What is business failure? A philosophical perspective

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Abstract. What constitutes a business failure? For example, it can be argued that there is no failure until the entrepreneur stops trying. Or, it can be argued that the business process is a continuous failure based on a cycle of trial and error. We can equally argue that the bankruptcy does not indicate failure; rather, ceasing the business is a rational choice of seizing a better opportunity. Or, we can argue that bankruptcy is always a proof of inefficient use of resources. Seemingly, failure can be approached from many alternative viewpoints of research and practice. In this paper, we discuss failure from a philosophical standpoint, tackling polarized perspectives of failure and their underlying logics.

Keywords: business failure, failure research, concept of failure
1 Introduction

Success and failure are often seen as two sides of the coin, so that by avoiding the latter, the former becomes more achievable (Rovenpor, 2004). However, survival is not a synonym for success, as individuals define it in their own terms (Cope, 2010). For example, having some revenue is generally seen less of a success than having a lot of revenue – yet, for a startup company any revenue may represent an important auspice of success. Like revenue, optimal use of resources is not a synonym for success, because a firm’s performance in a competitive environment depends on the ability of other firms to leverage resources (Beaver, 2003). Therefore, there are different degrees of success and, respectively, varying degrees of failure – in a word, relativity. This paper discusses the concept of failure, its nature and boundaries. By “philosophical perspective” we refer to asking profound questions, analyzing conceptual underpinnings, and maintaining a critical eye for existing research. Our goal is to better understand the alternative views and to communicate them to three stakeholder groups: entrepreneurs, researchers, and policy makers.

2 Method

This paper is a spinoff from a doctoral dissertation, presenting some outcomes from that research process. Because business failure has been studied in many fields of discipline, we performed a search query in the major business research databases by using a set of pre-determined keywords relating to failure, such as “failure”, “business failure”, “bankruptcy”. Articles for the literature review were selected based on their abstracts and, in sum, 114 journal articles relating to business failure were retrieved. These articles were reviewed to discover polarized views relating to the concept of failure.

3 Literature review

3.1 What is failure? Event versus process

Among the many polarizations relating to the concept of failure, it is possible to argue that there is no failure until the entrepreneur stops trying, for example because he perceives the future gains lower than the effort of staying in business (Gilad, Kaish, & Loebl, 1985). Or, it can be argued that the business process is a continuous failure based on a cycle of trial and error (Stokes & Blackburn, 2002). Similarly, failure may be seen as a discrete event of discontinuance or bankruptcy (Peat, 2007) – or, as a process leading to any undesired business outcome with varying degree of
definitiveness (Ooghe & Prijcker, 2008). By combining these dichotomies, we can even argue that *bankruptcy does not indicate failure*; rather, it is possible that ceasing the business is indeed a rational choice determined by learning gains (Coelho, 2005), opportunity cost of remaining in the business as oppose to closing it (Blum, 1974), or seizing a more lucrative business opportunity (Theng & Boon, 1996). The specific definition of failure carries theoretical and practical importance: if we argue that bankruptcy is a sign of failure we must also concur that bankruptcy statistics are the best way of researching failure. However, it is easy to see that a) bank ruptcies do not include all failed business ventures, e.g. incorporated startup projects, and b) not all discontinuances are a failure. Such is the case when there is no loss to creditors (Lussier, 1996), when the entrepreneur makes a profitable exit, or the company merges with another one. As the organizational entity ceases to exist, it is classified as a discontinued business, whereas the stakeholders consider the venture as a success. Spin-offs by serial entrepreneurs are desirable contingencies of discontinuing an organization in its extant form through an exit, and their number can be used to measure the learning gains of failure (Feeser & Willard, 1989).

