

Chair of Strategic Management

Master Thesis / Project Proposal

**Highway to Hell: Towards a process model of
entrepreneurial failure**

Highway to Hell: Ein Prozessmodell
unternehmerischen Scheiterns

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Introduction

When thinking of entrepreneurship, we habitually only have the prominent success stories in mind. Similarly, the entrepreneurship research landscape oftentimes tries to explain ‘success’ (Alstete, 2008; Flamholtz, 2002; Frese, Brantjes, & Hoorn, 2002; Rauch & Frese, 2000; Van Gelderen, Thurik, & Bosma, 2006). However, statistics reveal a different story. The German *Institut für Mittelstandsforschung* (Ifm Bonn, 2014) shows that the balance of new businesses compared to liquidations per annum has always been very small. In the last three years, it has even been negative. That means, more companies liquidated their business than new businesses were registered in Germany since 2012. Similarly to Germany, new startups are more likely to fail than to succeed all over the world. 75% of all new companies go out of business during their first two years of life (Blank, 2013; Fuckupnights, 2015).

Researchers from different academic subjects became aware of that topic as well. Journals from domains of entrepreneurship, business management and organization studies increasingly deal with entrepreneurial failure, which becomes evident by the growing number of publications. Literature provides us with a profound analysis of many specific issues of entrepreneurial failure. We know many reasons for failure that are out of context (Dimitras, Zanakis, & Zopounidis, 1996; Fatoki, 2014; Gaskill, Van Auken, & Manning, 1993; Lussier, 1995; Pretorius, 2008; Robson & Obeng, 2008; Running, Ligon, & Miskioglu, 1999; Tushabomwe-Kazooba, 2006) and we also know that sometimes external events lead to business liquidation (Everett & Watson, 1998; Krasniqi, 2007). Besides, literature explains that implications of failure can be positive (Mueller & Shepherd, 2012; Yamakawa, Peng, & Deeds, 2013). All in all, literature provides us with information on failure that either deals with diverse explanatory factors of entrepreneurial failure. However, little is known about the process that lead to failure. More specifically, literature is rather silent about how timing, sequences of events and decision-making interact with each other.

The high business mortality highlights the importance to shift the focus of entrepreneurial research. We have to understand entrepreneurial failure better in order to understand why and how businesses do fail. There are plenty of reasons why a venture could go down, such as no market need (Egeln, Falk, Heger, Höwer, & Metzger, 2010), cash-flow-problems (Huyghebaert, Gaeremynck, Roodhooft, & Van De Gucht, 2000), the wrong team (Egeln et al., 2010), dense competition (Egeln et al., 2010), lacking

business model or planning (Lussier, 1995), ill-managed marketing or managerial insufficiency (Gaskill et al., 1993; Tushabomwe-Kazooba, 2006) and so forth (Dimitras et al., 1996; Pretorius, 2008; Robson & Obeng, 2008; Running et al., 1999; Tushabomwe-Kazooba, 2006). However, there is little evidence about how all those delicate issues interact with each other. A process analysis of entrepreneurial failure would help to fill this gap, but process analysis of entrepreneurial failure hardly exists.

In this research project I investigate the entrepreneurial failure process. More specifically I apply a multiple case study to develop a better understanding of the processes of how startups fail. The process model is built from data collected from interviews as well as presentations given by failed entrepreneurs. A visual mapping strategy serves as data analysis technique. This method presents the cases in a visualized flowchart and helps to gain a process perspective on entrepreneurial failure.

This master thesis is contributing to existing literature threefold and adds to the still underdeveloped field of research on entrepreneurial failure. First, this study contributes by suggesting a process model. Previous research has mainly identified single reasons for failure, however little is known about the intimate interaction between these reasons over time. Second, the study compares the interview-results looking for similarities and thus detects patterns (Eisenhardt & Graebner, 2007). While previous research mostly examined influences the underlying mechanisms that lead to failure, remained unclear. By describing and explaining the process this study will shed light on the underlying mechanisms that connect the antecedents to entrepreneurial failure. Third, this study has important practical implications. With the aid of a process analysis the survey presents previous research results that looked at specific reasons or events causing failure in a context and establishes links among these factors. By outlining the process patterns of entrepreneurial failure, this study may help entrepreneurs to break out of these processes that eventually lead to failure.

