Key Steps of Development in SMEs: Stepping Back from Failure

By

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An MRP Submitted to
Saint Mary's University, Halifax, Nova Scotia
In Partial Fulfillment of the Requirements for
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Abstract

This paper seeks to add to the concept of linear small to medium-sized enterprise growth research through the analysis of existing linear growth models, and common causes of failure. Two literature reviews starting with a collection of linear growth models, followed by an examination of the common causes of SME failure identify the key steps in the SME development process. These key steps involve the attitude and skill of the entrepreneur and managers, recruitment and motivation of employees, organizational structure, and the formalization of processes. The specific steps of development build upon each other, and therefore facilitate the future success of the business. Although key steps can be delayed for a length of time with limited negative effects if the company possesses complementary strengths, the implementation of these steps is key to long-term success and reaching the full potential of the firm. If steps of development are missed, the company must loop back and make necessary adjustments to increase the potential for success in future stages. This concept gives support to the linear growth model as a roadmap for ideal SME internal development in the face of growth.

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Introduction

There have been many attempts to capture the process of growth within small to medium sized businesses (SMEs). Although there are many theories regarding the growth process, one of the most popular models is the linear growth model. Academics have created many versions of the linear growth model (Hanks, Watson, Jansen, & Chandler, 1993). Many of these models share significant similarities, yet carry distinct differences. These models describe a path of growth that is experienced by many businesses. However, businesses can experience these step in a different order. These irregularities in the practical applications of the linear growth model can be the source of problems and cause failure in future steps of development and stages in the growth process (Greiner, 1972; Steinmetz, 1969). Taking this into account, there is a linearity of business growth that represents an ideal order of development steps. There are also steps that may be delayed in the presence of particular compensating strengths with little consequence to the success of the business. This paper will explore and compare common linear growth models to identify key steps in the development process that lead to an increase in the potential for failure. From here, the common causes of failure will be explored to identify where businesses go wrong in their development process. The linear growth models and the failure literature will then be compared to match the critical steps in the SME growth process that prevent businesses from falling prey to common fatal mistakes. This paper will argue that there are key steps in the development process that, if missed, will require the business to loop back to implement the necessary changes for future success.

Chapter 1: SME Linear Growth Model Literature Review

There have been many detailed accounts of the linear path that SMEs take in the growth process. Although many of these accounts focus on different elements of growth and business development, many similarities can be found representing the general progression of a growing SME. In order to identify these similarities, and highlight contrasting ideas, the linear growth models will be compared using a standard growth progression of start-up, expansion, and maturity. Although some linear growth models continue their model beyond the maturity stage, these represent businesses that are diversifying from their original line of business, an activity often associated with larger companies, thus not included in this review of SME growth.

1.1 What is an SME?

There are many different definitions of what constitutes an SME, not only in size requirements, but also what measure accurately represents a firm's size. For instance, Canada identifies SMEs as businesses that employ less than 499 employees (Government of Canada, 2014) while Indonesia prefers to identify SMEs as firms with less than $800,000 worth of assets (Indian Institution of Foreign Trade, 2014). The table below identifies the definition of an SME in seven different countries and economic zones across the world.

Table 1.1: International SME Definitions

Country	Criteria
Canada	<499 employees
USA	<1,500 employees, turnover <$29M
Mexico	<100 staff
Brazil	<100 staff
Australia	<200 employees
Indonesia	<$800,000 worth of assets
European Union	<250 paid employees, =<50M euros, Balance Sheet Total =<43M euros

Source: Chart is created from (European Commission, 2003; Government of Canada, 2014; Indian Institution of Foreign Trade, 2014)

Not only can the definition differ between countries, but it can also change drastically between industries (Hillary, 2000). Different definitions between industries makes sense as some industries are much more labor intensive than others, making it possible for some industries, such as social media, to operate with very few employees while bringing in millions in revenue. When we speak of SMEs in this paper we refer to the Canadian definition of SMEs.

1.2 Comparing Models

In order to compare the models analyzed, they will be assessed using the Hanks et al. (1993) taxonomic model that compared an extensive list of SMEs, plotted them according to number of employees, organizational structure, formalization of processes, and decision making methods, and identified four clearly recognizable clusters (Hanks et al., 1993). These four clusters represent the four most popular SME growth model stages including start-up, expansion, maturity, and diversification (Hanks et al., 1993). These categories will be used in order to compare the chosen linear growth models. As mentioned, in order to focus on stages most relevant to entrepreneurs and SMEs, this paper will focus on the first three stages: start-up, expansion, and maturity. The diversification stage often takes place much later in an organization's life cycle when the primary sources of growth have been exhausted. Diversification is also a much more complex process and a key strategy of much larger businesses than this paper is focusing on.

In researching linear growth models there are a few main models that are commonly cited and well accepted that stand out as detailed accounts of the growth process. These models have many similarities, but also have different focuses including owner centric, organizational centric, and industry specific. Steinmetz (1969) offers an owner centric view of SME growth. Although this source is relatively dated, the relationship between the entrepreneur and their business remains relatively consistent as Steinmetz (1969) is cited by many academic papers over the past few decades. Rosling (2013) also offers an entrepreneur centric view of SME growth. The Rosling model was developed as industry literature for the Shirlaws Business Coaching firm that John Rosling, the author of the document, owns. This offers a view from the consulting industry that focuses more on the personal journey of the entrepreneur. Lewis and Churchill (1972) took a more organization centric view of SME growth. Their model focuses mainly on the management of systems within the business that contribute to the progression of an SME through the linear growth model. This model goes in depth into the individual key foci that successful SMEs travel through, and has been cited many times throughout the last few decades since its publishing. Greiner (1972) offers both an entrepreneur and a management view of SME growth. Due to this generalized focus it identified more aspects of SME growth, making it an ideal source. This model has been cited by many academics since its publication. Jones (2009) offers a similar, more recent account of both entrepreneur and management perspectives. The consistencies between the main points in Jones (2009) and Greiner (1972) suggest that date references are still relevant to business today. Finally, Kazanjian (1998) offers an information technology industry specific account of SME growth. After analysis of this source, it was clear that many of the ideas discussed by Kazanjian are consistent with those of the other linear growth model authors in its identification of internal factors that affect SME growth.

The six models analyzed share many similar qualities. The stages outlined in each model are provided in *Table 1.2* along with how they each fit together within the context of the taxonomic model presented in the Hanks et al. (1993) analysis of common linear growth models including the start-up, expansion and maturity stages.

Table 1.2: Standardized Model Comparison of Stages

	Start-up Stage	**Expansion Stage**	**Maturity Stage**
Steinmetz (1969)	- Live or Die	- Being a Manager	- Indirect Control
Greiner (1972)	- Creativity	- Direction	- Delegation
Lewis & Churchill (1983)	- Existence - Survival - Success-Disengagement	- Success-Growth - Take-off	- Resource Maturity
Kazanjian (1988)	- Conception and Development - Commercialization	- Growth	- Stability
Jones (2009)	- The Start-up		- Steadying the Ship
Rosling (2013)	- Start-up	- Growth	- Plateau

Table 1.3 breaks down the general ideas that are discussed by each of the models and how they align in the Hanks et al. (1993) analysis of linear growth models. These themes will be discussed in the remainder of chapter 1.

Table 1.3: Model Comparison of Main Focuses

	Start-up Stage	Expansion Stage	Maturity Stage
Steinmetz (1969)	- Dependant on owner's skill	- Owner to manager transition - Formalizing processes	- Agency theory - Cost control - Competition
Greiner (1972)	- Creativity - Dedication	- Communication formalized - Processes formalized - Decentralizing decision-making	- Employee motivation/ rewards - Strategic planning
Lewis & Churchill (1983)	- Revenue generation - Efficiency - Cash flow	- Delegation of tasks - Functional managers often adopted - Owner to manager transition	- Maintaining flexibility - Harnessing entrepreneurial spirit
Kazanjian (1988)	- Product development - Production efficiency - Formalized roles	- Mass production, selling, distribution - Formalizing processes	- Strategic planning - Consolidation of power
Jones (2009)	- Excitement - High energy	- Quality control - Product delivery	-Specialization - Formalized roles
Rosling (2013)	- Reputation building	- Investing in skills	- Investing in skills - Strategic planning

In order to compare these models in a more in depth manner, the ideas presented have been divided into five broad categories in which they can be compared. These categories are: the owner’s role, organizational structure, working environment, formalization of processes and planning, and production and customers.

1.3 Start-up Stage

The start-up stage is the first and earliest stage in the SME growth model. This will include the initial development of the product and identification of the market in which it will compete (Greiner, 1972). This stage continues through beginning production in the market (Jones, 2009), and into establishing a feasible and sustainable business (Lewis et al., 1983).

1.3.1 Owner's Role

The start-up stage is the first step in the Hanks et al. (1993) taxonomic model. This can be a particularly difficult time for the owner as they are the key decision maker of every aspect of the business (Steinmetz, 1969; Lewis & Churchill, 1983; Jones, 2009). The owner's ability to plan will be key to the entrepreneur's success (Steinmetz, 1969). This kind of pressure can be difficult for less dedicated and confident entrepreneurs. The Lewis and Churchill model on the other hand identifies a lack of formal planning in this stage (Lewis et al., 1983). Planning takes place when the owner feels it is necessary, and is approached in any way the owner feels fitting. This lack of formal planning by the owner will change as a business moves through the growth stages.

The owner wants to be everywhere, see all risks before they become problems, and only rewards himself with a modest salary in order to invest back into the business (Steinmetz, 1969; Greiner, 1972). Other models such as the Rosling (2013), and Jones (2009) models disagree with this isolated view of the owner, instead arguing that the key responsibility of the owner at this point is to focus on the excitement and team commitment. They argue that energy and drive in the organization is the key to success in these early stages (Rosling, 2013; Jones, 2009). As employees are brought on, the owner assumes a more leadership-oriented role, where employee motivation and buy-in are highly important (Steinmetz, 1969; Lewis et al., 1983).

Steinmetz has a particularly pessimistic view of the small business owner during the start-up stage stating that the entrepreneur is a “pathetic individual” with no one willing to help him (Steinmetz, 1969, p. 31). In addition, they are often inexperienced in management responsibilities, or have a general dislike for administrative work (Steinmetz, 1969; Greiner, 1972). Over time this may change, or the owner will consider hiring professional managers to handle these tasks. Regardless of the size of the start-up, at some point the owner will have to trust some operational responsibilities to employees to give the owner time to focus on important things such as building the business, establishing a reputation, and creating positive cash flow (Rosling, 2013). The Kazanjian model, focusing on high-tech firms, identifies the importance of a product development focus of the entrepreneur during the start-up stage rather than the operational side of the business (Kazanjian, 1988). Product development will be important for many firms as having a well-refined product will help to establish a reputation, and make scaling up production a much smoother process.

1.3.2 Organizational Structure

The organizational structure during the start-up stage is fairly minimal, with often only one level of employees (Steinmetz, 1969; Greiner, 1972; Kazanjian, 1988; Lewis et al., 1983)**.** The Lewis and Churchill model identifies minimal need for initial employees having a high level of skill and creative thinking ability (Lewis et al., 1983). This is understandable, as the owner is calling all the shots at this point and they do not have the same stake in the game. The Jones model refers to these employees as the committed 'core team' that will drive the success of the business (Jones, 2009). This discrepancy in employee quality may be due to the differing experience of the authors in bringing in that initial team.

As previously mentioned, as the organization grows and more levels are added to the structure of the organization, there is a greater demand for quality leadership from the owner of the business. Additional employees also introduce new administrative responsibilities such as payroll, scheduling, and benefits (Greiner, 1972). However, because of the limited levels in the business, linear growth models do not go in-depth into the organizational structure at this stage.

1.3.3 Working Environment

At the very beginning, the owner may be working directly with the employees to ensure operational tasks are performed effectively, however after the size of the organization grows to a point where the owner is pre-occupied with administrative duties, employees may lose motivation and loyalty (Steinmetz, 1969). The energy that the owner provided to the organization is no longer present. These very same administrative duties may also distract the owner from other important duties such as innovation, and product development that helped to build an environment of excitement and loyalty in the first place (Steinmetz, 1969; Greiner, 1972). The Rosling model shares in this belief that the owner is the source of the culture of excitement (Rosling, 2013). The Jones model focuses more on the idea that the employees supply their own energy, rather than the entrepreneur supplying the excitement and drive. Jones states that it is the employees' dedication and willingness to pitch in to get everything done that is the source of the high-energy culture (Jones, 2009).

1.3.4 Formalized Processes and Planning

During the start-up stage there are very few formalized processes in the organization (Steinmetz, 1969; Greiner, 1972; Lewis et al., 1983; Jones, 2009; Kazanjian, 1988; Rosling, 2013). Ad hoc solutions are common when faced with problems, and informal processes are organized around project management principles rather than as on-going responsibility (Jones, 2009; Kazanjian, 1988). However, this approach can begin to cause issues when more employees are brought on to the team. Owner responsibilities such as payroll and scheduling may need to be formalized in order to ensure timely execution.

The Steinmetz model argues at this point in the development of the organization the owner is the source of all planning activities and there is no formalized process in which they do so (Steinmetz, 1969; Lewis et al., 1983). The Kazanjian model disagrees with the idea of the owner making decisions in isolation in stating that all organizational members are a part of the planning process, or at the very least aware of the company's strategic goals and the reasoning behind them (Kazanjian, 1988). The lack of involvement of the staff in the planning process in the Steinmetz model is consistent with the way the initial employees are perceived - a group of people with no particular skill or knowledge in business practices (Steinmetz, 1969). Other models portray the initial employees as a source of energy and drive in the operation of the business (Jones, 2009; Kazanjian, 1988). The entrepreneur may see this dedication and be more willing to include them in the planning process (Jones, 2009).

1.3.5 Production and Customers

When starting a business, the entrepreneur has an idea for a product or service, and it is during the start-up stage that they find out if it is a good idea (Steinmetz, 1969). Either the company will achieve general customer approval, or they will fail (Steinmetz, 1969). There is a concentrated focus on customer feedback in order to adapt the product to the customers' needs. Building a customer base is key at this stage in the development of the organization in order to survive (Lewis et al., 1983).

