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The Decline of Small Firms: A Preliminary Investigation into the Concept of Complacency

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Abstract
This exploratory study reports inductive efforts to ground complacency in the reality of practical observation. Based on detailed interviews with the directors of 12 Small Business Development Centers (SBDC), and 8 retrospective cases, it demonstrates the dynamics of complacency as a context of decline of small firms, and the role of key stakeholders in the reversal of decline. The interviews and cases illustrate the pervasive role of complacency, which manifests in managerial weaknesses and operational malfunctioning, and leads to decline. Moreover, an analysis of both interviews and cases reveals that concessions extracted from key stakeholders through third-party negotiations help declining small firms to survive.

Résumé
Cette étude préliminaire rend compte d'une démarche inductive visant à fonder le concept de l'autosatisfaction (complacency) sur la réalité observée. Partant de dix entretiens en profondeur menés avec les responsables de douze centres de développement de la petite entreprise et de huit études de cas rétrospectives, l'étude démontre la dynamique de l'autosatisfaction comme vecteur du déclin des petites entreprises et le rôle des principaux intéressés dans leur redressement. Les entretiens et les études de cas illustrent le rôle considérable de l'autosatisfaction qui se manifeste dans les failles de gestion et les dysfonctionnements d'exploitation et, ultimement, dans l'effritement des entreprises. En outre, l'analyse des entretiens et des cas révèle que les concessions obtenues des principaux intéressés lors de négociations trilatérales permettent à l'entreprise en difficulté de survivre.

"The reason why firms succeed or fail is perhaps the central question in strategy."

—Porter, 1991, p. 95

It is well known that the failure rate of small businesses is high. Historically, about 400,000 small businesses fail each year in the U.S. (Small Business Administration, 1986), and the failure rate of start-up firms in their first five years has been about 65% (Bracker, Keats, & Pearson, 1988). Although there are many reasons for the failure of small firms, an overwhelming majority of them are attributed to the managerial weaknesses of their owners (Berryman, 1983; Boyle & Desai, 1991; Haswell & Holmes, 1989; Peterson, Kozmetsky, & Ridgway, 1983; Sheldon, 1994; Wichmann, 1983). This rather comprehensive category usually includes shortcomings in personal managerial skills, as well as weaknesses in almost any phase of the firm's operations. While this attribution has face validity, it precludes more insightful analysis of failure by ignoring contextual circumstances which can affect the influence of various deficiencies to induce or reinforce decline.

Because of its comprehensive nature, the term management includes all operations a business usually undertakes. Operational weaknesses usually reflect managerial incompetence or inadequacy. Although one or

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more weaknesses generally result in the failure of a firm, the weaknesses and their interactions work within a context of managerial attitudes, which we refer to as *complacency*. The attribution of failure to a blanket rubric "managerial weaknesses" ignores this context, that is, complacency, and thus defies a concrete analysis of failure. *Webster's Third New International Dictionary* (1961) defined complacency as "satisfaction or self-satisfaction accompanied by unawareness of actual dangers and deficiencies." Presumably this satisfaction stems from a misplaced perception of excellence regarding one's acts or circumstances.

This definition of complacency has two possible implications when applied to small firm owners. First, unawareness indicates that problem-sensing ability (Kiesler & Sproull, 1982) may be missing in a troubled firm whose management is satisfied with the current state of affairs. In such a business, problems may be set aside as random events, and efforts made to rationalize their continuing existence (Reece, 1994). Second, it might be that opportunities that once brought success have abandoned the troubled firm, or actions that worked in the past no longer do so, but managers remain oblivious to these changes. Past success leads to a belief in the firm's infallibility and reinforces a false confidence "that can edge toward arrogance" (Reece, 1994, p. 52). Thus, complacency is associated with cognitive/behavioural phenomena involving a lack of managerial attention toward critical operational and strategic areas (Hedge, 1982; Reece, 1994) and/or a managerial inability to abandon strategies that no longer work (Labich & de Llosa, 1994; Reece, 1994). Although complacency is manifested in managerial actions or lack of actions, managerial cognitive behaviour is of primary importance in understanding complacency. We believe that a simultaneous focus on both complacency and managerial weaknesses can better unfold the dynamics of their respective roles in the small firm's decline. Further, earlier theory and observations involving managerial cognitive behaviour reinforce the need for such a focus.

A major managerial task, particularly when faced with a decline, is the effective extraction of critical resources from the firm's task environment (Pfeffer & Salancik, 1978). Since a firm's ability to attain its goals is determined, in part, by legitimacy through constituency satisfaction, the reversal of declining performance often depends on stakeholder support (Hambrick, 1985; Ramanujam, 1984). Providers of critical resources might seriously constrain management's ability to reverse decline. Even for big businesses, the loss of support from just one critical constituency—creditors—may lead to bankruptcy (Daily, 1994). Moreover, when decline proceeds and managerial complacency is apparent, further erosion of stakeholder support is likely. This erosion exacerbates the firm's financial situation and propels it closer to failure.

