

Exploring the Effect of Individual Factors on Business Failure in Iranian New Established Small Businesses

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Abstract

The majority of Entrepreneurship studies have focused on Business success while little information regarding Business failure exists. However our knowledge of entrepreneurship is not complete without recognition of the business failure. Also, more researches in this field have been done in developed countries and it is limited studies in those countries where economic, social, cultural and political differ. Individual factors are the main ones affecting the entrepreneurial process. This is a study on a sample of new established small businesses in industry sector. First, in qualitative study, interview analysis of 10 semi-structured interviews lead to identified four groups of individual factors including motivations, skills, capabilities, and characteristics. Then, these individual factors have been evaluated in a sample of 158 unsuccessful businesses and data analysis of 52 complete questioners pointed out that "Lack of crisis management skills" and "Lack of marketing, financial and human resource management skills" are the main individual factors affecting business failure in new established small businesses in industry sector.

Keywords: Business failure, Small business, New established business, Individual factor, Industry, Iran

1. Introduction

Business discontinuation is an important feature of dynamic economies, and entries and exits of businesses are closely linked (Bosma et al., 2009). Our understanding of entrepreneurship will never be completed until we have a clear understanding of what caused its discontinuation. Developing a deeper understanding of new venture failures, should provide critical information for several key stakeholders in new venture-entrepreneurs, venture financiers, and government policymakers (Liao et al., 2009).

Small and medium-sized enterprises (SME) are of almost importance for the Economy. In the European Union (EU), more than 99 % of the existing firms are SME; they stand for two-thirds of all employment possibilities and account for 60 % of value added. On the other hand, SME are economically and socially significant. They are not only seen as a main driver for generating employment, they also promote innovation, put business ideas into practice, foster Regional economic integration, and maintain social stability (ENSR, 2003). The high figures of SME inject economic variety (Hannan & Freeman, 1989) and generate competition, positive for economic output (Porter, 1990).

In spite of these facts, over a long period of time, policy-makers paid much attention to large enterprises, and SME was simply neglected in the public and academic focus. Only at the beginning of the 1990s, specific strategies and improvement of economic conditions for SME became a subject; meanwhile they rank high on the political agenda. Recently, much has been done to improve the environment for SME. A series of particular and appropriate legislation has been introduced to try to support growth and stability of SME and to redress the difficulties they face.

This seems to be mandatory, since research indicates that failure of SME is high, above all within the first years after starting (Franco & Haase, 2009). Timmons (1994) show that over 20 % of new ventures fail within one year and 66 % within six years. Other scholars state that approximately 50 % of small start-ups survive for more than five years (Franco & Haase, 2009). New established businesses no more than three years are usually faced difficulties and high percentage of this business lead to failure (FEE, 2004). Baldwin et al. (2000) show that 23 % of Canadian firms are likely to exit during their first year of operation. According to this research, a new firm has a 42% probability of surviving past its fourth year and a 20% likelihood of completing its first decade. They also show that small firms in their first years of entry have a higher hazard of exit compared with medium and large size firms. Mata and Portugal (1994) studying the survival of new manufacturing firms in Portugal, report on comparable results. Specifically they show that one fifth of such firms failed during the first year of entry and that only 50 % survived for four years.

Given that such a large number of SMEs are unsuccessful, it is meaningful to investigate the causes of poor performance and failure faced by these firms. According to Storey (1994), the failure of SME is a vitally important area for research and he rightly states that no policy can be formulated for SME without a central understanding of business malfunction's significance. This comprises the identification of major problems that are assumed to discourage and obstacle SME performance (Franco & Hasse, 2009). Much research has been done about success and growth factors of new firms (Franco & Hasse, 2009) while research on business failure of SME's help them to change. It is noted that some of the entrepreneurial capability variables cannot easily be changed. However, the benefits or risks associated with them can be assessed, with implications both for entrepreneurs and for public policy. Entrepreneurs whose resource base renders it less likely for them to succeed should proceed with caution or strengthen their position (Arasti & Zandi, 2010).