### 3.2 Interpretative definition of failure

Regarding entrepreneurs, Gulst and Maritz (2009) define failure as deviation from the entrepreneur’s desired expectations. This definition builds relativity inside the concept; failure becomes an interpretation as oppose to a fact. The downside of the approach is that it requires extraneous effort from an outsider, such as researcher, to find out whether failure has taken place. Additionally, as founders may interpret failure differently, similar events may be reported as a failure and non-failure depending on the case – in effect, classification attempts become difficult as no common definition for failure can be agreed upon. We can imagine a case which is judged as a failure by a highly ambitious entrepreneur – or venture capitalist, for that matter – but a success by another, perhaps a less ambitious lifestyle entrepreneur. Based on this *interpretative definition*, no decisive definition of failure is possible. Not only this, but the perception of failure or success can change over time as the entrepreneur’s mind develops, not remaining stable even within the individual (Beaver, 2003). Clearly, whether failure took place or not becomes a question of goals and motives of the entrepreneur and, if taken into account, the views of different stakeholder groups who may simultaneously judge the venture both a success and a failure. For example, investors typically see failure in terms of negative return on investment (Zacharakis et al., 1999), whereas entrepreneurs adopt different criteria, such as achievement or personal satisfaction. Even within a same group of people, there may be opposing views. This pluralism of interpretation causes headache for the researcher: Which interpretation is the truth? Finally, research of failure is cross-disciplinary, united not necessarily by the same theoretical underpinnings, but a shared interest in the phenomenon. The researcher has his own theoretical bias: for example, organizational theorists are interested in finding different explanations to failure than scholars of strategic management, accounting, or marketing (Rovenpor, 2004). Hence, even scholars are not free from interpretation, nor it is said here that they should be.
3.3 Failure of ventures and failure of people

Clearly, we must separate the failure of a venture from the failure of the adventurer because a failed venture is not the end of the entrepreneur. One can argue there are no failed entrepreneurs, only failed ventures (Gulst & Maritz, 2009). Or, in contrast, the entrepreneur can be seen failing when he stops trying without success. When the probability of future entrepreneurial activities is low after failure, it is justified to speak of failure of the entrepreneur. Nevertheless, the separation of the individual from the event is a useful one. The personal benefits of failure relate to learning: When a failure, e.g. bankruptcy – if applying the bankruptcy definition – has taken place, we need to assess the quality of learning to determine the degree of failure. From an economic perspective, the costs of failure need to be weighed against the learning gains which will ideally materialize as a higher chance of success in future ventures. If the failure case leads to the entrepreneur starting a company of great success, the return on failure has in fact been extremely positive. If no such gains materialize, the value of learning is low or zero, and the return on failure is negative. In fact, it is crucial for the society that entrepreneurs recognize more lucrative opportunities and are able to act upon them, even if this results in discontinuance of slow-moving projects in the favor of higher risk, higher gains. As there is no known formula for accurately recognizing the value of opportunity, any such learning and experience that helps entrepreneurs in developing practical capability of estimation is a desirable feature of failure. Shifting resources to more profitable allocations is a requisite for dynamic economy, even if it is seen as a failure from a micro-economic perspective (Fredland & Morris, 1976). However, it is obvious that there are sunk costs of failure associated with a venture that did not perform as expected, which need to be weighed against the benefits for society and the individual. Nevertheless, the separation of failure of venture and failure of entrepreneur is not without a connection to society and its ability to approve or disprove failure.

3.4 Problems of explaining failure

In searching for the reasons for failure, one faces several issues, of which three are discussed. First, the attribution problem, or, how to assign a cause for failure? For example, the reports by founders or managers may be biased – either intentionally or unintentionally presenting a distorted view or leaving out information. The typical reporting biases, such as the recall bias (Podsakoff & Organ, 1986), are applicable to survey research, often used to find correlations between various internal and external factors and failure. Founders may be unable to understand or articulate causality (Bruno et al., 1987), and sense-making involved in the process is vulnerable to biased interpretations due to complexities of the business process, such as long timeframe, several participants with potentially opposing views, and unknown factors residing outside the company, e.g., customers’ interpretations, that would reveal new angles. The rationale for attribution is that by knowing causes for failure one is able to take preventative action against them (Abdelsamad & Kindling, 1978). However, the relationship between knowing the cause and preventing it from taking place is not eminent – there is a need for strategic transition that goes deeper into understanding
the particularity of the business process at hand. For example, knowing that a lack of capital causes business mortality in some cases has little value in an individual case, but connecting that insight to strategic action may increase prevention. However, if most research efforts are put to finding the cause instead of finding creative solutions, the strategic dimension can easily become neglected. Therefore, generic explanations risk losing their explanatory power under particular contexts – knowing that management shortcomings are a reason for failure is not useful for the manager making strategic choices in his own business environment (as oppose to policy makers who need different kind of information, perhaps of aggregated type).