Theoretical Orientation

Research on entrepreneurship, business management and organization studies dealt with entrepreneurial failure studying antecedents and consequences of failure. Its main findings, as presented in the following, give deeper insights into the phenomenon of business failure and are the breeding ground for the research stream investigating

learning opportunities from failure. The research stream investigating the downside of entrepreneurial activities has covered quite some facets of the failing-phenomenon, but academic literature mostly concentrates on selected aspects of failure like the analysis of risk factors (Everett & Watson, 1998; Van Gelderen et al., 2006) and reasons of failure (Dimitras et al., 1996; Fatoki, 2014; Gaskill et al., 1993; Lussier, 1995; Pretorius, 2008; Robson & Obeng, 2008; Running et al., 1999; Tushabomwe-Kazooba, 2006), that can be internal and also external (Fatoki, 2014). Furthermore, general process models of growth (Greiner, 1998) help to understand the process from a nascent firm growing to an established firm.

Research that examined antecedents, like risk factors during the early start-up phases or variables and causes of failure, is prevailing. This field of research can be divided into three levels of analysis.

First, the environmental level, which deals with external factors, like culture or laws and regulations. “External factors include non-availability of a logistics chain and a high cost of distribution, competition, rising costs of doing business, lack of finance and crime [(environmental level)]” (Fatoki, 2014, p. 922). Moreover, the impact of environmental, micro-economic risk factors (Everett & Watson, 1998) was analyzed or pre-startup success and risk factors were explained in a study from Van Gelderen et al. (2006) who conducted a longitudinal study. They found out, that the perceived risk of the market is a key factor in early business success.

Second, the organizational level, which deals with management issues, like strategy or management tactics. In order to structure variables of failure Pretorius (2008) developed a conceptual framework that clusters relevant variables into predictors, causes, recovery and learning from failure on the organizational level of analysis. Following Lussier’s (1995) early work, Dimitras et al. (1996) reviewed literature on failure causes and highlighted further prediction methods. Grouping causes into more general organizational and environmental variables, Gaskill et al. (1993) identified four areas that cause failure, which are: managerial and planning functions, vendor relations, competitive environment, and premature overexpansion.

Third, the individual level that is dealing with individuals and their psychological factors. “Internal factors include lack of management experience, lack of functional skills and poor staff training and development and poor attitudes towards customers [(individual level)]” (Fatoki, 2014, p. 922). Besides, many entrepreneurs overestimate

their skills being overconfident, especially among those who fail. Those entrepreneurs enter the market with their startup regardless that they might lack important information. But this might not be a central reason of failure, but it is rather the judgmental fallibility that causes trouble (Hogarth & Karelaia, 2012). Furthermore, interviewed entrepreneurs who failed with their business reported further reasons of failure, which can be summarized into lacking competencies, a poor network and wrong personnel (Ahmad & Seet, 2009).

A notable exception is the process study done by Venkataraman, Van De Ven, Buckeye, & Hudson (1990). In their study they proposed a process model (*Figure 1*), which is based on the assumptions that organization-environment interactions are essential to businesses and that such interactions with others are closely coupled to each other. Statistically, a certain amount of these transactions fail; this may lead to a domino effect of failed transactions and, thus, the survival of the firms depends on the firm's ability to adjust to these setbacks and to move on. Besides, a lack of legitimacy and resource constraints compound recovery from failed transactions. In the end, if the company is not able to rebuild the transaction set, it will fail (Venkataraman et al., 1990).