In Iran, the business discontinuation rate (6 %) is almost higher than average of efficiency-driven economies (4.9 %). Denmark and Italy in innovation-driven economies have the lowest business discontinuation rate (1.1 %) (Arasti, 2011a). In addition, Doing Business report published by World Bank (2011) is an annual report investigating the regulations that enhance business activity and those that constrain it. Doing Business reports a way to evaluate business environment of a country and presents quantitative indicators on business regulations and the protection of property rights that can be compared across 183 economies over time. Regulations affecting 11 areas of the life of a business are covered: starting a business, dealing with construction permits, registering property, obtaining credit, protecting investors, paying taxes, trading across borders, enforcing contracts, closing a business, getting electricity and employing workers. Iran with 72.9 million populations and GNI per capita (US\$ 4.530) is 129 from 183 countries in the ranking on the ease of doing business.

The ranking of starting a business in Iran is 42 while in obtaining credit is 89. We must mention that the Islamic Republic of Iran eased business start-up in 2011 by installing a web portal allowing entrepreneurs to search for and reserve a unique company name, the establishment of a new private credit bureau improved access to credit information. The Islamic Republic of Iran made enforcing contracts easier and faster by introducing electronic filing of some documents, text message notification and an electronic case management system. These data show that the business environment in Iran is not encouraging for entrepreneurs and makes a lot of barriers to them (Arasti, 2011b). Therefore, a study on business failure and the factors that cause failure in Iranian context could help policy makers to identify the most important challenges of business that lead to business discontinuance.

This paper has been structured in five parts. In the second section a review of the literature on individual factors in failure business and specifically on new established small businesses has been presented. The third section describes the methodology of research. The results have been presented in the fourth section. Finally paper has been concluded by result discussion and conclusion.

2. Literature Review

The term "failure" in the Oxford English Dictionary is defined as "to become deficient, to be inadequate". In general, many different terminologies are related to business failure, such as firm closures, entrepreneurial exit, dissolution, discontinuance, insolvency, organizational mortality and bankruptcy. Normally, entrepreneurial failure is referred to as the cease of an operation for financial reasons. Since we examined nascent entrepreneurs during the firm's gestation process, one type of entrepreneurial failure is the discontinuance of venturing efforts by entrepreneurs (Liao et al., 2009). In particular, definitions of business disappearance, closure, exit, and failure are confused and often overlapping. "Disappearance" of a business may occur because the business failed, because the business acquired by or merged into another company, or because the owners voluntarily closed it (Cardozo & Borchert, 2004). "Exit" refers to several different meanings; it can refer to the exit of the business from trading in a specific market or from producing a particular product. It also refers to the end of the owner's participation in the business;

as in the search for “exit routes” by entrepreneurs wishing to sell or exit from a business (Stokes & Blackburn, 2002). But business failure can be defined as wanting or needing to sell or liquidate to avoid losses or to pay off creditors or general inability to make a profitable go of the business (Gaskill et al., 1993).

The majority of studies in business failure were focused on business rather than the owner of business, while the entrepreneurs and the factors related are the most important factors to entrepreneurial process. The most cases that have attracted the attention of researchers are reasons of business failure, patterns for failure prediction and strategy for weak businesses, while the events occurred for company and its owner and manager were review less than one (Stocks & Blackburn, 2002).

In reviewing the literature of effective factors on business failure, some factors have more prominent roles. Some researchers were categorizes effective factors of business failure as individual factors describe as some factors that controlled by the person and environmental factors describe as some factors that the person has no control on it but a strategy determination could reduce harmful pressures. Liao (2004) has mentioned the effects of four groups of factors including characteristics of founder, resources, structural characteristics and strategies of the firm, and environmental conditions in which a firm operates on business failure (Ooghe & De Prijcker, 2008).

Managerial experience and financial management, seems vital in determining the success or failure of the firm based on a survey to study the causes of firm bankruptcy in Canada found that almost half of the firms in Canada go bankrupt due to internal problems caused by managerial inexperience and lack of Knowledge and vision (Baldwin et al., 1997).