Not only are the product qualities themselves of key importance during this stage, but the commercialization of the product, and the process of production is also important. The relationship between revenues and expenses are important to ensure a positive cash flow (Lewis et al., 1983; Jones, 2009). Part of this focus on production will mean dealing with capacity and quality management issues. As orders grow, the owner will need to be aware of the ability of the company to meet the demands of the customer, while maintaining a constant level of quality (Jones, 2009). This higher level of demand will require close attention to labour and resources available during peak periods. Having employees working overtime hours can decrease product quality, and running machines for longer periods can cause delays in production from broken components. As stated earlier, the growing orders can cause a boost in employee morale, however, the owner should be aware that this boost in morale could mask profitability issues as employees get excited about increased orders.

1.3.6 Transition to Expansion

Equally important in a growth stage model is an analysis of how a company can successfully transition from one stage to the next. Lewis et al. (1983) and Kazanjian (1988) do not offer an in-depth look at what specific mechanisms move a company along the linear model (Lewis et al., 1983; Kazanjian, 1988). Steinmetz looks at the transitions from the point of view of the entrepreneur and attributes the success of the transition periods to the mindset of the owner (Steinmetz, 1969). Being that his model is centred on exploring the entrepreneur's journey of letting go of control, this is of no surprise. Steinmetz (1969) argues that the transition into the accelerated growth phase is highly dependent on the owner shifting from a 'do it yourself' mentality to assuming a more supervisory role (Steinmetz, 1969). As operations scale up, it will no longer be possible for the owner to have his hand in every aspect of day-to-day business (Steinmetz, 1969; Rosling, 2013).

Greiner takes a more generalized approach and states that there are a variety of evolutionary and revolutionary changes within a business and a skilled manager will be able to identify them (Greiner, 1972). Greiner (1972) takes the position that a company's future is highly dependent on its past and how a company manages these types of changes is extremely important to analyze (Greiner, 1972). As Greiner states in his 1972 article, “The term evolution is used to describe prolonged periods of growth where no major upheaval occurs in organization practices,” (Greiner, 1972, p. 322). These periods of calm and steady growth lead to what Greiner calls revolutionary change. As Greiner states, “The term revolutionary is used to describe those periods of substantial turmoil in organization life,” (Greiner, 1972, p. 322). To describe the relationship between the two, the author identifies a situation involving organizational structure. Over an extended period of growth (evolutionary period), the centralized decision making structure of small firm may become inefficient and the company must transition to a more decentralized structure (Greiner, 1972). This transition to increase efficiency is the revolutionary change (Greiner, 1972). This seems to be an accurate model to describe the effects of growth on the operations within a business. Growth causes many changes and the organization must adopt new strategies to manage their higher level of production (Greiner, 1972; Jones, 2009; Kazanjian, 1988). Although there can be multiple evolutions and revolutions throughout the model, there are a few that can be identified that relate directly to the transition from the broad ‘Set-up’ phase to the ‘Growth’ phase (Greiner, 1972). Similar to Steinmetz (1969), Greiner (1972) also identifies the question of the role of the owner in operations. Greiner identifies this as the ‘crisis of leadership’ and that bringing in a capable business manager will keep the organization strong over periods of sustained growth (Greiner, 1972). Although the authors seem to focus mainly on leadership, there seems to be a variety of preparations in order to smoothly transition into accelerated growth. It may be a bit too general to state that the company just needs to bring in a capable leader who will initiate the necessary changes.

By the end of the start-up stage, the business should have everything in place to commercialize their product or service, and the owners attention is turned toward ensuring adequate management is in place to handle growth in the next stage (Jones, 2009). Before advancing to the expansion stage, the management team should be in place and prepared for the extended period of growth that the expansion stage will bring with it (Greiner, 1972).

1.4 Expansion Stage

The expansion stage is characterized by an extended period of growth. At this point, the business has already identified their commercialization method, and core strengths as a business. As the business is growing rapidly during this stage, there are many managerial tasks that must be performed in order to handle the additional demand and scaled production (Greiner, 1972). This higher level of demand can often lead to stress on the production process causing employees to work overtime (Jones, 2009). The capable managers put in place during the start-up stage will be tasked with handling this rapid growth (Lewis et al., 1983). At the same time, the business is finally bringing in a substantial amount in revenue and profits, leading to the owners being able to begin financially rewarding themselves (Steinmetz, 1969).

1.4.1 Owner's Role

During the expansion stage the owner's role continues to shift from a 'do it yourself' mindset to a manager role (Steinmetz, 1969; Greiner, 1972; Lewis et al., 1983). This means giving managers greater autonomy to make the necessary routine decisions

(Greiner, 1972). Because the decision making power is distributed to a greater number of people, the owner must be aware and comfortable with the fact that mistakes will be made (Lewis et al., 1983). Some owners may have difficulty letting go of direct control over something they have worked so hard to create, but as the company grows, the owner will no longer have time to handle all decision-making requirements (Steinmetz, 1969). The owner is still in control of the broad view of the company and a department based organizational structure often adopted at this stage will help to separate issues and clear confusion in the mind of the owner trying to control it all (Kazanjian, 1988).

The owner may be going through some changes in lifestyle at this stage as well. At this stage the owner can be considered a success, their hard work is finally beginning to pay off, and they are able to begin rewarding themselves financially (Steinmetz, 1969; Rosling, 2013). This may be in the form of a new house, a cottage, a luxury car, a boat, or a variety of other luxury items (Rosling, 2013). There are issues that can arise from this sudden accumulation of wealth by the owner that can pull their attention from the continued success of the company. The new standard of living can cause family issues as the entrepreneur, their significant other, or their children are not used to having the amount of money that is brought in by the successful company (Steinmetz, 1969).

The additional employees brought in to handle the quickly growing demand may also cause some issues at this stage in organizational development. More employees leads to more problems for the management team to deal with. The owner must focus on bringing in quality, professionally trained, and experienced managers to handle these issues while the owner concentrates on the big picture (Kazanjian, 1988; Rosling, 2013).

1.4.2 Organizational Structure

As operations expand and more pressure is put on marketing, finance, and human resources functions, more levels in the organization are developed to keep things organized and organizational members accountable (Steinmetz, 1969). A functional organizational structure is often adopted at this point in an organization's growth (Greiner, 1972; Kazanjian, 1988; Lewis et al., 1983). These department managers must be able to handle the growing complexity of the business as it grows (Rosling, 2013).

It is common at this stage to find a difference between the managers who have been with the companies through the process, and managers who have been brought on for their professional background in management. Managers who have been there over the process of growth are often very dedicated and emotionally attached to the company's success (Steinmetz, 1969). On the other hand, newly hired managers may not feel the same sense of dedication, and even feel as though they are not a part of the initial 'core team' (Lewis et al., 1983).

1.4.3 Working Environment

As the owner adds to the managerial team it brings the potential for managers and supervisors to act in ways that are not beneficial to the organization. Game theory concepts such as the principal-agent theory come into focus at this point as managerial responsibility and personal goals does not always align causing unfavorable behavior from management (Grossman & Hart, 1983). The Steinmetz model identifies other issues that may arise including resentment of the owner for his financial gains from the company

(Steinmetz, 1969). The employees that have been around since the beginning stages may feel their contribution is underappreciated leading to selfish decision making. This, left unchecked, may lead to a general loss of energy and drive that made the company successful in the first place (Steinmetz, 1969).

The departmentalization of the organization may also have some unintended and unforeseen consequences. The culture can become disjointed and inconsistent between the departments (Jones, 2009). The Jones (2009) model suggests that bringing together the people in the organization to develop a mission and vision statement can help to ensure that each member of the organization is onboard with the direction of the company as a whole (Jones, 2009). The Rosling (2013) model proposes another approach centered on training and the development of employee skills, which provides an environment of improvement and employee appreciation (Rosling, 2013). This may be effective as it frames employees as a central component of the success of the organization rather than a 'cog in the wheel' that employees often find themselves feeling at one point or another in their career.

Lower level employees who have been with the company since its inception may also feel restricted by the newly instated centralized hierarchy. Operations employees, having a significant amount of experience in the production process, may feel they know better than their managers, taking matters into their own hands when issues arise (Greiner, 1972). These beliefs may even be true as there is no guarantee that new managers hired to fill the new hierarchy are any good at managing the production process (Steinmetz, 1969). Because of these factors, efficiency and team effectiveness may suffer across the organization (Steinmetz, 1969). This may also be seen in order departments such as marketing and sales. Employees who have been around for a long period of time may hold on to old methods of dealing with customers that no longer aligns with the company's processes.

1.4.4 Formalized Processes and Planning

After a period of rapid growth, it is common for the owner to attribute the feat to their perceived superior business skill, which can lead to irrational spending decisions on risky projects, overly ambitious expansion efforts, and expensive office furnishings (Steinmetz, 1969). To avoid this excessive use of cash it is widely recommended that budgets, and accounting systems for inventory and purchases be adopted (Greiner, 1972; Lewis et al., 1983; Jones, 2009). This also serves to relieve the past informal systems that have been strained by rapid growth (Lewis et al., 1983).

Adopting a management team brings along with it the need for incentives and motivation techniques to address principle agent issues. Principle-agent issues involve the conflict of interest between the employees and management team of an organization, and its shareholders, or owner (Bohren, 1998). To address the principle-agent issues, formal incentives are often also adopted (Greiner, 1972; Lewis et al., 1983; Jones, 2009). As the organization is also adapting to a new organizational structure, a more structured task system is also required to ensure that roles and responsibilities are handled in a timely and consistent manner (Kazanjian, 1988). Communication in the organization is formalized as more employees are added to the team (Greiner, 1972). Previously, due to the small number of employees, an informal system was feasible, but now that employees are not in direct contact with upper management, communication cannot flow as easily (Greiner, 1972).

The Jones (2009) model deviates from the other models in stating that growth must be slowed in order to implement the formalized processes and planning necessary in the expansion stage, and moving forward through the linear growth model. This slowing of business growth to implement the necessary mechanisms that will ensure success in future growth stages seem to be important. If a company missed a vital part of business development, can they go back and fix it at a later stage? If so, does the theory that business development occurs in a precise, linear order hold?

1.4.5 Production and Customers

When looking at production efficiency at this stage in business growth the models identify both positive and negative effects that may be seen. It is hard to say which factor will have the greatest effect on the organization. Steinmetz identifies factors that may hinder the productivity of a company at this stage, including rigidity in thinking, unfavourable actions of appointed managers, overhead expenses from larger buildings and higher capacity machinery, and wider product lines reducing economies of scale (Steinmetz, 1969). The decreased direct supervision of the owner may cause a drop in the efficiency of operations (Steinmetz, 1969). Steinmetz (1969) argues that it is not that the newly instated managers do not care about their role in the company, but no manager will be as passionate about ensuring product success as the owner of the business (Steinmetz, 1969). During the expansion stage, there are many new-hires in all levels of the new organizational structure, and some new managers may not be as confident or as knowledgeable in production of the company's product (Steinmetz, 1969). The Greiner model points out that there are also potential gains in production from new formalized processes introduced during the expansion stage (Greiner, 1972). These new formalized processes may contribute towards product consistency and quality, and production efficiency as new manufacturing processes are introduced (Greiner, 1972).

In addition to the opposing forces on productivity, management must also keep a close eye on the relationship between profits and future growth (Kazanjian, 1988). The key decision makers may fall into the trap of pursuing growth without considering the rate of return on the opportunity (McCormick, 2009).

1.4.6 Transition to Maturity

The transition to maturity occurs when high growth opportunities in the company's chosen market are fully explored (Kazanjian, 1988). It is at this stage, after an extended period of growth, that companies can fall into a state of panic (Rosling, 2013). Everything was going so well, yet growth is slowing and this can be a very stressful time for owners, managers, and even employees (Rosling, 2013). A few stage models address other common elements of the transition from accelerated growth to a stabilization of the company. The entrepreneur focus of Steinmetz identifies another shift in the owner's role in the company (Steinmetz, 1969). After the supervisory role the owner played in the growth stage, the owner now must shift their focus from the fluid operation of the firm to a more broad strategy focus (Steinmetz, 1969). In order to continue growing, there will often be an increased focus on finding new opportunities, reaching new markets, and choosing projects that will growth the company further (Steinmetz, 1969; Lewis et al., 1983; Greiner, 1972; Rosling, 2013). This can be very difficult and time consuming, and therefore will take a large portion of the owner's time (Rosling, 2013).

Greiner also comments on the 'revolutions' experienced by organizations at this stage. After large-scale growth and decentralization of decision making power, there tends to be loss in coordination between departments, or product line teams (Greiner, 1972). Executives and senior managers can feel as though they are losing control of the business (Greiner, 1972). The main 'revolutionary' action here is to employ coordination techniques appropriate to the size of the firm. Some managers may attempt to return to the centralized system that was employed before the growth stage, but it will often fail (Greiner, 1972). The higher level of coordination during the transition between growth and stabilization will ensure the initiatives taken on in the stabilization phase will be successful. The level coordination is highly dependent on how the organization was set-up in earlier stages in the growth process. For instance, when Greiner suggests that functional managers are often adopted in his 'Success' stage, which aligns with the Hanks et al. (1993) taxonomic model stage 'expansion', the level of coordination will be directly affected by the processes previously established (Greiner, 1972). This suggests that appropriate planning in earlier stages can allow for a smoother transition between the 'expansion' and the 'maturity' stages.

Jones also puts forth the idea that new formal processes are necessary at this new level of operations (Jones, 2009). However, Jones deviates from other growth model authors by stating that management must actively slow the company's growth in order to put the control systems in place (Jones, 2009). Slowing growth may free up time for an organization to adopt new processes, but it may ultimately stunt the growth of the company as competitors continue to expand, and capture market share. Although it may be hectic for members of the organization to continue their responsibilities throughout this change process, it can be manageable with the proper process building in the 'expansion stage'. Other specific areas identified by Jones that need to be addressed are employee skills and knowledge, role of the entrepreneur as CEO, organizational structure, and accountability (Jones, 2009).

As the expansion period comes to an end, sales growth is slowing and the overwhelming level of management attention is decreasing with it. Now the management team has an opportunity to breathe, see what is working, what can be improved, and make necessary changes to increase the efficiency of all functional areas.

1.5 Maturity Stage

The maturity stage occurs when the extended period of growth experienced in the *expansion* stage comes to an end. Sales growth begins to level, and the business settles at its new size (Jones, 2009). At this point, management turns its attention towards controlling margins, maintaining flexibility, and perpetuating an entrepreneurial spirit within the organization (Lewis et al., 1983). The business leaders also turn their attention to other competitors and focus on strategy in order to hold the market share gained in the previous stage (Steinmetz, 1969).