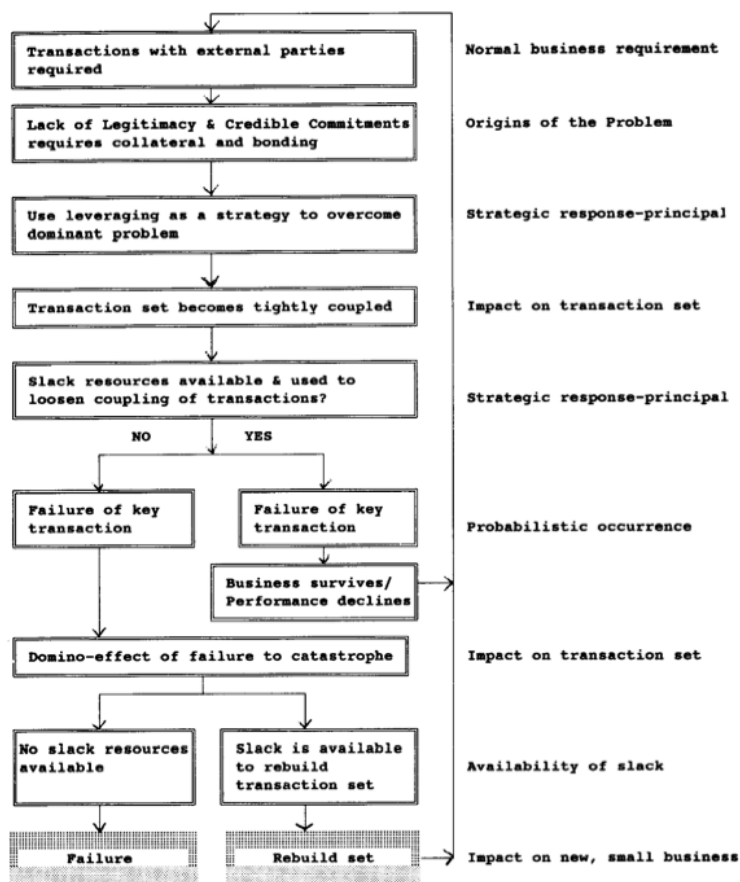


Figure 1: Extracted from Venkataraman et al. (1990, p. 289)

An important contribution of this process model is that it highlights that there are patterns in the startup process that lead to entrepreneurial failure. Besides, the study dealt with a failing process on the organizational and environmental level of analysis showing how the organization's transactions with the environment influence the failure process. Nevertheless, all of the approaches mentioned have provided very valuable insights into entrepreneurial failure from different particular environmental, organizational or individual perspectives.

Critique of previous approaches

Despite the advances of previous approaches, the understanding of entrepreneurial failure is still inadequate. Most of previous research examined at specific factors influencing entrepreneurial failure, however, they missed to understand the process that leads to failure. The relevance of a process model was already indicated by Venkataraman et al. (1990). However, this process model is somewhat problematic. Venkataraman et al. (1990) reduced the data to one scientific object, namely 'market transaction'. This gives no further insights on which concrete transactions or which other factors were crucial in the sequence of events. A multi-level process analysis aims at giving a differentiated process providing more informative content. And more importantly, Venkataraman et al. (1990) focused the organization-environment interface. That means, this study argues from a transaction and resource perspective and so it does not reveal further insights into important factors like decision-making, financing or market events. Yet, a company has to engage in market transaction, because it is the nature of every business to interact with the organizational environment. Therefore, it is necessary to examine, which other factors play a role in the collapse of a business, which at the beginning of its corporate activities always has to struggle with liabilities of smallness, newness and a lack of legitimacy. Despite that fact, some startups survive while others fail. There must be a complex interaction between internal and external events and organizational management decisions concerning marketing, finance and entrepreneurial strategy that cause trouble. Hence, since this study argues with environmental and organizational aspects, it lacks factors on the individual level of analysis and also the interface of individual and organizational factors.

This lack of research on the individual-organizational intersection is surprising, because researchers have always stressed its importance (Bercovitz & Feldman, 2008). Especially young organizations, that have a rather simple organizational setting, have to focus on individual facets influencing business survival (Preisendorfer & Voss, 1990). Accordingly, scholars suggested shifting the academic focus on an individual and organizational interface of analysis. There was quite some research done on the examination of individual factors in entrepreneurship literature (Hiemstra, Van Der Kooy, & Frese, 2006; Hogarth & Karelaia, 2012). Besides, Kreiner, Hollensbe & Sheep (2006) argue that there is no clear distinction between individual and organizational identities and this is why they call for an analysis on the individual and organizational boundary. The authors stress the importance of individual attitudes and emotions that affect organizational outcomes (Kreiner et al., 2006). Especially, psychological factors impact opportunity recognition and motivational factors influence market entry decisions, which in the end decide over success or failure (Hogarth & Karelaia, 2012). This is why the individual-organizational interaction has to be of special interest in the research stream investigating entrepreneurial failure. Consequently, the study at hand provides the academic community with insights about the individual and organizational level of analysis accounting for entrepreneurial failure in a comprehensive process model.