Management’s motivation, qualities and skills have an impact on the way a company is (miss) managed. Insufficient and inappropriate skills of management could cause failure in a lot of companies. Have expertise in only limited areas and not willing to accept professional advice, reduce the possibilities of the company’s chances to survive in the medium term (Ooghe & De Prijcker, 2008). Some other studies focused more on the managerial causes of failure, categorized them simply as poor management (FEE, 2004), and concluded that this combined with the personality traits of the owner-manager and external factors cause business failure (Berryman, 1983). Earliest empirical studies on business failure, examined the role of various owners and firm characteristics to explain business failures. Many aspects of poor management are reported to be connected to several related issues, such as poor financial circumstances, inadequate accounting records, limited access to necessary information, and lack of good managerial advice (Gaskill et al., 1993). Management’s qualities and skills are not the only factors affecting the survival chances of a company. It is remarkable how many personal characteristics strongly affect the performance of a company (Ooghe & De Prijcker, 2008). The numerous characteristics shared by failed firms, are directly related to personal decision-based characteristics of the owner including lack of insight, inflexibility, emphasis on technical skills, etc. (Gaskill et al., 1993).

Managers and entrepreneurs are obliged to anticipate and to adjust their decisions to the changes and opportunities in the environment. Optimism and risk behavior are other possible causes of declining performance. Research indicates that entrepreneurs are somewhat more inclined to take risks than are managers, this difference even increases when the entrepreneur has the goal of a significant venture growth. Many over-optimistic (young) entrepreneurs are faced with problems to attract external finance from banks. Moreover, a higher inherent risk aversion of management and changes in the value of tax shields and future bankruptcy costs also make relatively safe projects more desirable (Ooghe & De Prijcker, 2008).

New firms create new jobs, open up opportunities for upward social mobility, foster economic flexibility, and contribute to competition and economic efficiency, but they have more risk rather than established business (Liao et al., 2009). According to statistics, SME’s in comparison with large businesses are more vulnerable and have more challenges to survive. Due to their size and limited human resources, SME typically lack the middle managers or functional specialists who in large firms play a major role in developing and implementing organizational strategies. As a consequence, SME owner-managers carry out a multiplicity of roles (Jennings & Beaver, 1997), which makes strategic management complex and owner-focused. Small businesses in Uganda are faced with a number of challenges that lead to business failure. Lack of entrepreneurial qualification as a difficulty in starting and managing their firms during their early stages is a major cause of business failure for small businesses (Kazooba, 2006). There appears to be a trend that years of schooling and higher education level are positively associated with a firm’s performance (Bates, 2005). Prior experience in running a business, positively related with a firm’s success (Gimeno et al., 1997; Madsen et al., 2003; Bosmaet al., 2004), Lacking higher education levels and entrepreneurial experience are main difficulties for the SME (Franco & Hasse, 2009). Previous studies in Iranian context in different sectors, pointed out that management deficiency is the most important reason to business failure (Arasti & Zandi, 2010).

As we can see in the literature, previous studies mentioned the importance of individual factors in business failure but very limited studies investigated on the new establish small business. This first study on individual factors affecting business failure in Iranian new established small businesses in industry sector tries to answer the below question:

Which individual factors affect business failure in Iranian new established small businesses in industry sector?

3. Research Methodology

In order to answer the research question, a narrative study was done on a sample of new established (no more than 3 years) small businesses (less than 50 employees). Goal oriented sampling used until theoretical saturation. In total 10 semi-structured interviews conducted on June 2011 and the two last interviews didn't add some new concepts related to the subject. Therefore we cut the data gathering after the 10th interview. Each interview was taken in average 80 minutes. Content analysis of interviews leads to identify all individual factors affecting business failure in four categories of motivations, skills, capabilities and characteristics. To test these results, four hypotheses were developed:

H1: Business failure of new established small businesses is affected by motivations of business owner.

