Entrepreneurs typically learn from failure business essay

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In the literature, there is no specific definition of failure. Every author that will be discussed in this essay has described failure using different parameters. Therefore, it is not possible to use a particular author's definition because their work is based on their different definitions. To begin with, one of the widely accepted definitions of failure is " the termination of a business that has fallen short of its goals, thereby failing to satisfy principal shareholder expectations" (Beaver and Jennings, 1996 mentioned in Cope, 2011, pp 605). This differs from the definition of Cochran, 1981, mentioned in Cope (2011, pp 605 Carter and Evans 2012, pp 181) who suggests failure as " bankruptcy or liquidation as the loss of capital and an inability to make a go of it". However, a similar view is shared by Shepherd (2003 pp. 318), who feels that " business failure occurs when a fall in revenues and/or a rise in expenses are of such that the firm becomes insolvent and is unable to attract new debt or equity funding; leading to the inability of operating under the current ownership and management". Oxford dictionary defines typical as having the distinctive qualities or characteristics of a particular type of person or thing or informal showing the characteristics expected of or popularly associated with a particular person or thing. It is typically expected that entrepreneurs will learn from failure. This essay will discuss the reasons the why entrepreneurs fail, the factors that increase the probability of failure, how and what entrepreneurs learn from failure. In the essay, all the theories or literature that has been mentioned is in context to small firms. The reasons they have been targeted is because there is higher incidence of faillure in small firms and are more likely to close than larger ones (Blackburn and Stokes, 2002).

To understand success, it is important to understand failure (Carter and Evans 2012). Sitkin (1992) as cited in Shepherd (2003 pp. 318) argues that failure is more important than success for learning. Sir James Dyson, the founder of Dyson Company (Entrepreneur 2012) also believes that a person never learns from success, but they do learn from failure.

The causes that lead to business failure have been divided into two categories; internal and external failures. The following table shows the internal and external factors contributing to failure of a business:

Internal and external factors contributing to failure cited in Carter and Evans (2012, pp. 184)

One of the major internal cause of failure is poor management – an event that occurs as a lack of entrepreneurial or managerial attention or focus (Carter and Evans, 2012 pp. 184-184). Beaver (2003 mentioned in the Carter and Evans. 2012 pp. 184) refers to a research done by Dun and Bradstreet in 1991 which proves that the primary cause of business failure in the USA is due to management incompetence of the business owner. This view is confirmed by Thornhill and Amit (2003 as mentioned in Cope, 2011) who also consider lack of management and financial planning skills as the most common causes of firm mortality.

Authors like Brough (1970); Stanford (1982); Hall (1992); Beaver and Jennings (1995) as mentioned in Beaver (2003 pp. 117) consider finance, demand forecasting, management, marketing, capitalization at start-up and strategy and planning as the main causes if business failure in small firms. Another view by Beaver (2003 pp. 117) is that if business start-ups are a

desperate response to unemployment, rather than based on sound principles and the committed fashioning and management of competitive advantage, it is inevitable that many firms will fail.

The external factors of failure are those that are beyond the control of even the most capable entrepreneurs and will trigger problems in new firms (Osborne, 1993 as mentioned in Carter and Evans, 2012 pp. 184). Entrepreneurs tend to attribute failure to external causes, such as market conditions and financial problems through a process known as attribution theory (Carter and Evans, 2012 pp. 184). Rosa, Carter and Hamilton (1996 as mentioned in Carter and Evans, 2012 pp. 185) interviewed 600 UK small business owner-managers and found that most of the business people tend to blame external factors to their possible shortcomings. The reason why entrepreneurs don't want to be associated with failure is due to the potential danger to their self-esteem (Cannon and Edmondson, 2005 Carter and Evans, 2012, pp. 185). This view has been encouraged due to the social norm of failure being regarded as a negative event and the stigmatization (Cope, 2011). One of the external causes of failure mentioned in Carter and Evans (2012) is bankruptcy of main customer or supplier. Len Rainford, M. D., Sameday UK went through the same problem with his business of warehousing when his biggest customer had gone bust. However, with the help of his banks and accountants, he was able to recover losses and make profits within 3 years. A similar problem was also faced by Vikram Talwar, founder of EXL Service, one of India's largest BPOs when their only client, Conseco went bankrupt (Bansal, 2008). They were able to recover because of the strategies of the management and help of the investors.

Other than the causes of failure, there are certain factors that increase the probability of failure. There are two main independent factors that are important determinants of a firm growth; size and age (Storey, 1994, Carter and Evans, 2012 and Bates and Nucci, 1990). Bates also found that firm age was the strongest single determinant of small business survival among firms owned by white males (Bates and Nucci, 1990 pp. 10).