1.5.1 Owner's Role

At the maturity stage the linear growth models continue to shift focus from the entrepreneur to the management team. As the owner moves towards controlling the company at an arm's length, it is increasingly important that they have found a team of skilled and experienced managers (Steinmetz, 1969; Greiner, 1972; Lewis et al., 1983; Kazanjian, 1988; Jones, 2009). As the owner is often still very passionate about the business, they will commonly surround themselves with those who are well informed (Steinmetz, 1969). As the Jones model states, the focus of the entrepreneur during the maturity stage is more geared towards the relationships between the company and external parties such as suppliers, and customers (Jones, 2009). Not only is the entrepreneur removed from the operational aspects of the business, but is often removed from a direct role in the finances of the firm (Lewis et al., 1983).

1.5.2 Organizational Structure

As a functional organizational structure is adopted, management replaces the owner as key decision maker within the business (Greiner, 1972). Many of the models analyzed identify a need to expand the management team in order to cover all responsibilities and additional processes involved in coordinating the functional departments (Greiner, 1972; Jones, 2009; Lewis et al., 1983). Steinmetz deviates from this idea stating that middle management is often overstaffed at this point (Steinmetz, 1969). This may be the case in a smaller firm as the functional division of the labor force thins out each department. For example, what use to be a core team of 10 employees within the firm is now divided between the five functional areas. If divided evenly, two employees per functional manager may be a little heavy on middle management. However, in larger firms, this will not be the case.

Jones identifies an issue that can arise from the change in the organizational structure during the growth stage. As the company is dividing into departments, there is an increased need for communication and coordination between managers (Jones, 2009). Although formalized systems can help with this, it is still a new consideration for management to get used to. The Jones model identifies a need for the management team to slow down growth in order to fix these issues (Jones, 2009). Although the other models do not identify this same requirement, it is clear that this newly adopted organizational structure continues to be a considerable concern during the maturity stage.

1.5.3 Working Environment

The analyzed linear growth models deviate at this point in terms of organizational culture. As growth is no longer fueling the excitement in the organization, maintaining the entrepreneurial spirit within the company is a high priority for the owner and management team (Lewis et al., 1983). In order to maintain this motivation organizations often use bonuses and rewards to incentivize favorable behavior (Greiner, 1972). As the Steinmetz model identified the organizational structure can be fairly top heavy at this point in the organization`s growth (Steinmetz, 1969). This can lead to a great deal of manager-manager, and manager-employee dispute (Steinmetz, 1969). Left unattended, this can lead to serious morale problems, and limited performance within the organization (Steinmetz, 1969).

Jones identifies a different force during this stage of growth. As the organization`s growth tapers, the workload also levels off (Jones, 2009). This, with the increased clarity of roles and responsibilities that the functional organizational structure offers, allows for renewed energy and a defined sense of purpose among the managers and employees (Jones, 2009). This allows individuals to focus on their role within the company and in turn increasing motivation and efficiency (Jones, 2009).

1.5.4 Formalized Processes and Planning

During the maturity stage, tapering growth allows the business managers to give additional focus towards formalizing rules, and procedures (Kazanjian, 1988). Although maintaining the entrepreneurial spirit of the organization is a top priority, there is also a number of important control systems that should be implemented in order to compete (Steinmetz, 1969). The Steinmetz model identifies an increased focus on the competition as smaller businesses begin to take market share (Steinmetz, 1969). Steinmetz also recognizes that these smaller firms may even be run by previously resigned managers who have decided to give the industry a go themselves (Steinmetz, 1969).

In order to remain competitive during this stage budgets, strategic planning, and standard cost systems should be implemented (Lewis et al., 1983). Jones adds to this focus on efficiency by stating that schedules of planned maintenance for machinery should be adopted in order to minimize situations of incapacitated production processes, thus increasing efficiency (Jones, 2009).

1.5.5 Rosling Model Deviation

It is at this point in the Rosling Model deviates from the linear quality that characterizes linear growth stage models. After the expansion stage, the Rosling model identifies three paths in which the organizations can take (Rosling, 2013). The first path, *advanced growth*, involves a continuation of growth from newly accessed market (Rosling, 2013). Access to these markets may be achieved through geographic, product, or product use diversification. This path obviously requires a level of planning in order to identify the new market, and position the organization to capitalize on it. The second path identified by Rosling is the *plateau* path that involves sales leveling off and maintaining a constant level (Rosling, 2013). This most resembles the maturity stage identified by the other linear growth models. The final path identified by the Rosling model is *decline*. This decline is identified by some of the models as a stage that follows the diversification stage as other businesses begin to take market share, or the industry begins to decline. Other models do not include decline in their stage model (Steinmetz, 1969; Lewis et al., 1983; Kazanjian, 1988).

The three paths introduced by Rosling raise some interesting questions. Must a business move on to a stage of diversification after a stage of maturity? And can a business skip from stage to stage in a non-linear manner? For instance, if a business plans ahead, can they avoid the maturity stage, and move directly to diversification? Or if an organization has missed an essential step in development over the previous stages, can they jump back in order to reach advanced growth or diversification rather than plateau, or decline?

1.5.6 Linear Growth Model Conclusion

The linear growth models analyzed have many similar stages of growth, involving many of the same developmental aspects. Major themes can be identified in the articles for each of the standardized stages in the growth process. These themes involve the entrepreneur and manager skills and attitude, employee recruitment and motivation, organizational structure, and formalization of processes and procedures. Many of the key aspects of SME development identified in the linear growth model literature, can have negative effects on a business if neglected. In order to identify what developmental steps are the most important, this paper will now look at the common causes of failure in SMEs and see where failed firms deviate from the identified linear growth path.

Chapter 2: SME Failure Literature Review

Although the linear growth models identify a chronological order to necessary changes and issues faced by businesses, it is clear that not all businesses follow the specific paths laid out by the literature. However, many of the steps identified are necessary in the growth process, and if not identified, they can lead an SME to failure. This section will review the key causes of failure identified by business failure literature. This will give a better look at how entrepreneurs stray from the path to success explained by the linear growth models.

2.1 Defining Failure

Before looking into the common causes of SME failure, it is important to define what exactly is meant by failure. Unfortunately, as is the case with the definition of SMEs themselves, there is very little consistency on what it means for a company to fail (Cochran, 1981). There are various explanations for what is meant by failure. Cochran (1981) notes that some authors define failure very narrowly as bankruptcy. Dun and Bradstreet, a US bankruptcy firm sees the term failure as a bit more inclusive widening the definition to include companies who cease operations with losses to creditors, including voluntary withdrawal, leaving behind unpaid obligations, and compromising with creditors to fulfill contracts (Cochran, 1981). Other authors have justified using the term failure to mean termination to prevent further losses (Ulmer & Nielson, 1947). Similarly, others have defined failure as failing to “make a go of it” (Cochran, 1981). Finally, at the extreme of the spectrum of failure definitions, Fredland and Morris (1976) include discontinuance of a business for any reason as a part of failure (Fredland &

Morris, 1976). This final definition seems to be a reasonable definition for the purposes of this paper. Discontinuance for any reason would include the discontinuance of businesses due to retirement of the entrepreneur, which if marks the end of the operation of the business, would mean failure to engage in succession planning. Back to the other side of the spectrum, bankruptcy seems to be too narrow a definition for this purpose. Many businesses fail without filing for bankruptcy, yet it is no longer economically feasible to continue. The Dun and Bradstreet definition is also a bit too constricted for the purposes of this paper as businesses often cease operations with no losses to creditors given sufficient designated collateral. For the remainder of this paper, failure will be defined as discontinuance for any reason, consistent with the Fredland and Morris definition (Fredland et al., 1976).

2.2 Two Categories of Failure

There are two types of business failure identified in the literature that are particularly interesting in the discussion of business growth models and business failure. Business failure can take the form of both a gradual decline, and a crisis situation. Both of these types of failure end in the discontinuance of the business, but academics seem to be at odds when discussing which of the two are more dangerous.

A situation of gradual decline sees a business slowly slipping in performance until it is too late to fix the problem. Many articles describe this as the 'boiled frog syndrome', and argue it is the most deadly type of business failure (Tichy & Devanna, 1986; Richardson etal., 1994). Boiled frog syndrome stems from the fact that when boiling a frog, if it is put directly into hot water, it will immediately jump out and escape. However, if the frog is placed in water at room temperature, and slowly increased in temperature, the frog will calmly await its demise. Although morbid, this example does a great job of describing the effect in business. An ever increasing issue may not alarm the management team until it is too late to act on it. Alternatively, it may remain a secondary problem that can wait to be addressed in the eyes of the management team. Academic writers who defend ‘boiled frog syndrome’ as the most dangerous type of failure argue that a crisis situation spurs an immediate action, mobilizing assets, and drawing the attention of top management (Richardson et al., 1994). Yet, research shows that firms that experience a slow decline see better success in turning it around (Chowdhury & Lang, 1993).

A crisis situation is characterized by a sudden event that drastically changes a business’ view of future performance (Harrigan , 1980). Many articles argue that this is the most deadly type of business challenge, citing a poor reaction by management, likening them to a ‘deer caught in the deadlights’ (Harrigan , 1980; Staw, Sandelands, & Dutton, 1981). The reasons of failure identified in this paper can take the form of either of these types of business failure, and important implications on the movement along the SME growth models.

2.3 Symptoms VS Reasons

There is a distinct difference between a symptom and a reason for business failure. Many entrepreneurs may sight lack of liquidity, and revenue and profits as the cause of their failure (Ropega, 2011). However, these are symptoms of deeper internal issues in their businesses. Ropega (2011) argues that reasons for business failure cannot be treated as a single factor that caused failure, but have to be considered as components of a much larger picture that led to failure (Ropega, 2011). For instance, as environmental changes occur in the industry, although there may not be immediate repercussions, it will negatively impact the business over time. However, environmental shifts, when paired with the inability to identify industry shifts can be fatal for a business. The focus of this section will be on the reasons for failure, rather than the symptoms of failure.

2.4 Entrepreneur Centered

As the entrepreneur is the main decision maker in the early stages of the business, there are many entrepreneur based errors that can drag a business down, and cause its failure. The main areas in which an entrepreneur can unwittingly cause the business to fail is in their goals for the business, their level of competence in the industry and business practices, the attitude they hold towards their subordinates and the business, and their attention to outward looking tasks and strategy. This section will outline these factors.

2.4.1 Goals

The literature identifies the entrepreneur’s goals as a key determinant of business success. Looking at failed businesses in particular, many of the authors note the common focus on selfish motivations for originally starting the business such as having a flexible working schedule, the need for autonomy, and the desire to become rich (Zilbershtein, 2012). Zilbershtein notes that these motivations are particularly prevalent among the failed entrepreneurs participating in his study of successful, and unsuccessful businesses (Zilbershtein, 2012). These goals likely affect the way these entrepreneurs act within the context of their business. For instance, leaving work early on Fridays, unwillingness to listen to advise may be common behaviours to see from these individuals. Once the businesses began operation, the desire to become rich resulted in organizational goals relating to financial performance rather than product or service quality (Zilbershtein, 2012).

Focusing too narrowly on growth can also lead to an organization meeting its demise. Pursuing growth without due attention to the revenue and cost relationship can lead businesses to grow for the sake of growing and ignoring profits (McCormick, 2009). Although opportunities for revenue growth present themselves they often lead to less profitable areas, erode a company's return on investment, and even lose the business money (Richardson et al., 1994). Pursuing these opportunities can also require the company to take on additional debt, adding to the expenses of the project. Over-borrowing to support these projects can lead to unmanageable interest expense (McCormick, 2009; Ropega , 2011). Although these projects may be feasible, the business may need to wait and accumulate the necessary capital to avoid crippling interest expenses (Gaskill et al., 1993). In addition to financial considerations, there may also be knowledge issues. As a business expands into new areas, the businesses focus can become less tailored to the specific skills and knowledge of the entrepreneur and management team (Richardson et al., 1994).

2.4.2 Competence

A major factor leading to the failure of SMEs identified in the literature is the entrepreneur's skills in the area of business planning and management (Gaskill et al., 1993; Knotts et al., 2003; Cochran, 1981). When interviewed in the Zilbershtein (2012) study, even the failed entrepreneurs themselves expressed their shortcomings and unwillingness to learn. Although identifying an entrepreneur's competence as a key factor seems like an obvious observation to make, the lack of skills and experience shows its face in various ways from using gut feelings to make key decisions, and making unrealistic predictions (Zilbershtein, 2012; Ropega , 2011).

Many failed business owners admit to using gut feelings in their decision making process (Zilbershtein, 2012). Although gut feelings can lead to positive outcomes, they are not backed my solid facts, and can therefore be extremely unreliable. This can be particularly evident in areas such as human resource management and financial management (Ropega, 2011). Management errors within a small business is a common cause of small business failure (Ropega, 2011).

Making unrealistic assumptions of market acceptance and business growth is also a key reason for business failure (Richardson et al., 1994). Business owners can often be far too optimistic when relying on gut feelings about what customers will and will not do (Ropega, 2011). This can often lead to business failure as overestimation in demand will lead to overcapacity in production space, high overhead expenses, loss of liquidity, and solvency issues (Ropega, 2011). These, and many other serious issues can be ignored due to over optimism and acting on gut feelings.

2.4.3 Attitude

In general, entrepreneurs are very passionate about their businesses (Zilbershtein, 2012). After all, their business often takes up the majority of their waking hours until managers are put in place to handle daily operation. This does not seem to be any less true in the case of failed entrepreneurs (Zilbershtein, 2012). However, the attitude that the entrepreneur brings to their role as decision maker of the small business can have a great effect on the success of the business. Zilbershtein digs deep in his interviews with failed entrepreneurs and identifies specific tendencies that are consistent among failed entrepreneurs. There seems to be a common ‘hero mentality’ shared by failed entrepreneurs (Zilbershtein, 2012). Failed entrepreneurs tend to see themselves as the centre of the action in their small business and make key decisions in isolation without asking for others input (Zilbershtein, 2012). These entrepreneurs rarely accept advice from others, and tend to surround themselves with people who have similar ideas (Richardson et al., 1994). This is likely due to a need to be in control, and lack of willingness to share decision making power that Zilbershtein observed and this entrepreneur centric view of a small business seems to limit the success seen by entrepreneurs (Zilbershtein, 2012). Research shows that successful firms are often people centered rather than system focused, which is the systems and processes put in place by the key decision maker (Zilbershtein, 2012).