Research on Entrepreneurial Failure

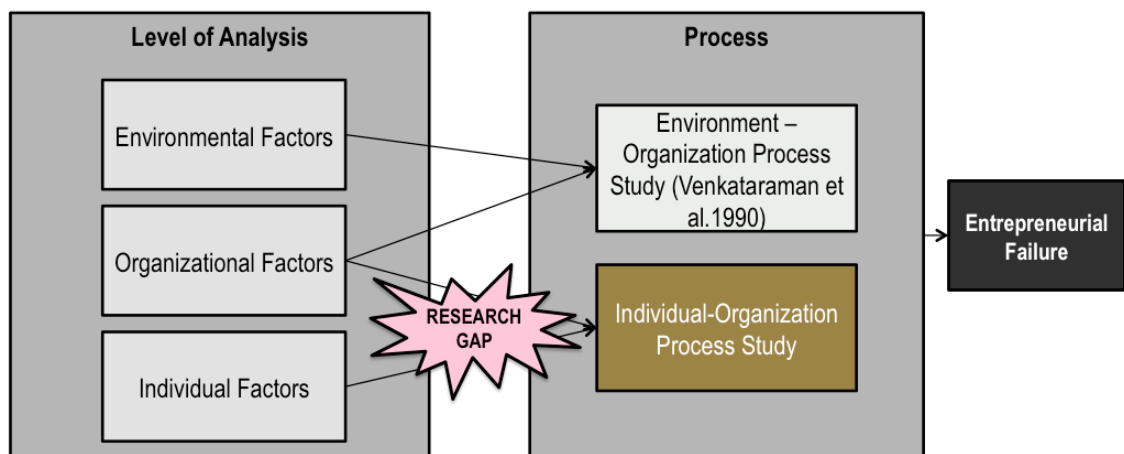


Figure 2: Research Gap visualized

In this study I investigate a failing process considering the individual and the organization. Therefore, the research question motivating this paper is asking: **Is there a pattern in the sequence of events during the startup process that leads to entrepre-**

neurial failure? To address this question the objective of this master thesis is to inductively develop a process map explaining how decisions, internal and external events over time were followed by a business exit by outlining the process patterns of entrepreneurial failure.

Methods

Research design. I use an inductive theory building approach considering the experiences of entrepreneurs with failure. This is appropriate because a process view on business failure is quite new to research on entrepreneurial failure and there is not enough data to test an established theory (quantitative). In the pursuit of building a process model on entrepreneurial failure a qualitative multiple case study design will serve as methodological approach for theorizing (Eisenhardt, 1989; Strauss & Corbin, 1998). The research question is looking for a pattern and, thus, is trying to make sense of how things evolve over time (Langley, 2011). The decision to take a qualitative approach as research design is mainly influenced by the ability to take into account the context and explain complex processes (Eisenhardt & Graebner, 2007; Pettigrew, 1997). In order to answer the research questions multiple levels of analysis are required, which only qualitative research can provide with the aid of different data like interviews, observations and archives, which case studies usually combine (Eisenhardt & Graebner, 2007; Eisenhardt, 1989). A case study research design has several advantages. It has the potential to create new insights, show relationships across cases and literature and, in addition, the established theory is supported by direct evidence from the cases (Eisenhardt, 1989). Besides, a focus on process data the information can be structured and help for a better understanding of the entrepreneurs' experiences (Langley, 2011).

Data collection. The target group for data collection is addressed through personal contacts to the startup community in Hamburg and through the *Fuckup Night* event, where people who experienced failure and are interested in stories about failure come together to share their failure experience with the audience. *FuckUp Nights*, is an exemplary format that originated from Mexico and recently spread all over the world responding to the new focus in entrepreneurial communities that is dedicated to examine business failure (Fuckupnights, 2015). This event format is very successful because founders experienced that failure adds to their understanding about entrepreneurship

and that it might be fruitful, if they open up for that topic and discuss mistakes openly. This setting is ideal, because its story-telling technique provides us with different cases of business closure. Speakers at *Fuckup Night* talk about events, activities and choices they had to make, which in the end were not successful. By this means process data can be collected. This case selection also restricts the generalization of findings, since most of the cases are from Germany and especially from Hamburg (Eisenhardt, 1989).

