adopt the financial reporting and analysis practices recommended in the literature (McMahon and Davies 1994). Alternatively, it may simply be a lack of sophistication on the part of some SME owners. Sophisticated and capable SME owners may understand the benefits of compensating for their own inadequate knowledge or skills by accessing external assistance. However, less sophisticated and less capable SME owners may be unaware of their own shortcomings or unwilling to reach out for help, believing they should do it all themselves.⁵

It could be argued that part of the potential ‘pay-off’ to SME owners, who seek professional advice, may relate to improving the odds of success or, conversely, reducing the probability of failure. Therefore, this study seeks to provide evidence of reduced propensity to fail where SME owners access advice. Hopefully, if evidence of this type can be provided (and disseminated to the SME community) it might encourage more SME owners to access advice in a timely manner.⁶

At the outset it is important to make clear a very real limitation evident in the previous discussion and in the remainder of this paper. This limitation relates to the implicit assumption that where SME owners access advice and have been more successful, the increased success rate is due to the advice received. However, it is equally possible, that businesses that seek advice are better managed (or the managers have different educational backgrounds⁷) and it is the skills of the manager that are more important (than their use of advice) in reducing the probability of business failure. This dilemma cannot be resolved easily (if at all) and, therefore, the results of any study relating failure rates to advice received can at best be seen as providing support for a belief, rather than confirming that belief.

DEFINITIONS OF SME FAILURE

Because there are no formal reporting requirements for the majority of SMEs, it is difficult, if not impossible, to obtain sufficient reliable information to measure their performance in an economic sense (i.e. rate of return on capital). Most studies, therefore, have relied on some recorded event as a

⁴ However, Kent (1994, p.57) also found that ‘many clients using accountants for tax and compliance work do not receive any management advisory services’.

⁵ Or they may simply be unwilling to pay for the help or unable to acquire the resources to pay for the help.

⁶ Anecdotal evidence based on conversations with advice providers suggests that it common for SME owners to seek advice when it is too late.

⁷ Holmes and Nicholls (1988) conclude that there was a positive relationship between owner manager education and the use of accounting information.



surrogate measure of failure. The two events for which data has been most readily available are: the discontinuance of a business for any reason; and formal bankruptcy proceedings. Between these two extremes, two further definitions have been proposed: termination to prevent further losses (Ulmer and Nielsen 1947); and failure to 'make a go of it' (Cochran 1981).

The first definition of failure (discontinuance of a business for any reason) is the least homogeneous, with many variations in the way discontinuance is defined. At one extreme, discontinuance includes every change in ownership or closure (referred to as *discontinuance of ownership*). At the other extreme, a discontinuance is recorded only when a business ceases to operate (referred to as *discontinuance of business*). Fredland and Morris, (1976) argued that business discontinuance is a proxy for failure, as discontinuance suggests that resources have been shifted to more profitable opportunities. Churchill (1952) noted, however, that the sale or liquidation of a business did not necessarily imply failure because many businesses were given up due to illness or retirement or because of alternative opportunities.

Dun and Bradstreet (1979) defined as failures: businesses that go into bankruptcy or cease operations with resulting losses to creditors. The implication is that continuing businesses and businesses that cease without loss to creditors (although there may have been losses to the owners) are regarded as non-failed. This appears to be a very narrow definition of failure and may exclude many businesses that would commonly be regarded as having failed. For example, businesses that are barely breaking even, providing neither a reasonable income for the owner, nor a fair return to the investor, could be regarded as 'failing' businesses (Land 1975) but would not be included in this definition.

Ulmer and Nielsen (1947) defined as failures, those firms that were disposed of (sold or liquidated) with losses to prevent further losses. Losses in this context would include the owner's capital and, therefore, a business could be regarded as having failed even though there may have been no loss to creditors. Defining failure to include businesses that were sold, or ceased, to prevent further losses, appears more relevant (particularly for owners or potential owners; advisers to small business; and policy makers) than using a measure based on either discontinuance or bankruptcy. However, it is not a simple, nor a particularly objective measure, because generally it must rely on the opinion of someone associated with the business.