Looking specifically at how entrepreneurs tackle issues there is evidence that shows that failed entrepreneurs demonstrate a reluctance to adapt and find new solutions to problems facing the business (Ropega, 2011). As the organization grows it will face new and greater issues that may not be manageable using the methods employed when the business was a start-up (Ropega, 2011). Zilbershtein noted that failed entrepreneurs also have a common tendency to work on issues within the business one at a time based on priority whereas successful entrepreneurs were able to work on multiple issues simultaneously (Zilbershtein, 2012). This may be due to the unwillingness to share responsibility as previously stated. Entrepreneurs may also work to hide symptoms instead of addressing them head on (Ropega, 2011). Issues may be neglected until it is too late, and the business fails (Ropega, 2011).

Also a main factor leading to business failure is the entrepreneur's initial reaction to reaching a period or stage of sustained growth. Times of great success can lead to an inflated ego of the owner (Bruno, Leidecker, & Harder, 1987). All the hard work has finally paid off, and the owner may act in a few different ways. They may begin to increase capital expenditures on expensive office furniture and equipment in order to demonstrate the level of success they have acquired (Ropega, 2011). This excessive spending can begin to be a drag on the company's earnings. The entrepreneur may also begin to reward themselves monetarily, and buy expensive luxury items such as flashy cars, and find attractive, money focused individuals as partners (Richardson et al., 1994). This type of behaviour can quickly become too much for the business to support (Richardson et al., 1994). Others may increase their personal spending in order to fit in with a crowd of high social status (Ropega, 2011). In either scenario the owner begins to show off their wealth, and prioritize short-term personal goals over the best interests of the business (Ropega, 2011). Ultimately, this focus on the entrepreneur's personal lifestyle leads to lack of interest on the part of the individual (Richardson et al., 1994).

2.4.4 Strategy

In addition to behaviours displayed by the entrepreneur that commonly lead to business failure, there are also important responsibilities that entrepreneurs fail to perform that can lead to failure. A lack of planning can be extremely detrimental to the survival of a business (Scherger, Vigier, & Barbera-Marine, 2014; Knotts et al., 2003). Studies have shown that very little planning goes on in small business, and this may be contributing to the high failure rates of small business (Perry, 2001). This is particularly the case in competitive industries (Gaskill et al., 1993). The firms that successful plan often have a much lower likelihood of failure (Perry, 2001). Part of the planning problem seen by failed businesses includes the lack of planning for contingencies. Failure to perform adequate contingency plans is identified as a common cause of business failure (Richardson et al., 1994). Crises can emerge very quickly, and if a business has not prepared itself for it, it may not be handled efficiently. This lack of planning also shows itself in the form of poor pricing strategies (Gaskill et al., 1993). This also connects back to the previously mentioned unrealistic projections of customer behaviour (Richardson et al., 1994). Other potentially fatal issues that can arise from an entrepreneur’s lack of planning is poor product timing and product design, inappropriate distribution and selling strategy, unclear business plan, and customer concentration (Bruno et al., 1987).

Failure on the part of the entrepreneur to be outward looking is also a key point of failure identified by the literature. Entrepreneurs that spend a large portion of their time working in the business performing daily operational and administrative tasks lead to environmental changes going unnoticed (McCormick, 2009). This internal focus is often driven by the owner’s preference towards internal development rather than business strategy and planning (Zilbershtein, 2012). Failure can often result from this as business owners fail to recognize changes in the economy, competition, and loss of key strategic advantages of their own organization (Ropega, 2011). These neglected areas are major sources of risk for small firms. Perhaps the most vulnerable to this type of failure are introverted and hardworking family businesses (Richardson et al., 1994). These businesses often suffer from organizational inertia in the face of extreme environmental change (Richardson et al., 1994).

The behavior and skills of the entrepreneur can have a profound effect on the success and failure of SMEs, particularly in the early stages where the entrepreneur is the central decision maker for the firm. As the business grows, and the entrepreneur becomes increasingly removed from the management portion of their role, the causes of failure shift from the entrepreneur to the management team, and the various internal infrastructure of the SME.

2.5 Management Centered

As the business brings managers on board, a portion of the responsibility for the ongoing success of the business is entrusted to them. The systems put in place by the owner and management team are also key determinants of the success of the business. The main areas that cause business failure that is centered on the management of the business is the organizational structure, human resource function, the control systems put in place, and the relationships formed with outside parties. The following section outlines these factors.

2.5.1 Organizational Structure

As an organization has moved along the growth model beyond the start-up stage, managers typically begin to take responsibility for the operational tasks and administrative duties within the business. Along with the new management team, a new set of factors that can effect business survival come into play. This is particularly evident in the process of organizational structure change, human resources management, and implemented control systems, and external relationships with suppliers and customers.

The changing organizational structure that results in a business moving through the linear growth model can present some challenges to a growing business. As general or functional managers are adopted, there is a tendency for the decision-making power to remain centralized around the entrepreneur (Scherger et al., 2014), not changing from the original structure during the start-up stage (Ropega, 2011). This can be hazardous to the success of the business when the size of the organization no longer allows the owner to be everywhere at once.

If the entrepreneur does manage distribute control to a set of managers, this functional separation of the growing business can lead to tasks that were once everyone's responsibility to get done becoming nobody's responsibility (McCormick, 2009). This can lead to important business functions falling through the cracks and limiting the businesses success, or even result in failure. It is often difficult to bring about changes in the organizational structure because of rigidity in the way of thinking in a business (Ropega, 2011). The managers are accustomed to operating in a certain way, and can be resistant to change. In addition to this, due to the increased responsibility and autonomy of managers in a functional organizational structure, any shortcoming in commitment of the managers becomes apparent during this step in the growth model (Ropega, 2011). Each of these factors have contributed to the downfall of countless growing businesses.

The final organizational structure related cause of failure relates to the separation of management from the daily operations and contact with the customers or clients. The separation of top management from the everyday frontline activities can lead to a blindness to market changes in the industry (Richardson et al., 1994). This is particularly the case for businesses who do not spend enough time purposefully looking at the external factors that affect their business and organizations who do not have formal communication or feedback systems between management and employees. Major issues and changes in an industry are often clearest to those who interact with market participants on a regular basis.

2.5.2 Human Resources

The skill level of the management team is a key factor in determining the success of a business (Bruno et al., 1987; McCormick, 2009). Similarly, a lack of skills and qualified staff is highly detrimental to a small or medium sized business as it grows (Ropega, 2011). One might think that once a small business has a key set of managers that are passionate and understand the intricacies of the business, the owner is set for the future having done his part. However, the required level of skills and qualifications often grow with the business. A manager who is fantastic at managing a small firm may be confused and inadequate in coordinating a medium sized business. Managers may lack experience and be incapable of managing the new size of the firm as it grows (Bruno et al., 1987). This lack of management can sharply degrade the performance of the organization as a whole. Other factors can contribute to the presence of unqualified managers in a business. Hiring and promoting based on nepotism rather than experience and qualifications can lead to an inadequate management team (Bruno et al., 1987). Small and medium sized businesses can be particularly susceptible to this as the business owners may wish to give their children or family members experience in the business in order to take an upper management role in the future.

After a sustained period of success in business, it is not uncommon for a feeling of infallibility and overconfidence to be present in the organizational culture (Bruno et al., 1987). This can cause businesses to act ambitiously, which is not always a bad attitude. However, this acting on ambition can quickly turn into reckless and potentially fatal actions that risk the continuance of the business. This is not only present in the management team. This overconfidence can come from key employees as well (Bruno et al., 1987; Knotts et al., 2003). Although excitement and motivation of the employees is key to running a successful operation, this must be controlled in order to avoid unfavourable behavior.

On the other side of the spectrum, an unmotivated team can be equally disastrous for a business of any size (Ropega , 2011; Richardson et al., 1994). Many factors can contribute to a lack of motivation within an organization, which makes it a particularly difficult thing to control. A lack of motivation can also affect a management team. Although adopting a functional structure can offer a manager a new sense of focus within the business, it is also possible to lose sight of the full picture of the value the business delivers to the customer. Being removed from the value delivery may limit a manager`s motivation and commitment.

2.5.3 Control

There are various systems within an organization that are key to accurately conducting and monitoring the inner workings of a business. Of particular interest to business failure literature are accounting and operation and financial control systems.

The accounting practices of small to medium sized business were identified as a proponent of small to medium sized business failure. Record keeping is of extreme importance to a business as the accurate tracking of cash, revenues, and costs are main indicators of business vitality (Gaskill et al., 1993). However, as any good businessman knows, statements can be altered to show more favourable situations by a bit of creative accounting (McCormick, 2009). This creative accounting can be motivated by a variety of reasons from gaming the business tax structure, or masking questionable behaviour and spending habits of the owner. Unfortunately, this type of behaviour can mask other, potentially deadly, issues threatening the survival of a business (McCormick, 2009). At the very least, it can cause a false sense of security among management and employees (McCormick, 2009). In addition to the detriment that creative accounting can have on a small to medium sized business, a lack of record keeping has also been identified as a reason for business failure in the literature (Knotts et al., 2003). This lack of recordkeeping can limit the access to information for decision making purposes (Knotts et al., 2003). This lack of available information may lead entrepreneurs and managers to make gut decisions as previously mentioned.

The lack of control systems in a growing business can also lead to failure (McCormick, 2009). Poor inventory control can have negative effects on production and cash management (Gaskill et al., 1993). Too little inventory stocked may cause production to be halted, often leaving employees with no productive tasks to busy themselves with. This halt of production can also reach the customer as orders are not met in a timely manner. On the other side of the coin, too much inventory can increase storage costs, tie up cash, and increase the need for short-term financing, which carries a heavy interest burden. In addition to this, poor capital management in other areas such as account receivable management and accounts payable management can also be detrimental to a small to medium sized business (Knotts et al., 2003). Failing to accurately manage capital can act as a drag to business prosperity.

Inadequate control systems can also have an effect on product quality. Low quality control in the production process can allow defective or subpar quality product to reach the consumer, limiting product acceptance, and negatively affecting the success of the business (Knotts et al., 2003). In Knotts, Jones, and Udell`s study of failed small to medium sized business, failed SMEs scored a low 68.3% average in the quality and control of their production methods (Knotts et al., 2003). This study identifies the lack of control systems as a key cause of small to medium sized business failure (Knotts et al., 2003). Also noted was the absence of a continuous improvement program in the failed businesses included in the study (Knotts et al., 2003). Ropega (2011) adds to this assessment of the need for adequate control systems by stating that the lack of modern technology in small to medium businesses can also contribute to failure through financial and production control methods that are inferior to the technology used in the industry by their competitors (Ropega, 2011).

2.5.4 Relationship

Also identified by the literature as a key reason for small to medium sized business failure is their relationships and interactions with external parties such as suppliers, financiers, and professional assistance. Vendor relations and issues with inventory delivery can cause halts in production, similarly to the lack of inventory management identified previously (McCormick, 2009). Poor relationships with financiers can also lead to business failure (Bruno et al., 1987). For instance, if a creditors covenants are routinely violated, the creditor could request repayment of loans, or restrict lines of credit to a point that continued operations are no longer possible. Similarly, if key investors are dissatisfied with management performance, and no longer believe in the business, funds could be pulled, leaving the business to search for alternate investors, which may or may not be possible due to the condition of the business. Finally, Bruno, Leidecker, and Harder (1987) identify incompetent assistance from professionals such as lawyers and consultants as a cause of business failure (Bruno et al., 1987).

2.6 Failure Literature Review Conclusion

There are many reasons for business failure that are identified in small to medium sized business failure literature. The reasons identified in smaller businesses mainly revolve around the entrepreneur in the form of misled goals, insufficient business competence, poor attitude towards management, and lack of focus on strategy and the competitive environment. Once a management team is put into place in a growing business, the shifted responsibility results in a higher emphasis on systems and the skill and commitment of management. Specifically, the management centered reasons for business failure lie within the organization structure implementation, human resource management, process control systems, and relationships with external parties.

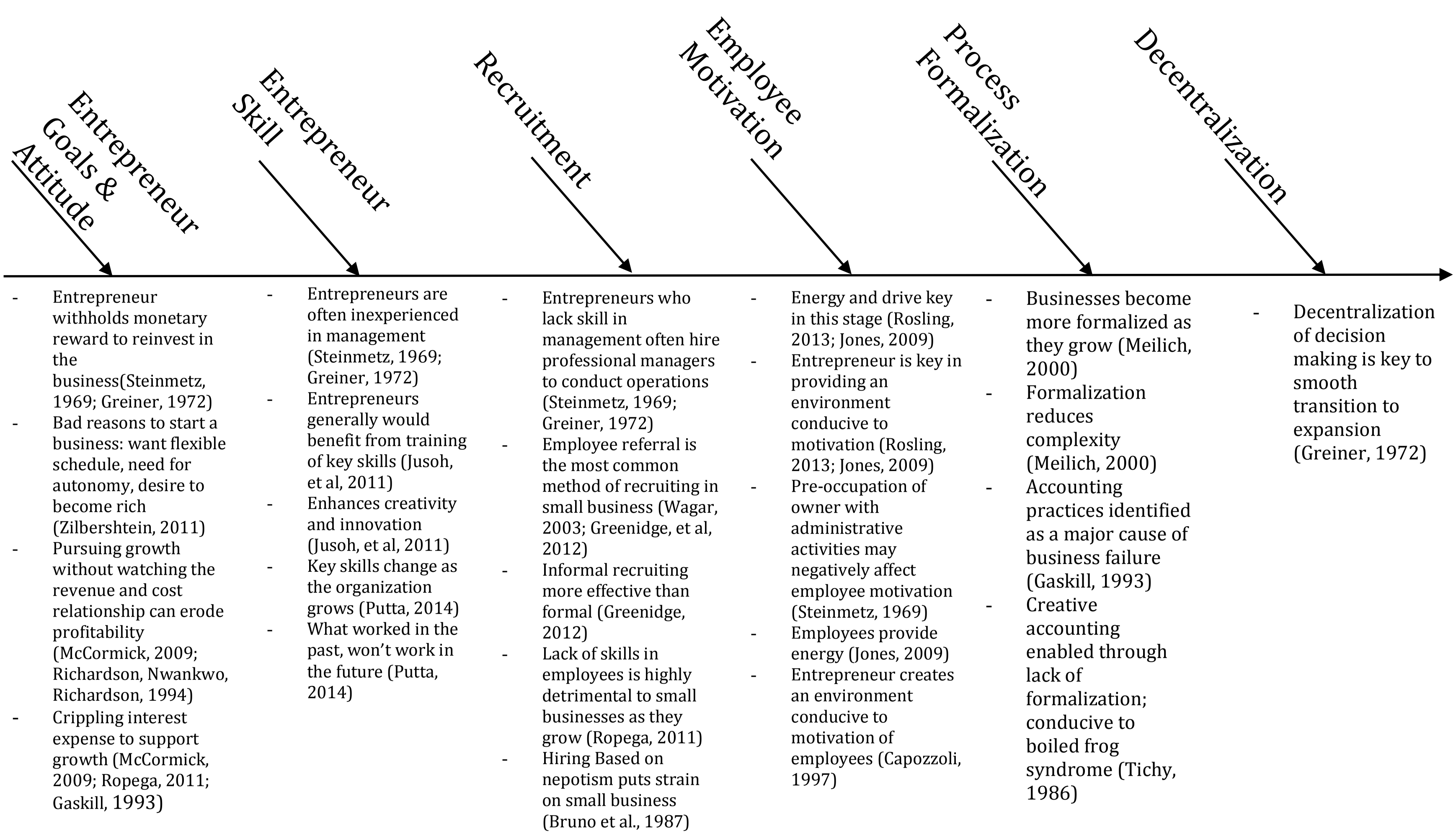
Chapter 3: Identifying Key Steps and Loops