H2: Business failure of new established small businesses is affected by skills of business owner.

H3: Business failure of new established small businesses is affected by capabilities of business owner.

H4: Business failure of new established small businesses is affected by characteristics of business owner.

These hypotheses were tested by a quantitative study in a sample of 158 unsuccessful new established small businesses in industry sector. Data was gathered by a questionnaire between August and October 2011. Validity of questionnaire was guaranteed by expert opinion in the qualitative study. Reliability of questionnaire was measured by Cronbach's alpha that was 0.75 for whole questionnaire. To data analysis and examine the hypotheses one sample t-test and Friedman analysis of variance was used on 52 complete questionnaires by SPSS.

4. Finding

In this section we present the research finding in two subsections of qualitative and quantitative results.

4.1 Qualitative Results

In the sample of 10 unsuccessful entrepreneurs, the average age was 42 years old. The majority of them (9) were men and most of them (6) have university degree. 6 have experience in related sector, 2 in management and 3 in entrepreneurship.

All Interviews were recorded and then transcribed for content analysis and conclusions. Content analysis is a research technique for making replicable and valid inferences from text or other meaningful matters, to the contexts of their use. To conduct a content analysis on any such text, the text is coded or broken down into manageable categories on a variety of levels - word, word sense, phrase, sentence, or theme - and then examined using one of content analysis basic methods, either conceptual analysis, or relational analysis. All levels of content analysis have been presented in this section.

Table 1 presents interview coding of one interview as a sample. This is an interview with a business owner whose product was cardboard. He expresses his management skills and capabilities as well as motivation that affect business failure. For example: "*I could not make up my mind in the crisis ahead*" that refer to "lack of crisis management skill" or "*It was not logical to put the rest of our capital to this unsteady market and we could not foresee the future*" that refer to "incapacity of estimate business environment". In this interview, five individual factors affecting business failure have been identified (see Table 1).

Insert Table 1 Here

The same coding process has been done for all 10 interviews. In total 33 individual factors have been identified as affecting individual factors of failure in Iranian new established small businesses. The results have been presented in Table 2.

Insert Table 2 Here

Some factors have been repeated in different interviews. For example "Insist on mistake and continue the job" has been discussed in the second interview and repeated in the 8th interview. Then in this step all repetitions have been omitted and the results are given in Table 3.

Insert Table 3 Here

In the last step, the identified factors have been categorized in four groups based on their nature. These are motivations, skills, capabilities and characteristics presented in Table 4. For example marketing, financial management and human resource, and team management are categorized as category of “management skills”.

Insert Table 4 Here

After content analysis on 10 interviews, all individual factors affecting failure in Iranian new established small businesses identified in four groups of factors including motivations, skills, capabilities and characteristics. The research model was presented in Figure 1.

Insert Figure 1 Here

4.2 Quantitative Results

To test the research model and four research hypotheses, 52 complete questionnaires from unsuccessful businesses in Eshtehard Industrial sector were analyzed by SPSS. In the first subsection descriptive statistics on personal and organizational characteristics of sample and in the second one the results of t-test and Friedman analysis are presented.

4.2.1 Sample Description

In our sample, most of the interviewees were aged between 25 and 45 years old and married. 96.2 % of them were men. 44.3 % have university degree. About half of them had experience in related sector but only 30 % had management experience and 23.5 % had entrepreneurial experience.

The businesses were in different industry sector. Most of them were in chemical industry (30.8 %) as well as in mineral nonmetal industry (21.2 %). Also, 50 % of these new established businesses failed before the age of two years (See Table 5).

Insert Table 5 Here

4.2.2 Hypotheses Testing

To test the hypotheses we used “one sample t-test” analysis. According to the results, the individual factors affecting business failure in Iranian new established small business are “Lack of crisis management skills” and “Lack of marketing, financial, human resource and team management skills”. Then only the second hypothesis was conformed.