Second, the credibility of explanations is affected by the interpretation problem: the researcher interpreting the interpretations of the informant, or correlations in the data (Smith & Osborn, 2008). Such an activity, as argued earlier, is vulnerable to researcher’s bias, as theoretical frameworks guide the direction. Third, there is the classification problem: How do we classify reasons for failure? When going into the core of failure, we can, for example, narrow all causes down to financial reasons: The venture did not produce sufficient returns, and was cancelled as a consequence. Or, if we apply a perspective of human action: All reasons of failure relate to the shortcoming of team/managers, because it was their choices that lead to the failure. Should they have chosen otherwise, the firm could have continued. Hence, failure becomes a consequence of entrepreneurial actions. Further, in most cases we can reduce the root cause to demand: There was not sufficient market demand, so the company had no chance to survive, regardless of any strategic choices the management could have pulled off. But how can we separate the market from the product? Clearly, if there would have been a different or better product, there would have been demand for it – after all, there is always demand for something in the market. Thus, it is equally right to say all failures result from the shortcomings of a product, just as it is to argue failure was due to lack of market demand. As such, none of these explanations are right or wrong – or they are all equally so.

Finally, communicating the classification to other researchers is troublesome: general categories such as “Management incompetence”, “Bad product”, or “Wrong timing”, can be highly contestable, hard to verify, and inadequately defined by the researcher (Beaver, 2003). It is imperative that the researcher clarifies what he means e.g. by “Management incompetence”, why it was chosen in the classification scheme, and what are its boundaries – what is included and excluded. Further, what is the role of such classifications in attribution of failure? Can we, for example, argue that management caused 50% of failure, product 30%, timing 15% and the rest was a result of unknown factors? If not, are we indeed trapped in half-way from the goal of discovering the root cause of failure, or does our attribution yet provide valuable insights into the phenomenon of failure? These questions are critical when profoundly thinking the research motive, but remain unanswered in many works.
3.5 Failure and causation

The multidimensional complexity of failure (Bruno et al., 1987) results in multiple causation, or competing explanations, thereby raising the question: Can we create mutually exclusive and exhaustive categorizations of reasons for failure? And if not, why are researchers attempting to do so? Further, universal classifications for reasons of failure risk making redundant many interesting, contextual explanations. These explanations could help to understand the business case in its particular environment of time and place; not losing the environmental complexity but trying to derive the particular logic of failure from it. As such, although the question “Why did the firm fail?” remains, the sought answer is very much different: Instead of saying “Because there was no demand” we would go deeper in finding the root cause as a function of multiple factors such as the business model and customer insight, and find the failure was “Because the company X charged a price Y which was found too expensive by the customer group Z”. At the same time, we must acknowledge the limits of our ability to explain failure exhaustively. The most we can do is to offer a partial explanation, which is often influenced by interpretation of the informants as well as our researcher’s biases. Obviously, researchers can drill deeper into the complexity of reasons to make a contribution in the failure literature. In the case of financial reasons, for example, we can discuss following aspects: 1) timing of capital, 2) nature of capital, and 3) source of capital. Timing refers to e.g. undercapitalization in the beginning of the business process, the nature of capital means that the failure may incur due to negative cash flow (cash flow failure), lack of assets, or simply due to inability to accumulate revenue at any period. Third, the source of capital can introduce harmful limits and restrictions – for example, the deviating motives of venture capitalists and business founders are well documented as a source of tension and failure. Further, we can increase complexity to market-related factors by separating a static, permanent lack of demand – where customers simply didn’t want the product – and a dynamic, temporary lack of demand; for example, an art dealer failed because during a recession consumers cut their spending on luxury goods. As such, we have to adjust for time, not only for the outcome of failure, but for other variables as well. This means that research designs capturing a snapshot of the world are by default less effective than longitudinal studies incorporating multiple perspectives, such as contrasting views of customers and the firm, both of which constitute of a number of individuals. Finally, team-related failure factors can be reduced (or attempted to be reduced) to personality traits, skills and competences of the people working for the firm (Beaver, 2003). In conclusion, we argue that failure factors are arbitrary in many senses, and their utility depends greatly on the researcher’s ability to treat them as meaningful constructs.

