



## WHY SMALL BUSINESSES FAIL: AN EMPIRICAL LITERATURE REVIEW

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### Abstract

*Small businesses play a critical role in global economies, contributing significantly to employment, innovation, and GDP. However, their high failure rates—up to 50% within the first five years—highlight the need for a deeper understanding of the factors contributing to failure. This study synthesizes empirical research to identify the primary causes of small business failure, categorized into financial constraints, managerial deficiencies, market challenges, and environmental factors. Financial constraints include limited access to capital, poor financial management, and liquidity issues. Managerial deficiencies, such as lack of experience and ineffective decision-making, further exacerbate vulnerabilities. Market challenges stem from inadequate research, competition, and fluctuating demand, while environmental factors, including regulatory burdens and economic instability, amplify external pressures. The findings emphasize the interplay between internal and external challenges and highlight regional and sectoral variations. This review provides actionable insights for entrepreneurs, policymakers, and researchers, advocating for improved financial access, managerial training, and policy reforms to support small business resilience.*

*Keywords: Small business failures, SMEs, financial constraints, managerial deficiencies, market challenges, regulatory burdens*

## INTRODUCTION

Small businesses are the backbone of economies worldwide, contributing significantly to employment, innovation, and GDP. Small businesses have been the means through which accelerated economic growth and rapid industrialization have been achieved (Harris and Gibson, 2006; Sauser, 2005; van Eeden, Viviers and Venter, 2004; Arinaitwe, 2002; Kiggundu, 2002). Despite their pivotal role, small businesses often face high failure rates, with research indicating that up to 50% of small businesses fail within the first five years (OECD, 2020). While the contributions of small businesses to development are generally acknowledged, small business owners face many obstacles that limit their long-term survival and research on small business development has shown that the rate of failure in developing economies is higher than in the developed economies (Arinaitwe, 2002). This persistent challenge has raised concerns among policymakers, entrepreneurs, and researchers alike.

Understanding the causes of small business failure is critical to mitigating risks and fostering sustainable economic growth. While anecdotal evidence suggests a range of factors—such as inadequate funding, poor management, and competitive pressure, an empirical approach is necessary to identify, quantify, and analyze these causes systematically.

This literature review aims to synthesize findings from empirical studies on small business failure across various industries and geographic contexts. By examining these studies, the review identifies key contributing factors, highlights patterns and variations, and discusses implications for stakeholders. Additionally, it seeks to uncover gaps in the existing research, offering a roadmap for future investigations.

## METHODOLOGY

### Research Design

This review study adopts a systematic approach to identify, analyze, and synthesize empirical studies on the causes of small business failure. The methodology follows established guidelines for conducting systematic reviews, ensuring rigor, transparency, and replicability (Tranfield et al., 2003).

### Data Sources and Search Strategy

The review utilized multiple academic databases, including Scopus, Web of Science, JSTOR, and Google Scholar, to gather relevant studies. Keywords such as "*small business failure*," "*SME challenges*," "*entrepreneurship failure*," and "*factors influencing SME performance*" were used to identify empirical research. Boolean operators (e.g., AND, OR) and filters were applied to refine the search.

## **Inclusion and Exclusion Criteria**

To ensure relevance and quality, the review included studies meeting the following criteria:

- Published in peer-reviewed journals between 2000 and 2023.
- Focused on small and medium enterprises (SMEs).
- Employed empirical methods, such as surveys, case studies, or econometric analyses.
- Investigated causes of business failure, whether internal, external, or systemic.

Studies were excluded if they:

- Focused solely on large corporations or informal enterprises.
- There were theoretical papers lacking empirical validation.
- Were published in non-English languages without accessible translations.

## **Rationale for Period Selection (2000 – 2023)**

The selected period (2000 – 2023) ensures the inclusion of contemporary studies that reflect the evolving business landscape, economic conditions, and regulatory frameworks. Research published within this time frame provides relevant insights into recent small business challenges, including financial access, technological disruptions, and market dynamics. Additionally, selecting studies from this period allows for an assessment of how global crises (for example, the 2008 financial crisis and the COVID-19 pandemic) have impacted small business failure.

## **Study Selection Process**

A three-step selection process was implemented:

**Initial Screening:** Titles and abstracts were reviewed to identify potentially relevant studies.

**Full-Text Review:** Eligible studies underwent a detailed examination to confirm their alignment with the inclusion criteria.

**Data Extraction:** Key data points, such as study context, methodology, sample size, and findings, were systematically extracted and tabulated.

## **Data Analysis**

Thematic synthesis was employed to identify recurring factors and patterns across the studies (Thomas & Harden, 2008). Findings were categorized into four primary themes: financial constraints, managerial deficiencies, market challenges, and environmental factors. Sub-themes within each category were further analyzed to provide a nuanced understanding of the factors influencing small business failure.