Also, according to result of Friedman analysis ($P < 0.001$, chi-square = 126.1), the mean rank is significant and table 6 show that “Lack of crisis management skills” (mean rank = 5.35) and “Lack of marketing, financial and human resource and team management skills” (mean rank = 4.38) are the main individual factors affecting business failure of Iranian new established small business in industry sector.

Insert Table 6 Here

5. Discussion

The results pointed out that crisis management skills are the most important individual factors affecting failure in new established small businesses. Previous studies mention that new established small businesses deal with more challenges than large stable businesses. The majority of small businesses failed in their first three years (Franco & Haase, 2009). Then crisis management skills are much more important for new established small businesses. While the importance of “lack of crisis management skills” as a factor of failure did not study in most of researches.

Other important individual factors of failure are management skills that refer to marketing, financial and human resource and team management skills. The majority of previous studies on business failure have confirmed the effect of “lack of management skills” as the most important factor (Berryman, 1983; Gaskill et al., 1993; Baldwin et al., 1997; Kazooba, 2006; Ooghe & De Prijcker, 2008).

The other individual factors have been studied in previous researches. For example, “level of education” in Baldwin et al. (1997), Jennings and Beaver (1997), Gideon et al. (1997), Madsen et al. (2003) and Busman et al. (2004), “characteristics” in Gaskill et al. (1993), Kazooba (2006), and Ooghe and De Prijcker (2008) and “motivations” in Ooghe and De Prijcker (2008). These factors have been examined in our research too and the results showed that “change of motivations over time”, “have a traditional look in business”, “insist on mistake” and “lack of capabilities (time, knowledge and experience)” are respectively other individual factors of failure in new established small businesses.

6. Conclusion and Implication

This study has been done to identify the individual factors affecting failure in new established small businesses with a mixed of qualitative and quantitative research. First, a literature review lead to a conceptual framework of research.

Then a qualitative study was done by the semi-structured interviews with 10 unsuccessful entrepreneurs and results pointed out the individual factors in four categories of motivations, skills, capabilities and characteristics. Also, some factors were added to the framework. “Lack of proper time spent for the business”, “have a traditional look in business”, “over confidence to others”, “insist on mistake”, and “lack of crisis management skills” are some factors that have been added to literature.

In these results, the frequency of reference to “lack of management skills” and “lack of crisis management skills” shows that these individual factors are the most important factors in business failure. Based on qualitative results, four hypotheses have been developed and tested in a quantitative study by a survey in a sample of 152 unsuccessful entrepreneurs. The results show that two individual factors of “lack of crisis management skills” and “lack of marketing, financial, human resource and team management skills” are the most important factors affecting failure in Iranian new established small businesses.

Based on these results that identified “lack of marketing, financial, human resource and team management skills” as the most important individual factor of failure, reinforcement of management skills via formal and/or informal training could decrease the rate of failure in these businesses. Considering more challenges of new established small businesses in competition with large established businesses, training of “crisis management skills” could help entrepreneurs to the best decision making.

This study tried to have a comprehensive but detailed look on effective factors of business failure but as a first study on individual factors of failure in Iranian new established small businesses, it had some limitations especially to identify and access to unsuccessful entrepreneurs, because there is no database of unsuccessful businesses in Iran and in addition the unsuccessful entrepreneurs don’t have a tendency to iterate the virulent memoirs of failure.

Future studies could examine the effect of motivations and capabilities on a larger sample. Also, comparative studies on a sample of successful and unsuccessful businesses as well as between cultures are suggested.