3.6 Failure and truth

We have already touched the question: What is the truth behind failure? Positivists would argue interpretations of stakeholders can be distinguished from the objective truth revealed by measuring relevant variables separately from the reported causes prone to sense-making, and post-hoc rationalization (Zacharakis et al., 1999). The
question of truth is a part of a larger debate of perception of facts and measurement of facts. For a researcher, it may be difficult to explain failure by objective measurements, as he is forced to tackle a complex combination of business process, organization, and the external environment. To make convincing arguments, he needs to reconcile these views, which complicates research designs. It is no wonder, then, that the attempts seen in the literature are often less ambitious in their goal of discovering the objective truth behind failure. Even when such an attempt is made, the results risk being influenced by implicit assumptions. So, the question arises: What are the relevant measures to include in the research design? Researchers are facing a large number of hidden variables outside our knowledge and conception, which hinders their ability to explain the difference of business processes leading to failure and those resulting in success. Therefore, should we aim at creating a general theory of failure at all, or instead study the entrepreneurial processes leading to discovery of winning combinations through an iterative, continuous cycle of failure in dynamic markets? Such approaches are captured e.g. in the research of dynamic capabilities (Day, 2011*), and relate to determinism versus freedom of choice.

3.7 Determinism versus freedom of choice

As noted by Augier and Teece (2008), we may think failure as a result of path dependency, or determinism, which is “so strong that the enterprise simply cannot adapt”. According to this view, the choices affecting success or failure are made at the business is started, and there is little to do afterwards. The contrasting view states that strategic decisions and dynamic capabilities, or actions of free will, shape the future of the firm (Augier & Teece, 2008). This philosophical choice affects many important questions. Can we influence failure at all, or is it granted by exogenous factors? Do initial choices determine our fate, or can we change the course of future by our own action? If we assume freedom of choice, when are the decisive choices made in the business process? In other words, do initial parameters affect more than later adjustments? The obvious answer seems to be that both views have some truth to them. It is fair to assume the existence of some path dependency, perhaps of stochastic nature, implying that, by average, certain settings and strategic choices can lead to worse outcomes than others. However, managers are given the opportunity to make corrective adjustments (Augier & Teece, 2008). This ability may be bound to internal variables to a major degree, as it can be seen difficult for a company to shape its external environment to a significant degree. It is relevant to discover what combinations of internal and external factors produce better results than other, and which have a higher chance of resulting in failure. For example, Larson and Clute (1979) argue for the existence of “failure syndrome” which refers to a combination of personal characteristics, managerial deficiencies, and financial shortcomings possessed by certain individuals who are doomed to fail. In another vein, new ventures are often seen to exhibit high mortality (e.g. Rovenpor, 2004). The explanation to specific empirical findings may result in interesting theoretical discussion and explanatory constructs, such as liability of newness (Stinchcombe, 1965), arguing that new companies fail more often because they have less experience to solve emerging challenges and fewer resources to endure economic fluctuations.
and financial setbacks, as well as hire better managers and acquire customers (Rovenpor, 2004). Further, startup companies have a tough time introducing novelty and change in the market, especially when the customers are used to existing solutions and refuse to change their behavior or break relationships with existing providers. Since new ventures, such as start-ups, tend to have little capital, they may find it difficult to compete for awareness against the existing players equipped with large war chests, market experience, and an array of defensive marketing tactics, such as predatory pricing. As we can see, a fairly tight focus offer grounds for interesting explanations; however, this does not suggest dogmatism. Alternative explanations should be presented - for example, in the previous case one can argue that start-ups are less likely to fail than mature organizations, because their founders are highly motivated and committed, they offer a “better way of doing things”, and the company has initial resources, such as venture capital, to endure competitive pressure (Fichman & Levinthal, 1991). The risk of failure increases only after losing the initial advantages (Rovenpor, 2004), while later stabilizing through organizational routines and market position (Bruderl & Schussler, 1990).