Having reviewed the prominent linear growth models and the common causes of SME failure, it is clear where the main causes of failure lie on the linear growth models. To do this, this section will combine insights from both the linear growth and failure literature to inform entrepreneurs and managers and avoid common failures. In this section will aim to identify what can be done to avoid the common pitfalls in SME growth, and identify interrelationships between main points in development process and the main causes of failure in stages of growth. Through analyzing the failures in this way it becomes clear that at some point development will become extremely difficult without looping back to address neglected key issues in earlier stages. This can also provide insight into the linearity of the SME growth sequence, and explain why some successful business do not seem to emulate this sequence. Also identified are alternative focuses and strengths that can compensate for weak qualities of the internal workings of the business. For example, although it is important for the entrepreneur to be skilled in running a business, installing a skilled management team can compensate for this. Similarly, detailed processes, clear roles and responsibilities, and an environment of motivation can compensate for a shortfall of management skill on the part of the management team in the early stages.

3.1 Start-up

Figure 3.1 shows the linear sequence of steps in the start-up stage of SMEs.

Figure 3.1 - Start-up Stage Critical Steps



The first stage of the growth model, although early in the development of the business, has many conditions that must be met and steps that must be taken to contribute to success. The key steps within the start-up stage include ensuring appropriate entrepreneurial goals and attitude, entrepreneurial skill, quality recruitment methods, adequate employee motivation, process formalization, and decentralization of decision making power.

3.1.1 Entrepreneur's Goals and Attitude

The goals of the entrepreneur as they enter the market are a key component of entrepreneurial success (Zilbershtein, 2012). Some entrepreneurs have selfish reasons for starting a business including desire for a flexible work schedule, the need for autonomy, and desire to become rich (Zilbershtein, 2012). These reasons can cause unfavourable behaviour from the entrepreneur. The desire to become rich in particular can influence the entrepreneur to set financial goals such as sales without considering the relationship between revenue and costs resulting in unprofitable projects being taken on (McCormick, 2009). Blindly pursuing growth can negatively affect a company's return on investment, particularly as growth opportunities are initiated that are outside the skill set of the entrepreneur and key competitive advantages that the business holds (Richardson et al., 1994).

In addition to the negative effects on profitability that aggressively pursuing growth for the sake of growth can create, there is also the potential for businesses to be smothered in debt when financing capital intensive projects, for example. Additional interest expenses can quickly deteriorate the profit margins of a debt heavy business (McCormick, 2009; Ropega , 2011). Accumulating enough capital to fully or at least partially support projects will help to avoid crippling debt and interest expense (Gaskill et al., 1993).

3.1.2 Entrepreneur Skill

The skills of an entrepreneur in the areas of business, leadership, and planning are key to the success of businesses in the start-up stage. The majority of entrepreneurs would benefit from formal training yet very few actively seek this help (Jusoh, Zivae, Asimiran, & Kadir, 2011; Putta, 2014). Although entrepreneurs commonly have a core set of skills that they feel will drive their success, there is many more skills required (Hatch & Zweig, 2000). Among the skills that entrepreneur training commonly focuses on are promotions, advertising, price setting, and selling skills (Jusoh, Zivae, Asimiran, & Kadir, 2011). However, management skills are commonly neglected in entrepreneur training programs, which can be detrimental to the success of small businesses and ultimately lead to failure (Putta, 2014; Gaskill et al., 1993). Without the proper business skills, entrepreneurs often rely on intuition, or a gut feelings rather than less reason based decision making practices, which commonly leads to business failure (Ropega , 2011; Zilbershtein, 2012). Lack of entrepreneurial and management skill on the part of the business owner is identified as a key cause of small to medium sized enterprise failure, particularly in the start-up stage (Gaskill et al., 1993; Knotts et al., 2003; Cochran, 1981).

The list of skills a business owner is required to have to run a successful business is not a set list. As the business grows, the entrepreneur will need to acquire new skills to be a successful business owner (Putta, 2014). The skill set required changes from an entrepreneurial focus to a managerial focus in areas such as human resources, and financial management (Putta, 2014; Ropega , 2011). The type of management that worked in the early stages of the business will likely not be the best strategy throughout the growth process (Putta, 2014). A business owner can limit the negative effects of their personal shortcomings in business by installing a management team with diverse skill sets (Putta, 2014). However, during the start-up stage, this can be a heavy expense for a new business. Not having the necessary management skills can lead to business failure, which is discussed in the failure literature, as well as the growth literature. Responsibilities begin to fall through the cracks as the business gets larger, and consequently more complicated. In order to handle the increasing complexity of the business the entrepreneur must put their ego aside and develop an attitude of perpetual learning and humility.

Also an important skill that is neglected by many entrepreneurs that commonly leads to failure is the entrepreneur’s ability to plan business actions (Knotts et al., 2003; Scherger et al., 2014). Poor planning can lead to a variety of negative effects such as poor product timing, ineffective distribution strategies, unclear business plans, and high levels of customer concentration (Bruno et al., 1987). This lack of planning often also means that the entrepreneur does not spend time developing appropriate contingency plans, which are crucial when things don’t go as planned (Richardson et al., 1994). Skills in planning are critical as the business progresses in the start-up stage, and eventually progresses to the expansion stage. The entrepreneur must take time out of being actively involved in the operation of the business and plan the strategy of the business in order to avoid losing their competitive advantage in the market. This element of planning is discussed in both the linear growth model literature and failure literature.

The lack of business skills on the part of the entrepreneur can also lead to a general overconfidence or blind optimism regarding the success of the business (Von Bergen & Bressler, 2011). Over optimism can have unfavourable effects on the business including risk denial (Von Bergen & Bressler, 2011) and unrealistic assumptions (Richardson et al., 1994). Some entrepreneurs develop a hero mentality regarding their business and believe they are solely responsible for its success (Zilbershtein, 2012; Putta, 2014). This in itself has negative effects including acting on gut feelings, and reluctance towards new ideas. The self-centered entrepreneur may have trouble with sharing decision-making power as the business grows. This isolation of decision-making will lead to less creativity, and less analysis leading to a solution (Zilbershtein, 2012). Poor decisions on the part of the entrepreneur can impede the success of the business and eventually lead to business failure. If the entrepreneur can identify this behaviour before it is too late, they can change the way they make decisions by including managers and employees in the decision making process.

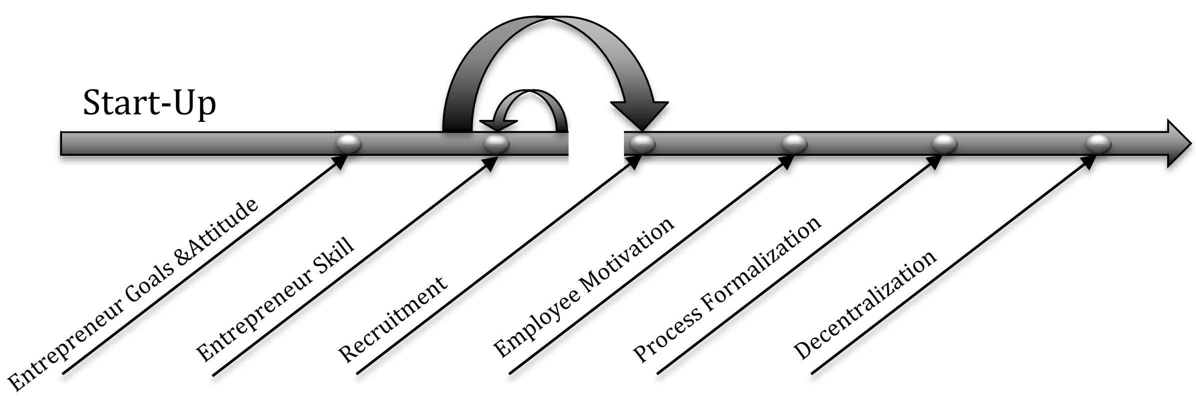
3.1.3 Recruitment

The recruitment and training process is often relatively neglected in small business (Greenidge, Alleyne, Parris, & Grant, 2012). This is a particularly significant source of risk for businesses in the start-up stage as the cost of hiring a poor employee is considerably higher (Wagar & Langrock, 2003). Greiner discusses the quality of employees in the early stages of SME growth and argues that employees need only have an average level of intelligence (Greiner, 1972). However the recruitment process should not only look for intelligent employees, but trustworthy, and dedicated employees. In small businesses it is often senior management who takes responsibility for hiring, and rarely do they receive any formal training in the recruitment procedure (Wagar & Langrock, 2003). The recruitment procedure includes the assessment of whether the position needs to be filled, job analysis, production of a job description, and person specification (Greenidge et al., 2012). Small businesses also face more limitations when looking to attract talent. It is often thought that a small business offers less opportunity for career growth, lower salaries, and monotonous work (Galabova & McKie, 2013). Yet, there are a number of benefits of working within a small firm such as gaining experience, often-flexible working times, and a friendly, close knit work environment (Galabova & McKie, 2013). Without knowledge of the factors that attract and repel talent from small firms, an entrepreneur may struggle to find appropriate fit for open positions. Without the necessary skills in recruitment, the entrepreneur may need to return his or her attention to entrepreneur skills training, something not commonly offered by management training programs, in order to ensure the future success of the business.

Many businesses use alternative methods of recruitment such as employee referrals (Wagar & Langrock, 2003). Research has shown that informal recruitment, such as referrals, are more effective than formal methods in recruiting talent (Greenidge et al., 2012). Small firms are more likely to use these methods, as they are inexpensive, and feasible due to the small size of the recruitment initiatives (Greenidge et al., 2012). Large firms have to process a much higher volume of applicants and positions making formalized systems necessary (Greenidge et al., 2012).

Recruitment methods can have a significant impact on the success of a business. Inadequate recruitment can lead to a lack of key skills in a business (Ropega, 2011), can open the door for hiring based on nepotism (Bruno et al., 1987), and can lead to misplaced confidence in key employees (Bruno et al., 1987; Knotts et al., 2003). *Figure 3.2* illustrates the path of the small business that neglects this step in the growth process. The business will be unable to recruit a skilled team without adequate recruiting knowledge.

Figure 3.2 - Recruitment Loop



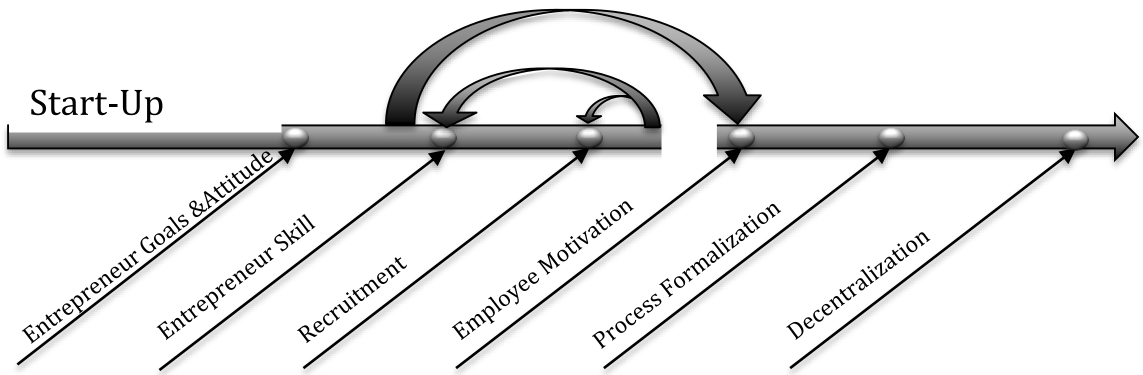
3.1.4 Employee Motivation

Once the right people have been brought on to the business, it is important for an entrepreneur to be able to keep them motivated. Managers cannot motivate employees directly, but must create an environment where employees are willing to motivate themselves (Capozzoli, 1997). A motivating environment facilitates the self-motivation of the individuals in order to stimulate optimal performance (Kamery, 2004). The entrepreneur manager can provide an environment that facilitates motivation by setting high standards that are achievable, stating clear objectives, providing adequate training, offering management contact, providing feedback, tailoring rewards to value of employees, safe and comfortable working conditions, and strong leadership (Capozzoli, 1997). Environments that stifle motivation often contain complicated office politics, unproductive meetings, misinformation, and unfair treatment, ultimately leading to low morale and low motivation (Kamery, 2004). An entrepreneur who has been trained in management and leadership will work toward facilitating a motivating environment. For instance, when setting employee targets, it is key to make sure they are attainable, yet push employees to achieve optimal performance. Without adequate entrepreneur and manager skills, finding this level will be difficult. The entrepreneur's management skill is a key factor in providing a motivating environment. If an entrepreneur in the start-up stage is struggling to maintain motivation, they need to understand their role as leader and learn what they need to provide their employees with to be productive at an optimal level.