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Table 1. Verbal Statement and Derived Concepts from One of the Interviews

Type of product	Verbal statement	Concepts
Cardboard	I could not make up my mind in the crisis ahead.	Lack of crisis management skills
	We could not fully manage our work.	Lack of team management skills
	One of my partner setbacks and that was the first feeling of failure but I didn't want to abandon the business.	Insistence on continuation of activity
	It was not logical to put the rest of our capital to this unsteady market and we could not foresee the future.	Incapability to estimate business environment
	Change in environment lead to financial failure and made us completely disappointed.	Disappointment

Table 2. Extracted Concepts for Each Interview

Interview No.	Type of product	Concepts
1	Lathing	1. having two jobs and lacking time
		2. psychological and family problems
		3. lacks suitable education
		4. traditional look at business
2	Door and window profiles UPVC	5. too much confidence in others
		6. insistence on previous mistakes
		7. incapacity to solve the problems
		8. family problems psychological pressures
3	Keyboard	9. lacking motivation for continuation of the job
		10. change of motivation
		11. unrelated job experience with the economic activity
		12. spending less time in job
4	Medical equipment	13. lacking motivation for continuation of the job
		14. lack of crisis management skills
		15. lack of knowledge of the director
5	Industrial insulating glass	16. lack of motivation for continuation of the job
		17. lack of marketing management skills
6	Industrial switchboard	18. lack of understanding and evaluation of probable threats in the job
		19. lack of financial management skills
		20. lack of familiarity with market and marketing
7	UPVC profile	21. lack of management skills
		22. lack of crisis management skills
8	Cardboard	23. lack of crisis management skills
		24. lack of team management skills
		25. insistence on continuation of activity
		26. incapability to estimate business environment
		27. disappointment
9	Cement blocks	28. lack of marketing management skills
		29. disappointment
		30. lack of management skills
		31. lack of crisis management skills
10	Safety glass and laminate	32. lack of management skills
		33. lack of crisis management skills

Table 3. Extracted Components

No.	Extracted component	Coding
1	Change of motivation over time	10
	Lack of motivation for continuation of the job	9, 13, 16
	Disappointment in the job	27, 29
2	Lack of management skills	17, 19, 21, 24, 26, 30, 32
	Lack of marketing skills	20, 28
	Lack of crisis management skills	7, 14, 18, 22, 23, 31, 33
3	Lack of proper education	3, 15
	Lack of proper time spent for the business	1, 12
	Lack of proper knowledge and experience	11
4	Have a traditional look at the business	4
	Family problems and psychological pressures	2, 8
	Over confidence on others	5
	Insist on mistake and continue the job	6, 25

Table 4. Extracted Dimensions

No.	Extracted dimension	Coding
1	Motivation	9, 10, 13, 16, 27, 29
2	Skills	7, 14, 17, 18, 19, 20, 21, 22, 23, 24, 26, 28, 30, 31, 32, 33
3	Capabilities	1, 3, 11, 12, 15
4	Characteristics	2, 4, 5, 6, 8, 25

Table 5. Descriptive Statistics of Sample (n=52)

Personal	Percentage
Age	
Under 25 years old	6.8
Between 25 and 45 years old	85
More than 45 years old	8.2
Gender	
Male	96.2
Female	3.8
Marital status: Married	94.2
Level of Education	
Under diploma	10
Diploma	30
University degree	60
Previous Experience	
In related sector	49
Management experience	30
Entrepreneurial experience	23.5
Organizational	Percentage
Business Lifetime	
Less than 1 year	34.6
Between 1 and 2 years	34.6
Between 2 and 3 years	11.5
No response	19.2
Business Activity	
Metal industry	9.6
Mineral nonmetal industry	21.2
Alimentary industry	11.5
Electronic industry	1.9
Weaving industry	3.8
Chemical industry	30.8
Cellulose industry	5.8
No response	15.4

Table 6. The Result T-Test and Friedman Analysis

No	Individual factors	Mean	t	Sig	Mean Rank
1	Change of motivation and lack of motivation to continuation the job	3.23	1.3	0.1	3.37
2	Lack of crisis management skills	4.40	13.1	0	5.35
3	Lack of marketing, financial, human resource and team management skills	3.62	4.4	0	4.38
4	Lack of capabilities (time, knowledge and experience)	2.19	-5.3	1	1.92
5	Have a traditional look in business	2.92	-0.5	0.7	3.13
6	Insist on mistake	2.77	-2.1	0.95	2.87

