10 Exit: Failure and Success

Jaydeep Pancholi and Norin Arshed

It may seem odd to learn about business exit and failure in a book about entrepreneurship and starting and growing successful businesss. However, it has been reported by the U.S. Small Business Administration that approximately 10% of all firms in the United States fail each year (Knott and Posen, 2005). In the UK, the rate is thought to be similar with 20% of businesses failing in their first year while a further 30% fail within the first three years (BIS, 2013). It is crucial to understand what is meant by business exit and failure to ensure that entrepreneurs and governments can learn from, and respond to failure. This chapter explores the meaning and importance of business failure followed by why firms fail and the effect this can have on the entrepreneur. It also discusses how to avoid such failures and provides an insight into some famous failures.

Understanding the meaning of failure

Understanding failure can be a challenging concept; terms such as 'failure', 'business death', 'closure' and 'exit' can be used to describe how an entrepreneur leaves a business, frequently overlapping in definition. The definition of business failure can be summarised as "a business that has fallen short of its goals or become insolvent, thus requiring involuntary termination or discontinuation of the business" (Politis and Gabrielsson, 2009, p. 365). In other words, business failure is the "cessation of involvement in a venture because it has not met a minimum threshold for economic viability as stipulated by the entrepreneur" (Ucbasaran *et al.*, 2013, p188). Other terms used can be defined as:

- **Business closure:** A situation in which a business entity discontinues in its existing form (Stokes and Blackburn, 2002). The inability of the business to survive and thus a discontinuance of the business (Hall, 1995).
- **Owner's exit:** The act of departing from a business ownership by the business owner (Stokes and Blackburn, 2001).

- **Exit:** No longer trading in a specific market or producing a particular product.

Famous failures

Polaroid – The camera that gave instant pictures was not only an admired form of photo-graphy but also a cultural phenomenon. A leader in photographic technology, Polaroid created a name for itself in the 1980s. However, through the weight of competition, technological advancements and change in consumer trends Polaroid went bankrupt in 2005.

Phones 4 U – Once a well-known independent retailer of mobile phones in the UK, Phones 4 U had gained a successful business strategy in offering special deals. However, in 2014 the company had become dependent upon contract deals with EE and Vodaphone, two major networks within the UK mobile phone industry. Failing in negotiations, contracts were not renewed, which led to business failure and store closures.

In 2014 there was 5.2 million businesses recorded in the UK, with 346,000 business births and 238,000 business deaths that year (Rhodes, 2014). New firms are the most vulnerable (Headd, 2003). Despite the most conservative estimates suggesting these rates are inflated (Levie *et al.*, 2011), the common consensus is that business failure is a common phenomenon and prevalent mostly amongst early stage ventures.

Given such statistics, the term 'failure' can hold a negative connotation, discouraging many from starting a business (Stokes and Blackburn, 2002). Business failure can be due to many reasons where entrepreneurs have not been able to sustain financial benefit through offering a product or service. When examining why a business fails, several factors can arise, questioning the lack of experience, strength of competition and changes in consumer trends. However, once a business has reached its peak in trading operations, managerial decisions will have to be taken on how an entrepreneur wishes to exit. Two options remain for an entrepreneur to exit their business: *voluntary* or *involuntary*.

Voluntary exit can be initiated by an entrepreneur knowing that their business is on the decline in the life cycle. As a result, an entrepreneur can put their business into liquidation; bringing the business activities of the company to an end (DeTienne *et al.*, 2014). However, it must be noted that there can be further reasoning for an owner liquidating their business, such as retirement or lack of interest, therefore this form of business exit could also end with a surplus rather a loss. For example, The Falck Group, now a successful Italian energy firm, had liquidated its initial steel business in the 1990s. The company had been in the family for five generations and they were able to raise investment for a new venture into renewable energy (Detienne and Chirico, 2013), once again becom-

ing successful in their new venture. However, for many entrepreneurs with a failing business, liquidation is an inevitable process before funds dissolve.

Instead of liquidation, as another form of voluntary business exit an entrepreneur can sell the business. If a business is profitable or has scope to achieve another business's objectives, such as capturing the same target market, an entrepreneur can attract the interest of their competitors or specific interest groups. This form of business exit would be more attractive for an entrepreneur who wants to end their business venture and leave with a surplus.

Case study: WhatsApp

The sale of WhatsApp, a mobile messaging application, to Facebook provides a good example of a profitable business exit. Facebook purchased WhatsApp for $19 billion in 2014 (Bhattacharya, 2014). With 450 million active users at the end of 2014, WhatsApp undertook a positive exit strategy enticing Facebook with a customer community which they had developed. Being purchased by a larger company proves to be a profitable exit strategy for mobile app developers with the rise of consumer usage.

For the majority of cases, business failure is led by an involuntary exit where an entrepreneur is forced to leave their business venture (Stokes and Blackburn, 2001). A case could arise through insolvency, where an entrepreneur has lost control of their financial balance sheets resulting in an increase of debt with insufficient income to cope with financial repayments. In this case an entrepreneur can declare bankruptcy – a legal clearance allowing an entrepreneur to be free of debt by directly handing over their bank accounts. This form of exit would also impede the entrepreneur's viability to future financial borrowing power, where lenders would question the track record of the individual. Any assets in the business owner's name would also be taken to pay towards the debt. However, the European Commission has reviewed the difficulties for failed entrepreneurs to gain finances, allowing a 'second chance' legal framework to encourage entrepreneurs to continue entrepreneurial activity in the hope of generating future income for the European Union (European Commission, 2011: p. 19).

Case study: Blockbuster

An example of bankruptcy can be demonstrated by movie rental store Blockbuster. Not being able to withstand online competition through the rise of the digital era the company had to declare bankruptcy (Hill and Gareth, 2013). In direct competition with a growing online rental company Netflix, Blockbuster was forced to close their 5000 stores in US and later in the UK.

In some cases of insolvency, a business can go into administration; handing over the company to a third party (an administrator) in an attempt to revive financial stability and set a plan of recovery.

Case study: HMV

Administration has been the case for high street music store HMV. With 73% of music and films downloaded online and a further projection of increasing to 90% by the end 2015, HMV have been attempting to maintain consumer interest (McDonald and Ailsa, 2014). HMV had to appoint management consultancy firm Deloitte after music suppliers refused to provide £300 million in additional financing to pay their bank debts. Deloitte had tried to find a buyer for the company and save some of the larger stores closing down. However, many of the company's assets were used to pay their debts. Nevertheless, today the company is still surviving, with the help of Hilco UK (a firm specialising in reconstructing failing firms).

Having looked into key terms used in both voluntary and involuntary forms of business exit, it is equally important to review the term 'failure'. Scholars of business exit have demonstrated that many companies have become successful in their business venture after failing several times, where not only experience was gained but also expertise (Müller and Stegmaier, 2015; Wolfe and Shepherd, 2015; Yamakawa *et al.*, 2015). Examples of famous failures (before success) include the likes of Richard Branson who failed in several businesses before establishing the Virgin brand – an entrepreneur's learning experience from failure may positively change their behavioural actions alongside their learning through success.

Exercise

Research and provide one example of a company for each of the following business exits: liquidation, exit and bankruptcy that has affected the student population. Justify your answer.

Why is business closure important?

There are five main categories of why entrepreneurs closed or changed their business in the UK (Figure 10.1). It is evident that the two main reasons may not be related to financial performance but due to a change in the owner's objectives or in finding a buyer for their business (Justo *et al.*, 2015; Levie *et al.*, 2011). Showing the different reasons why entrepreneurs close their business is important as it allows us to analyse the social and economic impacts of business closure.