## Limitations of Methodology

While this review adheres to rigorous standards, it is subject to several limitations:

- Potential publication bias, as studies with significant findings are more likely to be published.
- Geographic and sectorial variations in study contexts may limit generalizability.
- Exclusion of non-English studies could overlook valuable insights from non-Anglophone regions.

## LITERATURE REVIEW AND SYNTHESIS

This section synthesizes empirical findings on the causes of small business failure, categorized into four major themes: financial constraints, managerial deficiencies, market challenges, and environmental factors. Each theme is explored with supporting evidence from relevant studies, followed by an analysis of patterns, contradictions, and contextual variations.

### Financial Constraints

Financial challenges are among the most frequently cited causes of small business failure. Studies highlight that insufficient access to capital, poor financial management, and liquidity issues are critical factors undermining sustainability.

**Access to Capital:** Limited access to funding sources, such as bank loans or venture capital, is a significant barrier for SMEs, particularly in developing economies (Bruno et al., 1987; Fatoki & Asah, 2011).

**Financial Mismanagement:** Ineffective financial planning and lack of budgeting skills contribute to cash flow problems, leading to insolvency (Gaskill et al., 1993; Berryman, 1983).

**Liquidity and Debt Issues:** Studies reveal that excessive reliance on short-term debt increases financial vulnerability, particularly during economic downturns (Cressy, 2006; Watson, 2003).

### Managerial Deficiencies

Managerial competence plays a central role in small business success. Empirical studies consistently point to a lack of skills, experience, and strategic vision as major contributors to failure.

**Lack of Experience:** Entrepreneurs without prior business experience are more likely to make critical mistakes (Shepherd et al., 2000; van Gelder et al., 2007).

**Poor Decision-Making:** Ineffective leadership and flawed strategic decisions are common factors leading to failure (Storey, 1994; Lussier, 1995).

### **Market Challenges**

Navigating competitive markets poses significant challenges for small businesses.

**Inadequate Market Research:** Failure to understand customer needs leads to ineffective product positioning (Stokes & Blackburn, 2002).

**Competition:** Small businesses often lack resources to compete with established firms (Peng, 2001).

### **Environmental Factors**

External environmental factors, such as regulatory frameworks, economic conditions, and technological advancements, significantly influence small business survival.

**Regulatory Burdens:** Complex tax structures and licensing requirements impose high compliance costs (Blackburn et al., 2013).

**Economic Instability:** Recessionary periods and inflation disproportionately affect small businesses (Carter & Van Auken, 2006).

### **Synthesis and Patterns**

Empirical studies indicate that small business failure is often the result of an interplay between internal and external factors. For instance, financial constraints may stem from poor managerial decisions, while market challenges could be exacerbated by regulatory hurdles. Notably, regional variations in the causes of failure highlight the importance of contextualizing findings. For example:

- In developing economies, financial access and regulatory burdens are prominent challenges (Fatoki, 2014).
- In developed economies, competition and technological disruptions are more pronounced (Beck et al., 2006).

## **DISCUSSION**

### **Key Insights from Literature**

The empirical review reveals that small business failure is influenced by a complex interplay of financial, managerial, market, and environmental factors. These insights underline

the multidimensional nature of business challenges, where internal weaknesses are often exacerbated by external pressures.

**Financial Constraints as a Core Challenge:** Financial issues remain at the heart of small business failure. Limited access to capital, poor financial management, and liquidity problems are universally acknowledged challenges. Addressing this requires more accessible financing options, particularly for businesses in early growth stages. Government-backed loan programs and microfinance initiatives have shown promise in mitigating these issues, especially in developing economies (Beck et al., 2006).

**Managerial Competence as a Determinant of Success:** Managerial deficiencies, including lack of experience, strategic vision, and decision-making skills, are critical internal weaknesses. The findings highlight the importance of managerial training and education programs aimed at equipping entrepreneurs with skills in leadership, financial management, and market analysis. Tailored mentorship programs can provide additional support, helping entrepreneurs navigate complex challenges (Shepherd et al., 2000).

**Market Challenges and Competitive Pressures:** The inability to adapt to market demands, conduct effective research, or compete with established players remains a recurring theme. SMEs should adopt agile business models that allow for flexibility in product offerings and marketing strategies. Partnerships, co-branding opportunities, and leveraging digital platforms can help small businesses compete more effectively.

**Environmental and Policy Implications:** Regulatory burdens, economic instability, and technological disruptions disproportionately affect small businesses. Policymakers must create a supportive ecosystem by simplifying compliance processes, offering tax incentives, and facilitating access to technological resources. For instance, digital transformation grants and training initiatives could help SMEs harness technology for growth and innovation.