The empirical evidence on the negative relationship between size and age of the firm and the failure rates had been unanimous (Storey, 1994). There have been various studies to prove this relationship for example; the study done by Dunne, Roberts and Samuelson in 1989 (Storey, 1994 pp. 92)on manufacturing plants showed that the average failure rate for plants with employees in between five to nineteen was 104. 7 % higher than for plants with more than 250 employees. In this case, they had used the number of employees as a factor to recognize the size of the business. A similar study done by Gallagher and Stewart in 1985 as cited in Storey (1994 pp. 92) found that a firm employing less than twenty people was 78% more likely to fail over the next decade as compared to the one employing more than 1, 000. On comparison of the size of the firm in terms of the net assets, it was found by Dunne and Hughes (1992 mentioned in Storey, 1994 pp. 92) that the non-survivors over the 1980-5 period constituted 27% of those with net assets less than £1m, compared with 14 % of those with net assets exceeding £64m. In terms of age, Hudson (1987b mentioned in Storey, 1994 pp. 93) finds clear evidence that insolvency is a characteristic more suitable for young firms. He found that 61% of the firms that became insolvent did so

between 2-9 years after formation and that there was a peak age of 2-5 years.

Entrepreneurs who focus more on the success of the more than failure are also more likely to fail because drawing lessons from successes is much more difficult as success does not create an urgent need to enrich current knowledge structures or behaviors and on the other hand it reinforces existing beliefs and routines. (Ellis et al., 2006 mentioned in Cope, 2011).

After establishing the causes of failure, it is also important to understand how entrepreneurs recover and move on to learn lessons from failure. Failure causes damage not only financially and emotionally but also relationally and recovering and moving on from failure includes overcoming these costs too (Shepherd et al, 2009 mentioned in Cope, 2011 pp. 613 and Cope, 2011). According to Cope (2011) failure does not necessarily produce any long-term negative professional consequences as the key stakeholders accept failure as a fact of life in the start-up community. Cope (2011) feel that this encourages the entrepreneurs who are concerned about the possibility of receiving future support for their ideas as failure is not automatically considered a black mark by other professionals.

Shepherd (2003) and Shepherd and Kuratko (2009, pp. 451) use the word grief to define the emotional response to the loss of something important which causes behavioral, psychological, and physiological symptoms. The more important the project to the innovator, the more extreme the negative emotional reaction incurred upon failure (Shepherd and Kuratko, 2009, pp. 452). Shepherd and Kuratko (2009, pp. 452) also mention that grief can

obstruct learning from failure and in such circumstances; learning from failure involves a process of regulating the negative emotions. This process is called ‘ grief recovery’ (Shepherd 2003, Shepherd and Kuratko 2009). He argues that an individual has recovered from grief when thoughts surrounding the loss of the business no longer generate a negative emotional response.

Oscillation between the two models of coping behavior is the most effective in speeding

the recovery process.

Shepherd (2003) and Shepherd and

Kuratko (2009)

Involves actively confronting the loss and associated negative emotions in order to work through what happened and make sense of the failure. Shepherd (2003) and Shepherd and Kuratko (2009)

Avoiding, suppressing and purposefully distracting oneself from loss-related thoughts, allowing gradual fading of memories related with the loss.

Shepherd (2003) and Shepherd and Kuratko (2009

Figure 1: Using Shepherd’s approach to grief recovery as cited in Shepherd (2003) and Shepherd and Kuratko (2009).

The process of oscillation (shown in figure 1) is important as it gives the innovator the benefit of both orientations while minimizing the costs of maintaining either for an extended period and also allows them to learn

more from their failure experiences (Shepherd, 2003 and Shepherd and Kuratko 2009). In order to be effective, the oscillation approach requires the innovator to confront the loss and work through the events leading up to the failure; to distract one's thoughts away from the failure event to focus on addressing secondary causes of stress; and to recognize when one orientation has been held too long and be able to switch to the other orientation (Shepherd and Kuratko, 2009, pp. 454).

Grief is generated not only amongst the entrepreneur but also the team members (Shepherd, 2003). The organizations form support groups through which they provide an opportunity for their members to interact with others who have experienced a sense of loss. By interacting with others who have experienced similar grief-inducing events, individuals can model coping behaviors and build their coping self-efficacy skills (Shepherd, 2003). However, the amount of feedback information available also appears to impact the degree to which grief interferes with the learning process (Shepherd, 2003).

People learn using the outcome of action (feedback) to revise their belief systems (Huy, 1999; Kim, 1993; Weick, 1979 as mentioned in Shepherd, 2003, pp. 320). For the self-employed, learning from business failure occurs when they can use the information available about why the business failed to revise their existing knowledge of how to manage their own business effectively (Shepherd, 2003 pp. 320). For example, Ravi Kalakota has learned a number of lessons from the loss of his business, Hsupply. com, such as don't let venture capitalists hijack your vision, don't burn through capital rapidly to achieve short-term growth, and don't underestimate the

speed others will imitate your products and services (Gilbert, 2000 as mentioned in Shepherd, 2003, pp. 320).