The leadership ability of the entrepreneur is key to employee motivation. Transformational leadership has gained momentum in the business world over the past few decades. Bernard M. Bass, a seminal author in the transformational leadership area of study explains that transformational leadership, "occurs when leaders broaden and elevate the interests of their employees, when they generate awareness and acceptance of the purpose and mission of the group, and when they stir their employees to look beyond their own self-interest for the good of the group (Bass, 1991, p. 19)." As a manager and a leader, this is the type a behavior that is desired. Encouraging employees to become emotionally driven to affect the level of success of the firm provides a high level of motivation. Transformational leadership can make a significant difference in the performance of a business, and can mean the difference between success and failure in business (Bass, 1991).

Figure 3.3 illustrates the identified need for both the entrepreneur's skill in management and leadership, and the recruitment of quality workers in order to achieve an environment of motivation. If the entrepreneur is unable to provide adequate leadership for the employees in the organization, they must identify within the business, or recruit externally, a leader capable of motivating and mobilizing the employees. If the company is struggling to create an environment of motivation they must loop back to build management skills, and reassess leadership style to jump forward in the steps of growth to create an environment of motivation. Although it may be possible to return to the recruitment step to find engaged individuals more facilitating of a motivated environment, an effective leadership style such as transformational leadership should help to engage employees. Transformational leadership involves being a role model for employees, inspiring employees to achieve more, displaying genuine concern for the employee's needs, and challenging employees to be creative strive to innovate within the business (Bass, 1991). This type of leadership behavior will contribute towards employee motivation (Bass, 1991).

Figure 3.3 - Employee Motivation Loop



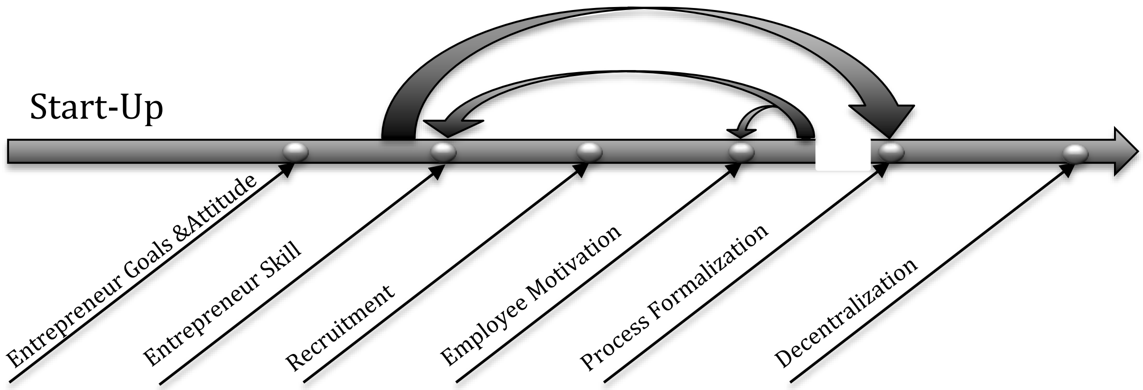
3.1.5 Process Formalization

Classical management theorists seek to find systemized ways to ensure rational management and formalize accountability within the firm (Meilich, 2000). Process formalization improves efficiency by improving time management, standardizing training and monitoring lowering required number of managers, decreasing coordination costs, lowering wage expenses, decreasing skill requirements of employees, limiting organizational politics, and making it easier to discipline unwilling employees (Meilich, 2000). Process formalization helps to decrease complexity in all aspects of a business, which becomes essential as the business grows in size (Meilich, 2000). Without the formalization of processes, business growth brings with it an increased number of mistakes, more responsibilities falling through the cracks, and a general decline in productivity. Process formalization can also decrease the alternative interpretations of roles in the organization (McKinley & Scherer, 2001).

Accounting practices in business must also be formalized in order to produce accurate data from which decisions can be made. Accounting practices of SMEs have been identified as a major cause of failure (Gaskill et al., 1993). Without adequate labour records and cost of goods sold figures that management accounting practices would offer, the profitability of individual projects may remain unclear to the management team or key decision maker. This missing information can be particularly harmful for a business that bids on projects, or a business that competes in a competitive market with thin margins. Creative accounting practices can be particularly harmful to a small business (McCormick, 2009; Knotts et al., 2003). It can lead to making decisions based on skewed information, and a false sense of security on the part of the entrepreneur and any other management team members (Knotts et al., 2003).

Figure 3.4 identifies the need for employee motivation and entrepreneurial skill in the implementation of process formalization. A business that wishes to advance to adopting formalized processes may run into difficulties without motivated employees who are willing to alter their behavior in order to conform to the new standards. The leadership ability of the entrepreneur and their success in providing an environment of motivation will be facilitative of this process. A certain level of management skill on the part of the entrepreneur is also important in order to identify efficient methods and key performance benchmarks to implement in the business. An entrepreneur that lacks management skill can work towards gaining these skills by participating in management training courses (Jusoh et al., 2011). The entrepreneur may also consider hiring a skilled manager to take the lead on management within the business (Greiner, 1972). These management skills will contribute to the quality and accuracy of the formalized processes.

Figure 3.4 - Process Formalization Loop



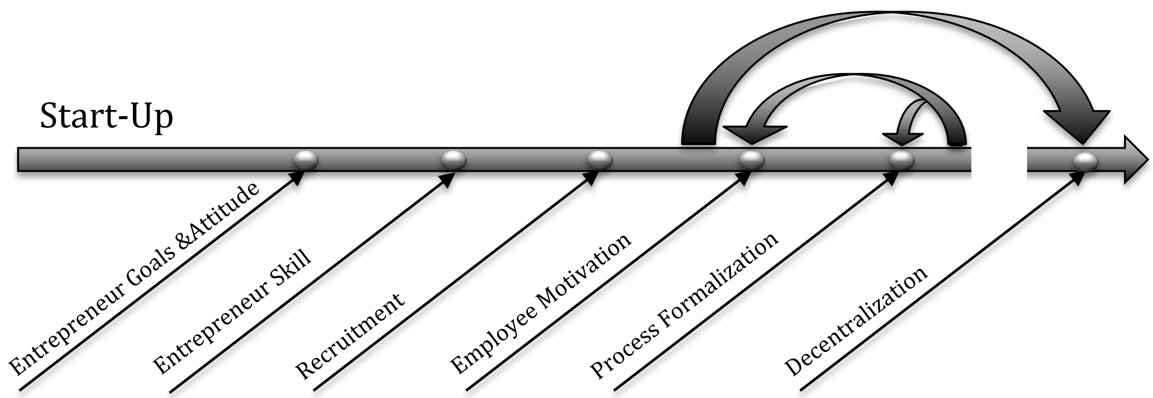
3.1.6 Decentralization

Before entering the expansion stage, it is often important for the entrepreneur to decentralize the decision-making power in the organization (Greiner, 1972). Once the business begins to grow, there will be a point that the entrepreneur can no longer make fully informed decisions on all aspects of the business. This may occur for some entrepreneurs sooner than others. Entrepreneurs often begin to rely heavily on technology to handle the higher level of responsibility, while ignoring the need for appropriate management action such as delegation to key employees (Fu, Chang, & Wu, 2001). If they have not already felt overwhelmed with the constant increase in business complexity, they soon will when revenue begins to grow, the product or service achieve broad acceptance, and more employees are taken on to meet the demand. This can lead to business failure as the entrepreneur becomes overwhelmed by daily activities, leaving no time for the business planning that is key to maintaining a competitive advantage. Decentralizing the decision-making power essentially empowering managers and employees to take responsibility for selected appropriate decisions on a daily basis (Fu et al., 2001). This reorganization of decision-making power will work to increase productivity, better align the environment for motivation, improve competitiveness, and will help to transition to a functional organizational structure in the expansion stage (McKinley et al., 2001).

This restructuring of the decision making power, the first major structural change, can create temporary instability in the business as employees adjust to their new set of responsibilities (McKinley et al., 2001). Through this environmental change, it is important for top management, at this point usually solely the entrepreneur, to actively participate in the changes (Fu et al., 2001). The entrepreneur's leadership ability will be of great importance during the implementation of this process. Although the distribution of power may temporarily create confusion in the organization, these actions will enhance the cognitive order in the long run as the business continues to grow in size and complexity (McKinley et al., 2001).

Figure 3.5 illustrates the need for a solid foundation of process formalization and employee motivation before implementing a decentralized decision making structure. Dispersing the decision making power throughout the organization will require a high level of motivation among the key employees entrusted with this responsibility. The confusion created by the structural change of the business can be detrimental to a business that has not taken the necessary steps to create a motivational environment. A significant focus on process formalization is also important in order to minimize ambiguity in roles and responsibilities. Businesses that neglect these two steps will struggle to effectively implement the decentralized decision-making structure, and therefore must loop back, address those issues in order to jump forward and implement the decentralized decision-making structure.

Figure 3.5 - Decentralization Loop

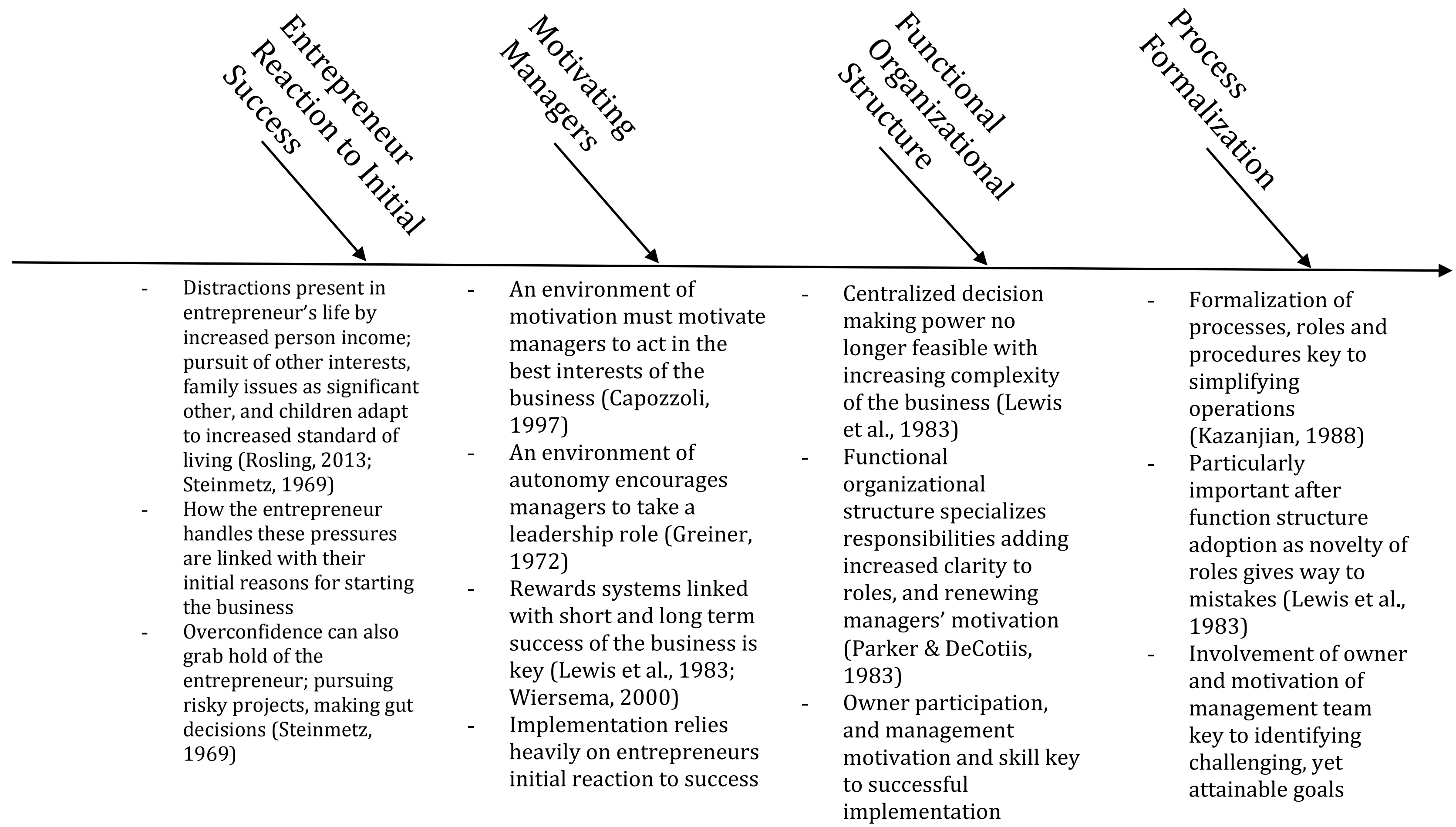


The conditions and steps that must be taken in the first stage of SME growth are all fairly obvious. But the progression of when each of them must be met is important due to the interrelated and building nature of the steps. Just as there is a proper order of activities to building a house, there is an optimal order of entrepreneurial and managerial tasks to building a business. Quality recruitment depends heavily on the management skill and judgment of the entrepreneur. The management and leadership skill of the entrepreneur along with the quality of recruitment will contribute towards building a motivated group of employees. From here process formalization will take the motivated employees, and simplify employee roles, and remove ambiguity from the process. In order to efficiently implement these formalized processes, the entrepreneur and any management team members must reinforce the processes to ensure uniformity throughout the business. Finally, the formalization of processes, and motivation of employees that makes it possible to decentralize the decision making power within the business.

3.2 Expansion

As the business begins to rapidly grow, there are key activities including adopting a functional organization structure, and further process formalization that it must undergo to continue to operate with efficiency and accuracy. Many of these activities depend on the entrepreneur as many of the changes the business will undergo will need support from the top of the management structure. The motivation of the management team to reinforce the importance, and oversee the implementation will also be of high importance.