4 Conclusions

4.1 Implications for researchers

Research on failure, such as any other research of human activity, is filled with counter-examples and opposing views, essentially deriving from multiple realities and their interpretation. Failure researchers have a shared interest in failure instead of use of same methods and focal points; they are using different lenses to study the topic. In fact, a unified theory of failure is missing from the literature. The academic debate often has a normative nature: How to help the entrepreneurs and managers to prevent failure and achieve success? Or, from economic perspective: How should businesses optimally allocate their resources for either profit maximization or maximization of social welfare? Due to differences in sampling and interpretation, the identified failure factors are not always compatible with one another. Rather, different authors give different names to the same phenomenon, and there is no generally accepted classification of failure factors (Lussier, 1996). However, even with overlapping explanations there lie many problems. Although findings relating to composition of failure may lead to accurate aggregate results, or a snapshot of situation at large, without understanding the mechanisms and logics at work, the complexities of specific exogenous (e.g. sectors and industries) and endogenous (e.g. organizational) factors can easily distort the generalizability of results. Failure researchers also need to position their research in regards to success. Studies comparing failure and success within and across comparative samples are scarce. However, further complexities arise, such as: What criteria to use in assessing the comparability of cases? By understanding environmental logics, such as industry realities, researchers can provide explanations that are accurate despite of necessary relaxations of scientific reliability. In other words, the explanatory power is more important than accuracy of
method. Finally, one should reflect upon the role of the researcher – giving advice in an attempt to change reality, or keeping distance and examining failure through a magnifying glass?

4.2 Implications for entrepreneurs

Should the entrepreneur try to avoid failure at any cost, or treat it as a learning experience? On one hand, failing involves *failure costs*, such as loss of resources (e.g. time), or emotional, psychological and financial costs. On the other hand, *failure returns*, such as learning gains, increased domain expertise and experience may increase the likelihood of success for future ventures. The risk of failure is substantial especially when certain conditions, such as novelty in product or market, little experience and lack of capital inside the firm, and unproven business model are met. As there is no formula for success, the gained experience from failure provides tacit information of the specific market context, otherwise difficult to obtain. In answering the question, we can distinguish risk-aversive tendencies (say, managerial type) from risk seeking behavior (*entrepreneurial type*). Seeking to discover what works and what not seems like a desirable trait of the ideal business man, coupled with the ability to face unpleasant truths instead of detaching oneself from business realities; a condition of entrepreneurial self-deception. We can define the existence of a failure-seeking decision-maker who, paradoxically, seeks to fail, although not in a self-destructive way, but for learning gains, excitement and other motivational incentives (Cope, 2010). He recognizes failure as not a permanent state of affairs, but a passing moment in time that can be changed at any point by creating a successful venture, thereby recovering momentary “wasted” time and efforts through deferred success. Finally, he is a rare case: because failing results in emotional distress and is an unpleasant experience, it requires a personality to not only tolerate failure – as oppose to behavioral avoidance of expected failure – but to actively seek it in hopes of learning gains and postponed benefits. Individuals who are risk tolerant and “with a plan” may correspond to this ideal type in reality, but one can also try and change his mental approach to failure to become a *failure seeker*. However, there are limits to failing: An entrepreneur who constantly fails is not considered the ideal type, even if he “explains away” the failure – in this case, he is self-delusional, although the difference to a rational entrepreneur is hard to make since it requires analyzing the extent and quality of learning from the process of failure. After all, the end goal of any business is success, not failure – even if only in one’s own terms. Finally, individual firms are vulnerable to different failure factors since they operate under unique conditions with different set of resources. Managers and entrepreneurs should bear this in mind when interpreting results of research, and consider if they can find sufficient structural similarity between particular research and their own business case (Lukka & Kasanen, 1995).