Following the understanding of the reasons for failure and how they learn from failure, it is now important to acknowledge the learning from failure. According to Len Rainford, “ there is no such thing as failure, it’s a learning curve”. He supports that even if entrepreneurs fail, they start again because they believe in bouncing back from failure and trying something else. An example of this is Sir James Dyson, the founder of Dyson Company. When he invented his first Dual cyclone vacuum cleaner, he spent 15 years creating 5, 126 versions that failed and all this paid off in the form of a multi-billion dollar company that it is now (Entrepreneur, 2012).

In the literature, the learning specifically points towards the launch of a new venture. It has been repeatedly mentioned by various academics that entrepreneurs who have learned from failure have become more motivated to start another enterprise (Cope 2011, Stokes and Blackburn, 2002)

An example of entrepreneur learning from failure is Madan Mohanka, founder of Tega Industries, the world’s third largest company designing solutions in the field of mining equipment (Bansal, 2008). When his company was having huge cash flow problems, and was almost on the brink of bankruptcy, he learnt some valuable lessons. The first one is that an entrepreneur should at least plan for 50% or double the investment, the second one is that if an entrepreneur believes in his/her product and business, he/she should never give up (Rashmi Bansal, 2008). When Madan went bankrupt, he mortgaged his wife’s jewelry, but did not abandon the dream.

Due to the failure, they learn lessons regarding what they should have done and how they can do it better and this adds value to the entrepreneur's " stock of experience" (Reuber and Fischer, 1999 in Cope, 2011, pp. 618) , " stock of knowledge" (Minniti and Bygrave, 2001; Reuber and Fischer, 1999 mentioned in Cope, 2011 pp. 605)and improves the level of " entrepreneurial preparedness" for the future entrepreneurial activity (Cope, 2005a; Harvey and Evans. 1995; cope and Zacharakis et al., 1999 ; Stokes and Blackburn, 2002 mentioned in Cope, 2011, pp. 618). This is done by revising previously ineffective routines, highlighting the mistakes, spotting new opportunities (Gupta, 2005; Politis, 2005) and expanding the skills and knowledge about the entrepreneurial process (Cope, 2011, pp. 618). '

Many entrepreneurs become successful serial entrepreneurs (Cope, 2011). According to the research done by Stokes and Blackburn (2002); 62% of entrepreneurs who failed, continued as a business owner in some way and almost three-quarters of their respondents also agreed that they have improved their skill in personal management areas like coping with setbacks, self-management and adapting to change. An example of this is Shankar Maruwada, owner of Marketics, an analytics company. When his first business went bust, he learnt his first lesson of failure; " things don't as per plan" and he and his team used the failure to get it right the second time with Marketics (Bansal, 2008). This proves the positive learning experience of failure. The repeated reference to a better awareness of " pressure points" " warning signs" and " stresses and strains" during the entrepreneurial process is evidence of the productive and practical learning outcomes of failure (Cope, 2011). Failure is also called a " trial and error" (Gibb, 1997;

Politis, 2005 in Cope, 2011) approach for entrepreneurs to understand “ what works and doesn’t work” (Sarasvathy and Menon, 2002, mentioned in Cope, 2011) thus increasing the probability of success.

Experiencing failure has also been found to lead to more positive attitudes to failure (Politis and Gabrielsson, 2009 in Shepherd, 2003). Studying and learning from failure can help entrepreneurs to avoid falling into unreflective cognitive ruts or “ learning traps” (Rerup, 2005; West and Wilson, 1995 in Shepherd, 2003). A study done by Scholl-hammer (1991) mentioned in Shepherd (2003) suggests that 51 percent of all entrepreneurs in the United States have previous owner-manager experience. This view is also supported by Timmons (1999 mentioned in Shepherd, 2003), who considers failure as a necessary step to success.

From the work of various researchers and especially Cope in the field of entrepreneurial learning, it is clear that entrepreneurs who have experienced failure are more prepared than those who have only enjoyed success. Learning from failure but it is not an automatic or instant process and thus requires time in moving on from the understanding of the failure and its causes to generating learning outcomes from it. Processes that fail lead to grief and by using methods like loss orientation, restoration orientation, and oscillation between these two methods, causes grief recovery (Shepherd, 2003). Learning is a dynamic and on-going process and it will take place during and beyond the process of failure (Bower, 1990 as mentioned in Shepherd, 2003, pp. 320). However, entrepreneurs will eventually move on and recover from the grief.