Figure 3.6 - Expansion Stage Critical Steps



3.2.1 Entrepreneur Reaction to Initial Success

As identified in the linear growth model literature there comes a time in SME growth that the entrepreneur considers his venture successful. This often comes during the expansion stage as revenue is growing, the operations are expanding, and the excitement in the organization is high from increased orders (Rosling, 2013). This period of extended growth requires a strong managerial and leadership focus in order to handle the increased demand on the employees. However, this is also a time in which entrepreneurs may decide to reward themselves for their hard work and success in business. This involves increased dividend payments to the owner to support a higher standard of living (Rosling, 2013). This along with additional family pressures, and establishing social standing can draw the attention of the entrepreneur away from the business (Rosling, 2013; Steinmetz, 1969). In the Zilberstein (2011) study into failure of SMEs he identifies the common alignment of successful entrepreneurs' personal goals and the goals of the organization. For instance, if the entrepreneur is committed to running a successful, consistently growing business, he will not fall prey to the distractions that an inflated personal bank account offers. It is clear that the entrepreneur's reaction to the success of their business links back to the original reasons that the entrepreneur decided to start a business in the first place. If the entrepreneur went into business for selfish reasons such as to become rich (Zilbershtein, 2012), as soon as this goal is achieved, the entrepreneur will be faced with a decision: Do they begin to enjoy the achievement of their original goals, or do they continue pushing to see how far they can push their business, and in turn, perhaps make for money, or achieve a higher level of detachment from the business? Installing skilled management who can take the reins of the business in the absence of the entrepreneur in the earlier start-up stage can help to counter this straying focus of the entrepreneur. Owners that fall into this trap without making alternative arrangements for management and leadership risk driving their organization to failure.

The distractions that success brings is not the only danger at this point in the entrepreneur's journey. The new found success could also go to the entrepreneur's head, causing them to place excessive confidence in their business acumen. This can lead to irrational spending behavior on risky projects, aggressive expansion efforts, and spending on expensive office furnishings to reflect the success of the business (Steinmetz, 1969). Opportunity for this behavior to take control is amplified if the entrepreneur had not addressed the need for competent leadership for the business in the start-up stage. Lack of business planning and management skills in the business is a major factor that can lead to business failure. Appropriate analysis, budgeting, and financial management can limit the over-confident actions of an entrepreneur who has reached a significant amount of business success.

3.2.2 Motivating Managers

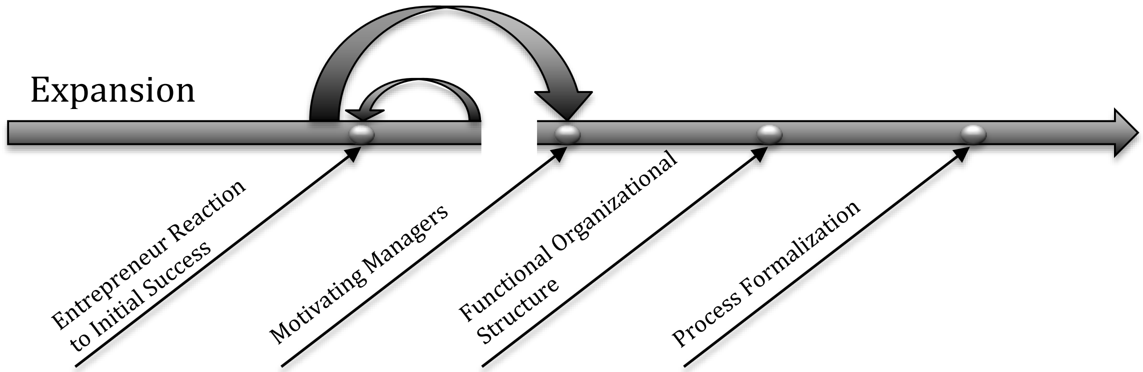
During the expansion stage the entrepreneur needs to shift their focus from a 'do it yourself' mentality to a manager mindset (Steinmetz, 1969; Greiner, 1972; Lewis et al., 1983). At this point, the entrepreneur needs to focus on ensuring that the management team is motivated to act in the best interests of the business (Bruno et al., 1987; McCormick, 2009). An unmotivated management team can be disastrous for a business during the expansion stage and can lead to the failure of the business (Ropega , 2011;

Richardson et al., 1994). As was the case during the start-up stage, motivation in the organization is highly dependent on the entrepreneur's ability to provide an environment conducive to motivation (Capozzoli, 1997). In the case of motivating managers it is also key to provide an environment of autonomy (Greiner, 1972). By giving managers room to make decisions and take a leadership role in the business they are more able to make a meaningful contribution to the business. In allowing for greater autonomy, the entrepreneur must also be aware they mistakes will be made (Lewis et al., 1983). It is easy for a business owner to see a mistake, whether actually a mistake, or just a mistake in the owner's eyes, and revoke some of the autonomy given to the management team. However, this would have a significant negative impact on the management team morale and motivation.

In order to motivate managers, it is also suggested that reward systems be put into place in order to align management's goals with what is best for the business (Lewis et al., 1983; Wiersema, 2000). In developing these reward systems, care must be taken to reward management for a combination of short and long term goals. Managers will shift their efforts to activities that reward well, and reward often (Higgins, 1981). Because of this, long term focused activities can often be neglected in favour of rewarded, short term goals. Successful incentive systems are aware of the relationship between management rewards relative to the benefit seen by the business, represent individual consideration of what each manger values, incentivize behavior that is best for the business, and can be measured reliably (Wiersema, 2000). Implementing a successful management rewards system can be very complicated and time consuming, therefore the engagement of the entrepreneur is key. This relies heavily on the entrepreneur's reaction to the initial success of the business. If the entrepreneur is distracted from the management of the business, having motivated managers with adequate rewards systems is key. Motivated and capable managers can provide a safety net for the distracted entrepreneur.

Figure 3.7 illustrates the importance of the reaction of the entrepreneur to the success of the business in motivating managers to act in the best interests of the business. Without the participation of the owner in the management of the business, the proper incentive programs will not be implemented. In addition to this, the absence of the entrepreneur due to the distraction previously stated, can produce a lack of direction of the company, and loss of dedication from all organizational members. If the entrepreneur cannot be an active leader for the organization, they should consider passing their leadership and management responsibilities on to a trained individual that has the proper experience and training, if this has not already been done. Although the entrepreneur cannot change their initial reaction to the success of the business, they should be able to recognize the impact of their actions on the business. At this point they must reassess where there priorities are, reassume the leadership role, or appoint or recruit someone to take their place. Some entrepreneurs are more suited towards start-ups and appoint a general manager in order to pursue other opportunities (Jones, 2009).

Figure 3.7 - Motivating Managers Loop

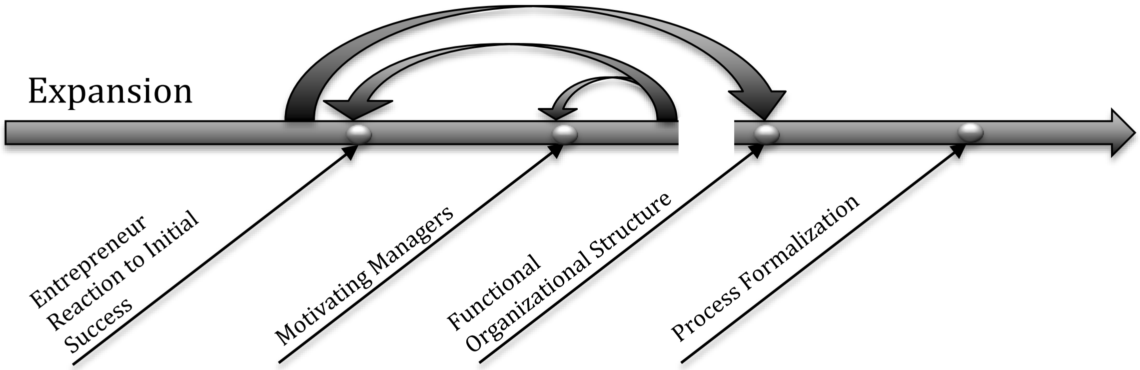


3.2.3 Functional Organizational Structure

During the expansion stage it is common for the decision making power to remain centralized around the entrepreneur (Scherger et al., 2014) with no change to the organizational structure. This can be detrimental to the success of the business while the business grows in sales and complexity. At this stage, the business becomes too large and complex for the entrepreneur to make strong business decisions in all areas of operation. It is because of this that the linear growth model literature recommends adopting a functional organizational structure, where decision making power is distributed among the management team. This step relies on the previous requirement of having motivated managers who the entrepreneur can trust to act in the best interest of the business. Any shortcomings in manager commitment or motivation becomes readily apparent when a functional structure is adopted (Ropega, 2011). Also a risk is the possibility of inefficient implementation of the new organizational structure. There is the risk of some important responsibilities falling through the cracks and being neglected in the new structure (McCormick, 2009). The entrepreneur will most likely be heavily involved in the transition to a functional structure to resolve any ambiguity in responsibilities. Once again, this depends on the reaction of the entrepreneur to the initial success of the business in the expansion stage. Successful implementation of the change to a functional organizational structure will, in general, simplify the roles within the organization, and therefore decrease the job stress of managers and employees (Parker & DeCotiis , 1983).

Figure 3.8 illustrates the need for motivated managers and the presence of the entrepreneur in the implementation of a functional organizational structure. Entrepreneurs that become distracted by other interests as a result of their new found wealth may not be present enough in the business to initiate and implement the adoption of a functional organizational structure. The absence of motivated managers can also hinder the success of the new structure. As this process will divide the company's departments, there will be a need for managers to accept more responsibility in their roles. Without a motivated group of key managers, responsibilities that are key to the success of the business can easily fall through the cracks amidst the chaos of the change process. In order to motivate managers, incentive systems are often put into place (Wiersema, 2000). Successful incentive systems motivate managers buy reflecting what is important to the manager, while being in line with the goals of the firm (Wiersema, 2000). The same transformational style that was successful in motivating lower level employees are also effective in motivating managers (Bass, 1991).

Figure 3.8 - Functional Organizational Structure Loop



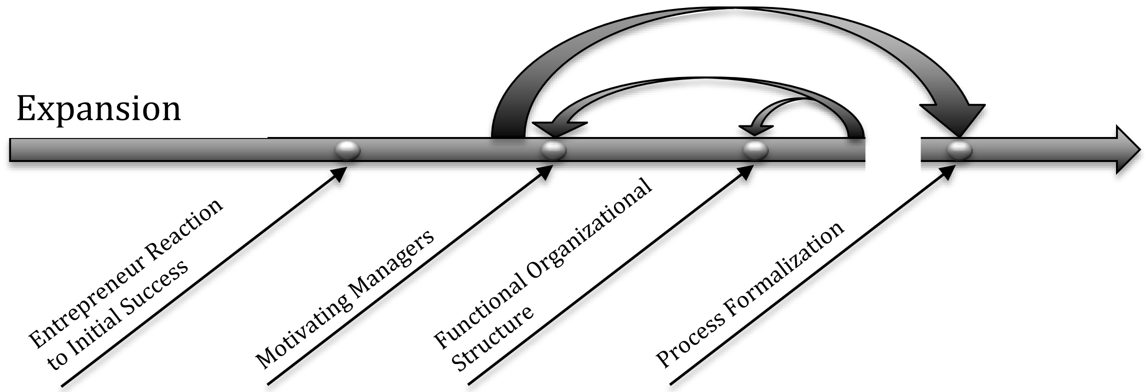
3.2.4 Process Formalization

Along with the new organizational structure of the business, there should also be an increased focus on the formalization of roles, responsibilities, and processes in the organization (Kazanjian, 1988). Budgets, accounting systems, inventory and purchasing regulations work to keep the company under control in the new decentralized decision making model (Greiner, 1972; Lewis et al., 1983; Jones, 2009). These financial controls require managers to plan ahead, justify decisions and spending, and limit the amount of harmful creative accounting practices that can hide critical issues in the business (McCormick, 2009). Insufficient accounting practices has been identified as a common proponent of SME failure. A lack of accounting procedures can be identified by the lack of information for processes such as determining production volumes, bidding on projects, or inventory control causing negative effects on production and cash management. As previously discussed in the motivation of managers, incentive systems should have already been implemented in order to motivate managers to act in the best interest of the business. SMEs often lack the knowledge in production technology that can offer increased control over many of these areas (Ropega, 2011).

Formalization of processes can increase efficiency in many ways including improving time management, increased training and monitoring, decreasing the number of managers needed, lowering wage expense, lowering the required level of skill of employees, limits internal politics, and makes it easier to identify and discipline underperforming employees (Meilich, 2000). As the organization grows and becomes more complex the need to control these factors increases (Meilich, 2000). In order to successfully implement formalized processes in the organization it is key to have a capable and motivated management team in order to ensure the standardized procedures are adhered to. Due to the decentralized nature of the organization at this point, it is more important to have the support of management in implementation than having direct involvement of the entrepreneur.

Figure 3.9 illustrates the need for motivated managers, and the implementation of a functional organizational structure in order to successfully adopt formalized processes in a business approaching the expansion stage. The process formalization must occur after the structure change in order to formalize the processes in the new organization of the business. These formalizations of tasks, accountability, communication, and operating processes and procedures, must standardize the responsibilities in each of the functional departments, and ensure the processes in which the departments interact between each other (Meilich, 2000).

Figure 3.9 - Process Formalization Loop



In the expansion stage there are clear relationships between the key steps identified in the linear stage model literature that will prevent the common causes of failure. The reaction of the entrepreneur to the initial success of the business will determine their success in maintaining a team of motivated managers. Although managers can be motivated without the presence of the entrepreneur, managers may tend to pursue personal goals for the organization in the absence of the entrepreneur and incentive programs. The adoption of a functional organizational structure will require the active involvement of the entrepreneur and upper management. As this new organizational structure will involve changes in role and responsibilities within the organization, there will be a need for revised formalized processes. These formalized processes must be capable of handling increased orders and additional employees during the remainder of the expansion stage.

3.3 Maturity

The business has exhausted all of its high growth opportunities in their current market and sales growth is slowing. The first key to success at this point is to not panic. The reaction of the business to the leveling growth is the first step towards success in the maturity stage. This provides the opportunity to focus on maintaining the entrepreneurial spirit that made the business successful in the first place, managing costs, and coordinating between departments to prepare to move forward at the new size. Each of these step build upon each other and are critical to avoiding failure. The below figure outlines these key steps.