### **Implications for Stakeholders**

**For Entrepreneurs-** Entrepreneurs must prioritize skill development, seek mentorship opportunities, and implement robust financial management practices. Strategic planning and continuous market research are essential to staying competitive.

**For Policymakers-** Policymakers should focus on creating a conducive environment for small businesses by streamlining regulations, increasing access to affordable credit, and supporting innovation through technology adoption programs.

**For Researchers-** This review highlights the need for further empirical studies examining the interplay of internal and external factors. Future research should explore longitudinal impacts and regional variations in business failure.

### **Research Gaps and Directions for Future Studies**

Despite significant contributions, the literature exhibits several gaps:

**Geographic Bias-** Most studies focus on developed economies, leaving a gap in understanding the unique challenges faced by small businesses in developing regions. Future research should address this imbalance to provide a more global perspective.

**Sectoral Analysis-** Empirical evidence on industry-specific causes of failure is limited. Studies comparing factors across sectors such as retail, manufacturing, and services would provide deeper insights.

**Longitudinal Studies-** Existing research often captures a snapshot of challenges without tracking businesses over time. Longitudinal studies could offer a clearer picture of how internal and external factors evolve and interact to influence outcomes.

### **CONCLUSION**

This literature review has synthesized empirical evidence to uncover the multifaceted causes of small business failure. Financial constraints, managerial deficiencies, market challenges, and environmental factors emerge as the primary drivers, with significant interplay between these domains. Limited access to capital, inadequate financial management, and liquidity issues undermines financial stability, while poor managerial skills and strategic decision-making compound internal vulnerabilities. Externally, intense competition, insufficient market research, and regulatory burdens exacerbate the risks faced by small businesses.

The findings underscore that small business failure is rarely caused by a single factor but rather a convergence of internal weaknesses and external pressures. Moreover, the regional and sectoral variations in the causes of failure highlight the need for tailored interventions that address specific contexts.

### **RECOMMENDATIONS**

#### **For Entrepreneurs**

**Skill Development:** Participate in training programs focused on financial literacy, leadership, and strategic planning. **Market Research:** Invest in understanding customer needs and competitive landscapes to enhance product-market fit. **Adaptive Strategies:** Implement flexible business models that allow for rapid adaptation to market or environmental changes.

### **For Policymakers**

**Access to Finance:** Expand government-backed loan schemes, microfinance programs, and venture capital initiatives targeting small businesses. **Regulatory Support:** Simplify compliance procedures and offer tax incentives to reduce administrative burdens. **Technology Grants:** Facilitate digital transformation by providing subsidies for adopting new technologies and training in digital skills.

### **For Researchers**

**Broaden Geographic Scope:** Focus on SMEs in under-researched regions, particularly in developing economies. **Sectoral and Comparative Studies:** Examine industry-specific factors and cross-sector comparisons to provide targeted insights. **Longitudinal Analysis:** Conduct long-term studies to capture the evolving dynamics of small business challenges and success.

### **For Educators and Mentors**

**Entrepreneurship Education:** Develop comprehensive curricula that integrate real-world case studies and practical tools. **Mentorship Programs:** Establish networks connecting experienced business leaders with aspiring entrepreneurs for guidance and support.

## **FINAL THOUGHTS**

Small businesses are integral to economic growth and societal progress, yet their failure rates remain alarmingly high. The evidence presented in this review provides a roadmap for mitigating failure by addressing key financial, managerial, market, and environmental challenges. Through collaboration between entrepreneurs, policymakers, researchers, and educators, sustainable solutions can be developed to empower small businesses, reduce failure rates, and drive global economic prosperity.

**Entrepreneurs:** Entrepreneurs must prioritize financial literacy, strategic planning and continuous skills development. Investing in professional training and mentorship programs can significantly improve decision-making capabilities. Additionally small business owners should seek diversified funding sources, including government grants, venture capital and micro finance initiatives to reduce financial constraints. Building strong market research capabilities will help in understanding customer needs and responding effectively to competition. Leveraging digital tools and e-commerce platforms can also provide a competitive edge in rapidly evolving markets.

**Policymakers:** Governments and policymakers should create an enabling environment for small businesses by simplifying regulatory requirements, reducing bureaucratic barriers and



enhancing access to financial resources. Implementing tax incentives, subsidies and streamlined business registration processes can encourage entrepreneurship. Furthermore, establishing publicly funded entrepreneurship training programs can equip small business owners with the managerial and financial skills necessary for long-term sustainability. Support for digital transformation initiatives, including subsidized access to technology and digital marketing training, can help small businesses remain competitive in the modern economy.

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