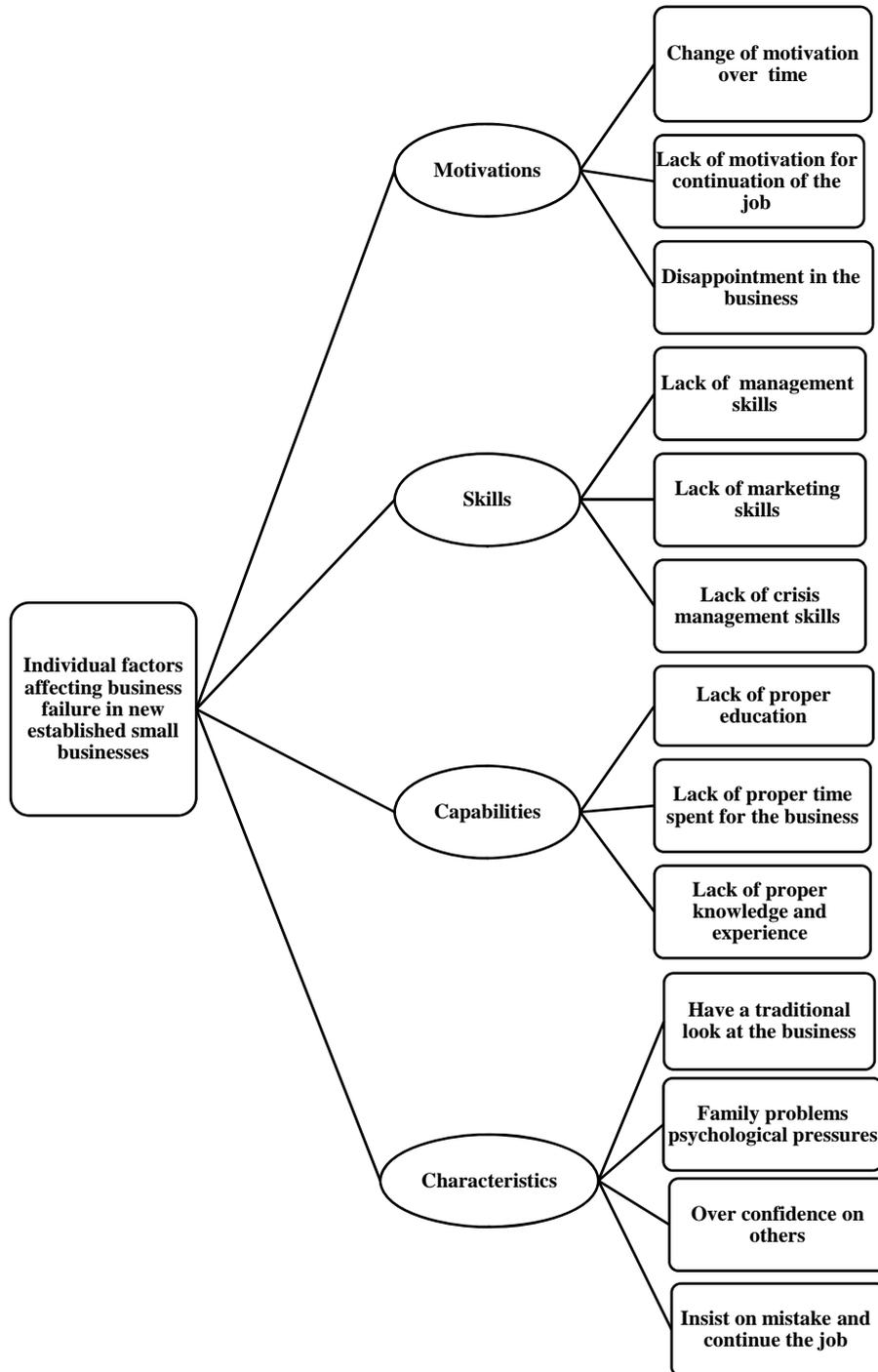


Figure 1. Individual Factors Affecting Business Failure of Iranian New Established Small Businesses