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1 Although, for example, a socially oriented firm emphasizes financial measurements of success less than the classical, profit-oriented firm.
4.3 Implications for policy makers

How should policy makers approach failure? From a macro-economic viewpoint, failures are bound to take place. They can be seen as casualties in the road for disruptive innovation that is characterized by great uncertainty, but which results in benefits for the society, e.g. increase in productivity, employment and competitiveness. Or, failure can be seen mal, something to avoid at any cost. The negative culture of failure may reduce risk taking and cause stigma for failed entrepreneurs. For the society at large, it is important to recognize the significance of failure, which derives from competition, renewal of industries and the creative destruction (Schumpeter, 1942). Benefits of failure research vary from micro-level (strategic choices) to macro-level (policy choices). For example, the externalities of failure vary between the levels of examination. Based on the Schumpeterian view, entrepreneurs take risks and aim at disruption. Driven by disruption, the failure rate of new ventures is inherently high. But the goal of disruption is nevertheless beneficial for the society, because the rare successes make the creative destruction that leads to new industries, employment and other innovation gains. As such, a high number of new ventures (followed by a high number of failures) is a sign of a healthy, dynamic economy (Graham & Li, 2002). In contrast, an economy with little risk taking has less new ventures and only “safe bets” emerge, leading to a lower degree of innovation. This said, the policy makers tend to be interested in lowering the failure rate of new ventures (Storey, 1994), even if there is no indication of the long term benefits of such activity. The contrasting view, then, is the individual tragedy and trauma of failure (Singh et al., 2007). What is good for the society (high activity of new ventures) is less good for founders of new ventures since they need to work in an economy of high failure rate – for policy makers, the solution may be to reduce the gravity of consequences at an individual level, or otherwise co-aligning the objectives of the society and the entrepreneur. Therefore, avoiding failure at any cost is not a proposed agenda for policy makers – much like separation of the venture and the individual, we suggest the separation of state and failure. For example, the short-term benefits of bailing out organizations that are “too big to fail” may seem lucrative due to employment and immediacy of financial crises, but this only leads to a false sense of security. By such activity, the society faces the opportunity cost of lost innovation: Because dominant organizations are effectively protected from bankruptcy by the state, new startups have less chance of disruption. The incentive is given, then, to defensive strategies, not strategies of innovation. In the long-term such a society may face innovation loss – thereby losing competitiveness in comparison to economies with fewer corporate bailouts.

4.4 Future research

Where should the focus of failure research be? If failure is inevitable and process, should we not consider curing failure rather than finding ways of preventing it? This would mean taking corrective measures inside the business process before the ultimate failure takes place, whereas prevention would mean creating such premises that decrease the chance of failure, such as better institutions, financing or education.
In other words, we can spot a tradeoff between failure prevention ex ante, and dynamic process of curing failure as it is happening. This relates to our decision of seeing failure either as an event or as a process. For example, controllers would follow financial metrics; marketers would track customer satisfaction and market changes, and so on. In summary, researchers need to consider the choice of failure concept, which represents the researcher’s philosophical approach to failure. Then, they decide the level of contribution and verify the consistency between method and the desired contribution. Researchers have several options. They may treat failure as a strict, easily definable concept (such as bankruptcy), or they may apply a pluralistic definition and face conceptual complexity. They may relax on the decisiveness of the method in exchange for theoretical insight, or they may strive for methodological perfection and accuracy, perhaps at the cost of interpreting the results. Finally, researchers may consider the trade-off between academically sound and pragmatically useful research. When the researcher’s goal is to produce knowledge to help managers and entrepreneurs to avoid or prevent failure, the research should be designed to support this type of contribution. Large data sets may provide useful insights for policy makers, but strategic decision-makers may struggle with oversimplification in the results. As noted by Beaver (2003), some works lack the practical utility, or even theoretical contribution, despite being methodologically sound. For failure research, which is essentially driven by normative focus, this represents a serious concern.

References