Those cases of failure presented at *Fuckup Night* will be recorded on videotapes and serve as one type of data for the process analysis. In order to identify a pattern in the course of events until the venture fails, it will be also necessary to conduct qualitative interviews with people who have prior experience in failing with their startup idea. At least fifteen to twenty qualitative in-depth interviews should reveal a pattern showing a sequence of crucial events that in their consequence lead to the shutdown of the business. The interviewees will meet the following attributes: they claim to have experienced a failure with their business idea and they spent at least three months working on building up their startup. The questionnaire should be designed in a way advising the interviewee to explain what happened to him or her step by step. The aim is to steer the interviewed entrepreneur in a direction that allows extracting as much information about the sequence of events before business closure as possible. In order to ensure a high scientific quality of the responses, there will be semi-structured, open questions prepared upfront for the survey, but the interview will not be restricted to those questions. If available, additional company data will be added to the case information.

The interviews will be recorded on audiotapes and afterwards all tapings will be coded in order to fracture data into a manageable analytical tool. The coded material will help to develop a process and to compare answers (Strauss & Corbin, 1998). In order to evaluate the results, Ann Langley (2011) suggest using different strategies from which I chose the visual mapping strategy due to three reasons. First, it is suitable for pattern recognition and thus for identifying a process. Second, visual mapping strategy only needs a moderate depth of details to identify patterns in case the interviews will not provide enough detailed information for other approaches. Third, visual mapping illustrates a process in a visualized flowchart that supports a better understanding. Standing alone, it would not be sufficient to build a theory, but comparing many process flowcharts of different cases could give a conceptual view on a general business failure process while granting moderate accuracy, generality and simplicity according to

Weick's (1979) good theory dimensions. Visual mapping is a drawing that summarizes what happened in the case on various dimensions. This allows a dense presentation of a lot of information in a chronological way. Different dimensions can be indicated graphically through the shape of the box. For instance, using round boxes for decisions, sharp-cornered boxes for activities and ovals for external events. In addition, bands, arrows and other symbols are used for the description of complex relationships among elements (Langley, 2011). Such drawings conceptualize case information and when comparing them with other cases a more general theory on the failing process can be extracted. Visual mapping offers the opportunity for "data reduction and synthesis" (Langley, 2011, p. 702), but psychological factors like emotions and cognitions are not easy to reveal (Langley, 2011). This data evaluation strategy is also helpful to elaborate practical implications from the results. Nevertheless, there is always room left for researcher's interpretation in qualitative research.

Project Plan and Risk Assessment

The time-frame (in tabular form) is presented as follows:

Calendar Week 2015	Phase	Content
28-33	Research Question	Narrows the topic area to a meaningful, manageable size; addresses issues of theoretical and practical significance, points toward a viable research project - that is, the question can be answered
28-33	Literature Review	Current state of the literature, insights from research contributing to the topic
31-33	Theoretical Foundation	Collect arguments / claims / counterarguments, develop assumptions that may uncover new areas of the topic --> research question
33-41	Research Design / Method	Type of data to be collected (prepare data collection), which will be a qualitative interview <ul style="list-style-type: none"> • Data collection tools and procedures • Type of analysis planned • Finding/selection of sites for collecting

		data Design questionnaire for qualitative interviews
41-43	Transcription	(“)
43-47	Analysis	Analyze interviews and additional data and extract process model
47-48	Result / Contribution to literature	New ideas that contest conventional wisdom, challenge prior assumptions, integrate prior streams of research to produce a new model, or refine understanding of a phenomenon
49	Summary	
49-51	Formatting	
51-2(2016)	Buffer-time	./.

The major risks associated with writing the master thesis will be the data collection phase and reaching the proposed number of minimum fifteen to twenty interviews of proper quality. This would also impact the methodology in evaluating data from the interviews as described before. Besides, coding could take more time than expected, but the time schedule also contains buffer-time for the finalization of the paper.

Research bibliography

Please find listed below additional literature on which the master thesis will be based to the mentioned references in the list of literature.

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