Cochran (1981, p.52) suggested that 'failure should mean inability to "make a go of it", whether losses entail one's own capital or someone else's, or indeed, any capital'. This definition is wider than that suggested by Ulmer and Nielsen as it would, presumably, include as failed any business that was not earning an adequate return (or was not meeting other owner objectives). The main difficulty with this definition is that most studies have relied on business closure, or sale, to trigger the classification of the business as either failed or non-failed. However, some businesses may continue operating even though they would be classified as having failed under this definition. In addition, an adequate return is hard to define: many SME owners may be willing to accept low financial returns as the cost of independence.

While this last definition of failure appears to be the most relevant (particularly for owners or potential owners; advisers to small business; and policy makers) it is clearly the most subjective. It would generally have to rely on the opinion of someone associated with the business and, therefore, any results could be difficult to verify. It should be noted that the definition of failure used by researchers has, generally, depended on the nature of the data available. In this study, business failure is defined as the discontinuance of the business; businesses that are sold, but continue to operate, are treated as continuing (successful) businesses.



HYPOTHESIS AND DESCRIPTION OF DATA

Much of the literature on SMEs discusses the importance of obtaining appropriate advice. The implication is that where appropriate advice is accessed, failure rates will be lower. Therefore, a reasonable hypothesis is that:

H1: The probability of failure will be lower for businesses that access advice.

If this hypothesis is supported by the data, further analysis will be undertaken to determine which sources of advice appear to be the most critical to SME survival.

A major difficulty in studying SMEs is the lack of a reliable data source. Bannock and Doran (1980, p.123) noted that 'Perhaps the most important gap in British Statistics, and indeed in virtually all other countries, is in statistics on new enterprise formation (births) and failures (deaths)'. Once a small business has ceased operating, information concerning the business becomes difficult to obtain. Typically most of the information resides with the owner as there is no systematic reporting of information on small businesses in the same way as is provided for larger concerns and particularly for listed companies.

This study uses data provided by the 1995-96, 1996-97 and 1997-98 Business Growth and Performance Surveys (also known as the Business Longitudinal Survey) undertaken by the Australian Bureau of Statistics (ABS). The surveys were designed to provide information on the growth and performance of Australian employing businesses for the federal government. The ABS Business Register was used as the population frame for the surveys. For confidentiality reasons, information on all large businesses (those employing more than 200 people) was excluded from the data set made available to researchers outside the ABS.

All employing businesses in the Australian economy were included in the scope of the survey except for businesses in the nature of: government enterprises; libraries; museums; parks and gardens; private households employing staff; agriculture, forestry and fishing; electricity, gas and water supply; communication services; government administration and defense; education; and health and community services.

Data collection was through self-administered questionnaires, copies of which can be obtained from the ABS. Because the ABS can legally enforce compliance with its data requests (under the *Census and Statistics Act 1905*) response rates were very high (typically in excess of 90%). With respect to the 1995-96 survey, responses were received from 5,027 SMEs and these businesses were surveyed again in each of the following two years. However, on examining the data, it was found that 13 businesses had no income (sales or other income). Therefore, these businesses were excluded from the data set used in this study on the assumption that they had probably not yet formally commenced trading; leaving 5,014 firms that could be examined over a three-year period.⁸ As the data set was relatively large, a one percent level of significance has been used throughout the paper.⁹

⁸ Including these firms did not alter the results.

⁹ Using a 5% level of significance did not change the results in any material way.



RESULTS

The ABS data from the 1995-96 survey contained information relating to the frequency with which SME owners had sought advice (during the year) from the following sources: banks; business consultants; external accountants; family and friends; industry associations; local businesses; others in the industry; small business development corporation; solicitors; and the tax office. Table 1 provides a summary of the frequency with which the SMEs in this study accessed the various sources of advice.