Figure 3.10 - Maturity Stage Critical Steps

Reaction to Leveling Growth

- Suspicion, and panic can run through the organization if management does not foresee the leveling in sales growth as the company enters maturity (Greiner, 1972)
- Refocusing on cost management is in order (Lewis et al., 1983)
- Key to past success not likely the key in this new stage; business can fall prey to organizational inertia (Richardson et al., 1994)
- Entrepreneur must shift from a supervisory role to a strong focus on business strategy (Steinmetz, 1969)

Maintaining Entrepreneurial Spirit

- Regulation and processes working against entrepreneurial spirit
- Entrepreneur must now facilitate conditions that promote innovation and entrepreneurship within the business (Lounsbury, 1998)
- Putting creative responsibilities in the hands of other will be difficult for entrepreneurs with a 'hero' mentality (Zilbershtein, 2012)
- Organizations built on relationship and participative leadership styles will often be more effective at inspiring entrepreneurship within organization (Soriano & Manuel, 2007)

Managing Costs

- Many companies fail to manage costs effectively due to lack of record keeping for decision making purposes (Gaskill & Van Auken, 1993)(Knotts, Jones, & Udell, 2003)
- Benchmarking and life-cycle costing are the most effective initiatives for SMEs (Wald, Schneider, Schulze, & Marfleet, 2013)
- Competent entrepreneur, skilled and motivated management are necessary for implementation of these and many other necessary measures

Functional Department Coordination

- Processes, systems, and procedures are often not conducive to the dissemination of knowledge (Supyuenyong, Islam & Kulkami, 2009)
- A carefully implemented knowledge management system can enhance sustainability in an organization and increase productivity (Mirza & Ali, 2011)
- Presence of skilled managers, motivated employees, and adaptability are key to implementation

3.3.1 Reaction to Leveling Growth

Once the business reaches the maturity stage, the entrepreneur and management team must be prepared in order to continue the success of the newly mature business. Maturity occurs when high growth opportunities in the market are fully explored (Kazanjian, 1988). This can commonly cause a loss of excitement in the firm, and at times, panic (Lewis et al., 1983). The business had been doing so well in the expansion stage but managers and the owner may begin to doubt their strategy, doubt the dedication of other managers, or doubt efforts of the employees. Executives and senior managers can feel as though they are losing control at his point in the growth model (Greiner, 1972). This stress and fear can cause the leadership team to react to the leveling sales with additional marketing activities or search farther outside of the businesses expertise for additional clients or customers when in actuality additional focus on cost management is necessary (Lewis et al., 1983). Businesses often fall prey to this panic, particularly in organizations with a strong internal focus, often driven by the entrepreneur and manager’s preference towards internal development (Zilbershtein, 2012). In addition to this, organizational inertia can often limit the response of management to changes in the environment (Richardson et al., 1994). The company had been growing so quickly in the expansion stage, they must have been doing something right, and so they continue to focus on the activities they feel made them successful previously. However, as we have seen in the linear growth model review, and the business failure literature, what makes a business successful in the past is likely not going to be the key to success in the future. Also contributing to the possibility of failure due to an inappropriate reaction to business maturity is a lack of skill of the part of the entrepreneur, and the managers of the business. An adequately trained business lead should be able to recognize the signs of the business entering a stage of maturity and react accordingly. What may also limit an entrepreneur and management team from recognizing these signs is a lack of formalized planning in the organization identified as a key factor in the expansion stage (Greiner, 1972; Lewis et al., 1983; Jones, 2009).

In order to successfully navigate the transition into the maturity stage the entrepreneur must shift from a split focus on management supervision and planning, to a strong focus on business strategy (Steinmetz, 1969). Managing costs and working with external parties such as suppliers, distributors, and customers will be key to a successful transition into the maturity stage (Jones, 2009). Formalized processes and controls implemented in the expansion stage will help in the cost management effort and provide quantifiable information on which to base business decisions. This requires a business savvy entrepreneur and competent management team to buckle down and trim costs to survive.

3.3.2 Maintaining Entrepreneurial Spirit

As more regulation and processes are installed in the operation of the business, it is common for a business to lose its entrepreneurial spirit. Development in business processes slows, new ideas generated by managers and employees become rare, and the business does not continue to improve.

Just as the entrepreneur generated an environment conducive to employee motivation in the expansion stage, the entrepreneur must now create conditions that facilitate innovation and entrepreneurship within the business (Lounsbury, 1998). This may take many forms such as allowing employees to explore ideas for increased efficiency and cost savings. This may even involve creating work-teams built for the purpose of identifying opportunities for improvement in the organization (Soriano et al., 2007). This idea of putting trust in the hands of employees may be very difficult for an entrepreneur with a ‘hero’ mentality that was discussed as a detrimental entrepreneur attitude in the failure literature. Empowering employees to take an active role in the improvement of the organization can increase motivation of involved parties, however a certain level of motivation is required from the employees in order to be engaged in the process. Collective entrepreneurship is achieved through the collaboration of motivated organization members, and cannot be a forced responsibility (Soriano et al., 2007). Certain leadership styles are more conducive to the organizational entrepreneurship that is required at this stage. Organizations that are built on relationship and participative leadership styles will often be more effective in transmitting the entrepreneurial spirit of the owner, while task oriented leadership styles will struggle to instill entrepreneurial values in the organization, regardless of how entrepreneurial they are themselves (Soriano et al., 2007).

3.3.3 Managing Costs

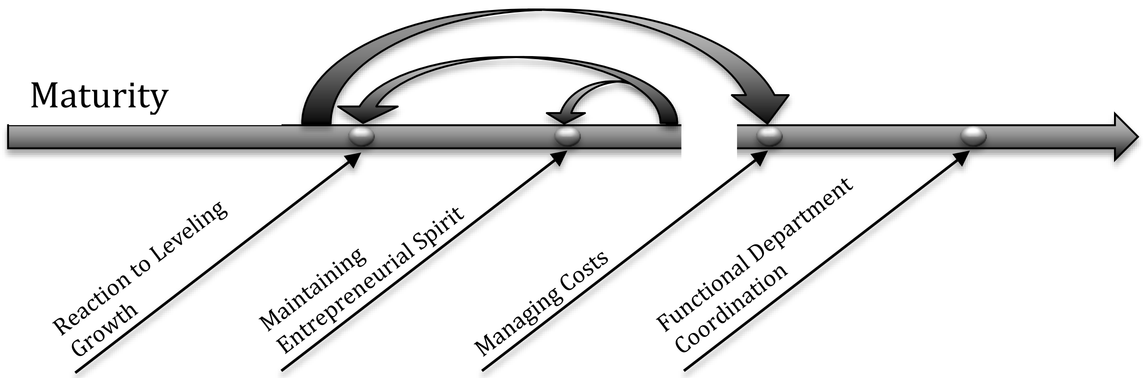
As the business enters the maturity stage, the focus of the organization shifts from the generation of sales and increasing capacity to the relationship between revenue and costs. Managing costs is key to maintaining a stable and significant profit margin. Many companies may fail at this stage due to the lack of record keeping for decision making purposes (Gaskill et al., 1993; Knotts et al., 2003). Without quantifiable information in order to identify costs that may be minimized, meaningful action in cost management will be very difficult. In addition to this, creative accounting can also create a false sense of security for managers. This practice is made increasingly more dangerous in an environment without available quantifiable data (McCormick, 2009).

Inventory control (Gaskill et al., 1993), accounts receivable, and quality management (Knotts et al., 2003) are prime candidates for management and entrepreneurial work-team focus at this stage. With quantifiable operations data, an organization can engage in supply chain analysis, risk-benefit analysis, and parallel process identification that can improve the profitability and stability of the business (Balachandran & Balachandran, 2005). In order to tackle these areas, it is common for successful businesses to install budgeting, strategic planning, and standard cost and control system practices in the business (Lewis et al., 1983). This is paired with increased formalization of roles and procedures in order to ensure smooth operation of the complex business functions (Kazanjian, 1988). It is common for successful mature businesses engage in these activities in order to compete in competitive markets (Wald et al., 2013). Wald, Schneider, Schulze, and Marfleet (2013) identified the most effective cost efficiency measures that are implemented by SMEs. Among the most effective are negotiations, contract management, purchase price comparison, benchmarking, internal cost allocation, checklists, activity-based costing, overhead value analysis, life cycle costing, and zero-based budgeting. Of these successful measures, benchmarking and life-cycle costing are the most effective measures (Wald et al., 2013).

In the implementation of these measures, there are many prior steps in development that will enable the smooth implementation of these control systems. Primarily, a competent entrepreneur and/or management team is required to not only identify the areas that need to be addressed, but also implement the changes necessary in the organization effectively. An engaged and motivated workforce must also be achieved in order to create effective entrepreneurial work-teams as previously discussed.

Figure 3.11 illustrates the requirement of the active involvement of the leadership team and an entrepreneurial mindset within the business during the implementation of cost managing measures previously described. Managing costs to get the most benefit out of sales is an initiative that requires the participation of the entire organization. Employees, who work in the business each day, can be a particularly effective driver of new ideas to manage costs. The reaction of the business to leveling growth will be important in this process. The management team must recognize the forces at play and remain focused on the areas that can continue to provide increased returns. A business that gets to this step in development may struggle to identify and implement the cost saving measures without these two steps in place and must loop back to rectify the missed steps.

Figure 3.11 - Managing Costs Loop



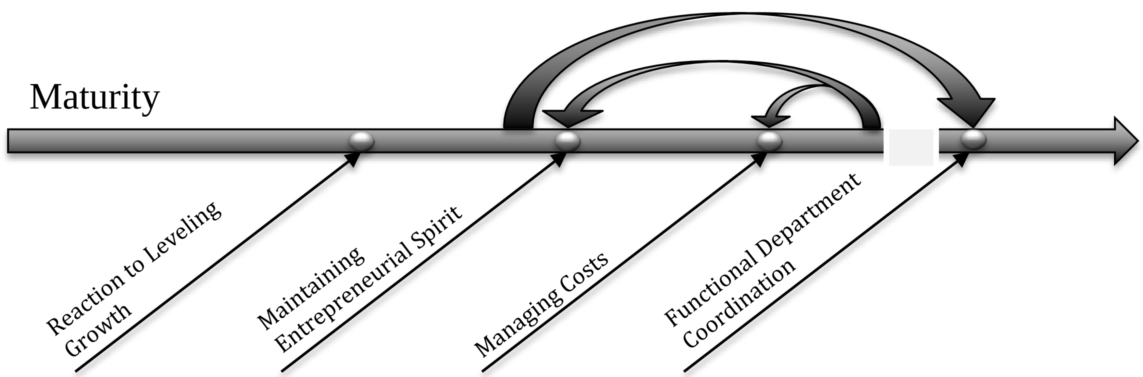
3.3.4 Functional Department Coordination

The coordination of functional departments is key at this stage in order to control costs, and prepare for the next stage of growth, diversification, that they face as a mature company. A common mistake at this point is the entrepreneur or management team recentralizing the organizational structure as growth slows and functional departments begin to blame each other for shrinking growth, causing further dysfunction in the organization (McCormick, 2009). A separated organization where information does not flow freely through the functional areas is the beginning of a path of failure for afflicted businesses. The systems, processes, and procedures introduced in earlier steps, although they are necessary, are often not conducive to the dissemination of knowledge (Supyuenyong et al., 2009). However, at this stage in the development of the business, coordination between managers is key (Jones, 2009).

After the adoption of the functional organizational structure, managers often have a renewed sense of purpose within the organization as the role they play becomes clear (Jones, 2009). However, successful companies pair this with a significant effort in the coordination of these departments. This becomes particularly important in the maturity stage. This includes coordination of knowledge processes and organizational software (Iyer, 2006). A carefully implemented knowledge management system can enhance sustainability in the organization and increase productivity (Mirza et al., 2011). This is key for an organization that is looking to manage costs and compete in a competitive market. The ownership and management skill enhances the SMEs ability to adopt such a system and effectively disseminate knowledge (Supyuenyong et al., 2009). Therefore, the presence of skilled managers is key in order to ensure the implementation of knowledge systems is successful. The culture and behaviour within the organization is also key to success of sharing knowledge (Supyuenyong et al., 2009). Therefore, employee motivation, and openness to entrepreneurial thinking aids the adoption of a knowledge management system.

Figure 3.12 illustrates the importance of maintaining the entrepreneurial spirit and cost management measures as a precursor to greater department coordination. The entrepreneurial spirit within the firm will contribute to the ease of adoption to the new coordination measures between the functional departments. Employees that cling to the old way of doing things will hinder the adoption of information management programs that will increase coordination between departments. Managing costs will also lead to the adoption of coordination measures. These two steps work together as the desire to manage costs can initiate the functional department coordination which can help to save unnecessary spending. A business that struggles with the implementation of a department coordination effort, may need to evaluate the entrepreneurial spirit within the firm, and their justification of why the increased level of coordination is necessary.

Figure 3.12 - Functional Department Coordination



Each of these steps build upon each other to create an appropriate internal environment to support success. A rational response from a rational entrepreneur and his business is the first step to success in this stage. This allows the entrepreneur to focus on maintaining the entrepreneurial spirit in the organization through employee empowerment. This employee empowerment will produce an environment where new ideas for cost savings can develop, and inter-relationships between departments can form. A business that struggles with the implementation of such cost saving and coordination measures must loop back to develop the necessary steps earlier in the stage, and from previous stages. It is this step back that will allow the business to progress and continue their path to success.

Conclusion

This paper set out to identify the key steps of internal development that contribute to the success of SMEs. By reviewing the linear growth model literature, the main components of each stage become apparent. When paired with the SME failure literature review, the steps in the growth process that are often delayed become clear. As has been explained, many companies may stray from the linear model. However, there are explanations for this. The linear growth models provide an ideal development path, strategically built to address problem that will arise in the near future. Although some companies may neglect a step in the growth process, this lack of foresight will eventually catch up to them in the form of bigger issues, or left unaddressed, business failure. SME owners and managers must actively loop back to implement the development step they have missed to avoid business failure. Although some steps in the SME development process may be neglected with fairly minor repercussions if there are other strengths of the business supplementing it, the lack of appropriate development will catch up with the company eventually. This contributes to the area of research by offering managers and business owners a detailed look into the internal development process that businesses typically undergo. With this information managers should be able to identify where along the linear growth model their business lies, what steps of development they experienced in the past, and what common pitfalls they should look out for in the future of the business.

Limitations

There are limitations to how in-depth this paper could go into exploring the application of these theories. The research is primarily based on North American literature, and may not be directly applicable to all countries and cultures. There is also a limited amount of case application. Although many of the conclusions drawn are supported by secondary research that involves case application and first-hand research, further research should explore the conclusions of this paper in longitudinal case studies of SMEs as they proceed through the growth processes of their businesses.

Further Research

Further research is needed to connect real business cases to the theories developed in this paper. This progression of key elements of the SME development process could be compared and applied to cases of business failure and turn-around in different countries. Different cultures may require more attention to areas that North American companies spend little time addressing. First hand research would add to the practical testing of these theories, and prove the level of utility it would provide SME owners and managers.

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