Table 1

Source and Fre

Source of Advice	Frequency Advice Sought (p.a.)		
	Never	1-3 times	>3 times
Bank	1,897	1,778	1,339
Business Consultant	3,622	883	509
External Accountant	1,027	1,748	2,239
Family & Friends	3,252	947	815
Industry Associations	3,018	1,057	939
Local Businesses	3,716	819	479
Others in the Industry	2,271	1,472	1,271
Small Business Development Corporation	4,220	640	154
Solicitor	2,142	1,721	1,151
Tax Office	2,974	1,557	483

For the SMEs in this study, advice was most frequently sought from: external accountants; banks; others in the industry; and solicitors.

Table 2 reports the number of businesses that had failed (discontinued operations) by the time of the last survey (1997-98), classified by the source and frequency of advice accessed. For example, of the 748 businesses that failed over the period of this study, 436 did not seek advice from their bank in the period 1995-96; 188 sought advice between 1-3 times; and 124 sought advice from their bank on more than 3 occasions. A Chi square test found these differences to be statistically significant. This finding was repeated for each source of advice shown in Table 1 and, therefore, provides strong support for hypothesis 1.



Table 2

Number of Fail

Source of Advice	Frequency Advice Sought (p.a.)			
	Never	1-3 times	>3 times	
Banks	436	188	124	*
Business Consultants	589	97	62	*
External Accountants	313	228	207	*
Family & Friends	551	121	76	*
Industry Associations	567	108	73	*
Local Businesses	620	80	48	*
Others in Your Industry	460	163	125	*
Small Business Development Corporation	680	55	13	*
Solicitors	443	193	112	*
Tax Office	524	182	42	*

* Chi Sq test significant at .01.

The next step in the analysis is to see which of these various sources of advice appears to have the greatest impact on reducing the probability of failure (increasing the probability of survival). Logistic regression was used to see how the probability of failure was related to the various sources of advice accessed by SME owners.¹⁰ Logistic regression finds the maximum likelihood model relating the log odds of an event to the explanatory variables.¹¹ The independent variables initially entered into the logistic regression model included all the sources of advice. The independent variables included in the final model are those that were the most significant in explaining the dependent variable (failure/survival). The fact that a variable was left out of the final model does not necessarily mean

¹⁰ Both multiple regression analysis and discriminant analysis were considered for use in developing a model to predict failure. ‘However, these techniques pose difficulties when the dependent variable can have only two values - an event occurring or not occurring’ (SPSS 1990, p.45). In this circumstance it is unreasonable to assume that the distribution of errors is normal as required for regression analysis. Also, in multiple regression, the predicted values cannot be interpreted as probabilities, because they are not constrained to fall in the range 0 to 1. In addition, the logistic regression model requires ‘far fewer assumptions than discriminant analysis; and even when the assumptions required for discriminant analysis are satisfied, logistic regression still performs well’ (SPSS 1990, p.45).

¹¹ In linear regression, model parameters are usually estimated using the method of least squares. Regression coefficients with the smallest sums of squared distances between the observed and the predicted values of the independent variable are selected for model inclusion. ‘In logistic regression the model parameters are estimated using the maximum-likelihood method. That is, the coefficients that make our observed results most “likely” are selected’ (SPSS 1990, p.47).



that it was not significantly related to the probability of failure (survival), but rather that it added no further significant explanation, after the inclusion of the variables already in the model.

Table 3

Coefficients for

Variable	b	S.E. of b	df	Sig
External Accountants	0.553	0.064	1	0.000
Industry Associations	0.295	0.066	1	0.000
Banks	0.190	0.069	1	0.006
Constant	-0.181	0.126	1	0.152

Table 3 shows the sources of advice that were included in the final model. Accessing advice from external accountants appears to have the greatest explanatory power followed by industry associations and banks. Including the other sources of advice did not significantly improve the failure (survival) prediction model.

So far the analysis has ignored other (demographic) variables that might impact on both failure and the propensity to access advice. For example, younger businesses may be more likely to fail and less likely to access advice. Similarly, failure rates have been shown to vary by industry and size of business, and these factors may also be related to the propensity to seek advice. Table 4 provides these demographic details for both the failed and continuing businesses in the sample.

From Table 4 it can be seen that the failed businesses were under-represented in wholesale trade and over-represented in accommodation, cafes and restaurants. The failed businesses were also dramatically over-represented in the less than two-years old age category and under-represented in all other age categories. Finally, the failed businesses were significantly smaller (in terms of number of employees) than continuing businesses. Table 5 provides the results of incorporating these demographic variables into the logistic regression model, together with all the sources of advice. As can be seen, age enters the final model as a significant predictor of survival (failure), while industry and size do not appear to add any further explanatory power. Accessing advice from external accountants remains in the model. However, accessing advice from industry associations is replaced by accessing advice from others in the industry; and accessing advice from bankers is no longer in the model.

The results from this study provide strong support for the belief that businesses that access advice are more likely to survive (less likely to fail). There is a significantly lower failure rate for SMEs that access advice; particularly from external accountants and others in the industry. This finding persists after controlling for industry, age and size of business.

CONCLUSIONS

The purpose of this study was to examine the potential impact on survival (failure) rates of accessing advice. A significant advantage of this study, over previously reported research, is that it used a relatively large database developed from surveys conducted on behalf of the Australian Federal Government and specifically aimed at providing a better understanding of the performance of Australian SMEs. As a result, the data was highly representative (with response rates typically over 90%) and allowed a number of potentially confounding variables to be adequately controlled.



Bearing in mind the limitation referred to earlier, the results of this study can be seen as providing support for the belief that failure rates are likely to be significantly lower for businesses that access advice. Further, it would appear that advice from external accountants and from others in the industry has the greatest explanatory power (together with the age of the business) in predicting SME survival (failure). It is hoped that the evidence presented in this study will encourage SME owners to make better use of the various sources of advice (both formal and informal) that are available.

Table 4

Demographics

Variable	Continuing N = 4,266		Failed N = 748	
	No.	(%)	No.	(%)
<i>Industry</i>				
Mining	40	(0.9)	12	(1.6)
Manufacturing	1,565	(36.7)	266	(35.6)
Construction	257	(6.0)	39	(5.2)
Wholesale Trade	658	(15.4)	85	(11.4) *
Retail Trade	438	(10.3)	87	(11.6)
Accom, Cafes, Restaurants	164	(3.8)	43	(5.7) *
Transport & Storage	170	(4.0)	28	(3.7)
Finance & Insurance	176	(4.1)	39	(5.2)
Property & Bus Services	608	(14.3)	107	(14.3)
Cultural & Rec Services	98	(2.3)	20	(2.7)
Personal & Other Services	92	(2.2)	22	(2.9)
Totals	4,266	(100.0)	748	(100.0)
<i>Age of Business</i>				
Less than 2 years old	249	(5.8)	417	(55.7) *
2 years to less than 5	708	(16.6)	76	(10.2) *
5 years to less than 10	1,165	(27.3)	115	(15.4) *
10 years to less than 20	1,205	(28.2)	78	(10.4) *
20 or more years old	939	(22.0)	62	(8.3) *
Totals	4,266	(100.0)	748	(100.0)
<i>Size of Business</i>				
	Mean	(Median)	Mean	(Median)
Number of Employees	27	(13)	24	(7) *

* Significantly different at 1% level.

Note: The significance tests were based on z scores for industry and age of business; and on the Mann-Whitney U test for number of employees.



Table 5

Coefficients for

Variable	b	S.E. of b	df	Sig
Age	0.937	0.040	1	0.000
External Accountants	0.689	0.063	1	0.000
Others in the Industry	0.243	0.063	1	0.000
Constant	-2.641	0.175	1	0.000

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