This article has two purposes. First, it elaborates a concept of managerial complacency as a context within which various managerial weaknesses can lead to decline. This elaboration involves showing the relationship of complacency to existing theory and grounding it in practical observation. Second, it explores complacency vis-à-vis the role of third parties in securing the cooperation and/or forbearance of stakeholders in order to reverse performance. Considering that small firms are frequently advised to seek institutional help to avert failure (e.g., Boyle & Desai, 1991; Chowdhury & Lang, 1993; Gatewood & Hylton, 1994; Good & Graves, 1993; Robinson, 1982; Welsh & White, 1981), it seems beneficial also to triangulate the relationships among complacency, stakeholder support, and performance improvement. To accomplish both purposes, we pursue a grounded theory approach (Glaser & Strauss, 1967). This article seeks to identify circumstances in which complacency and its relationships to and interactions with other key concepts might offer explanations of decline and recovery of small firms.

Conceptual Underpinnings

Complacency, Managerial Weaknesses, and Decline

Weitzel and Jonsson (1989) identified five definitions of decline: a reduction in organizational size; internal stagnation or inefficiency; a failure to recognize internal or external warning signals; a failure to adapt to external environmental demands; and a stage in the organization's life cycle. Although these definitions have different conceptual roots, the first four include both causes and consequences of decline, and are somewhat overlapping in nature. For example, internal inefficiency or failure to recognize internal or external warning signals may lead to a reduction in one or more size measures. Similarly, a reduction in size may lead to internal stagnation. In gathering data for this study, we viewed decline primarily as a performance issue, which is consistent with its predominant definition in terms of organizational size dimensions (e.g., Greenhalgh, 1983).

As noted above, a popular theory in small business management literature is that managerial weaknesses contribute to decline and failure (e.g., Berryman, 1983; Boyle & Desai, 1991; Haswell & Holmes, 1989; Peterson et al., 1983; Wichmann, 1983). Included under this rubric are personal characteristics (lack of insight, inflexibility, nepotism, poor selection of associates, unwillingness to delegate and empower, etc.) as well as operational weaknesses (undercapitalization, high over-

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head, inadequate cash flow, inadequate accounting records, inadequate billing systems, faulty pricing, insufficient advertising and promotion, imprecise targeting of markets, limited access to necessary information, etc.). This theory indicates a relationship with the first four definitions of decline listed above, and suggests that operational weaknesses, perhaps coupled with personal characteristics of the owner, lead to decline. Although these weaknesses are used to explain small business decline, there is no additional explanation as to why a particular weakness (or set of weaknesses) is detrimental in one situation and not in others. One possible explanation lies in understanding the attitudinal context within which the weaknesses exist. An important component of this context seems to be complacency on the part of the owner.

For instance, cognition literature suggests that a lack of action resulting from the failure to recognize a problem may induce decline. However, mere recognition of the problem does not necessarily guarantee its correction, as management may not have sufficient interest to address it (Weitzel & Jonsson, 1989). Although this attribution clearly involves complacency, the domain of complacency can be broadened somewhat. From the perspective of managerial cognition, three modes of problem sensing and problem solution can be considered. First, because of inherent managerial incompetence, the owner might fail to recognize the existence of a problem in one or more critical areas. Second, the owner might be aware of the problem but be incapable of dealing with it, or think that it will solve itself. Third, the owner knows the problem, can deal with it, but underestimates its seriousness. In practice, the distinction between the first two seems to break down. Since operational problems are usually recurrent, a problem rarely remains unknown to the owner for long. It may therefore be argued that problems per se do not necessarily cause decline. Decline is caused by the combination of problems and the lack of attention, interest, or sense of urgency to address them. Without prompt attention, even minor problems may grow over time and become unconsciously accepted as normal operating practices (Reece, 1994). Therefore, complacency underlies all forms of decline, although its magnitude tends to increase with the intensity of denial in a particular situation.

Hedge (1982) investigated the malfunctioning of 18 large North American and European corporations. Erosion of profits under complacent management, according to Hedge, is due to lack of strategic planning and neglect of critical areas, such as an increase in competition and technological changes. The effects of complacency can be insidious in large firms and perhaps even more so in small firms, because of their ownership and management structure. The owners of small firms are more likely to succumb to complacency because ownership is concentrated and decision-making authority centralized. Serious managerial mistakes increase the susceptibility of the firm to normal business hazards (Argenti, 1976) and shifts in competitive variables. More importantly, poor decisions can feed the owner's self-delusion, since there is no one there with the authority to question his actions. Contrary to traditional beliefs, small businesses do not necessarily fail because of a lack of resources to correct problems. Rather, they fail because of a lack of problem sensing and motivation for action on the part of management.

Owners who fail to take timely action "delude themselves into believing that a problem does not exist or that it is not serious" (Hambrick & D'Aveni, 1988, p. 16). This resembles a classic psychological response experiment which Tichy and Devanna (1986) referred to as the boiled frog phenomenon. According to this phenomenon, a live frog is dropped into a pan of cold water. The water is then heated very gradually. The frog is gradually heated to the boiling point; it fails to react and dies. As Tichy and Devanna explained (1986, p. 44), the frog "could have jumped out of the pan at any time, but the change in its environment happened so gradually that no response was triggered in the frog and death ensued." The boiled frog metaphor neatly illustrates the role of complacency in the decline of small firms. Owners "trapped in the boiled frog syndrome are, initially at least, too complacent—the frog remains blissfully unmoved while the environment around it heats up" (Richardson, Nwankwo, & Richardson, 1994, p. 11).

Three factors seem to affect the initiation of remedial actions in declining small firms. First, small firm owners either fail to detect subtle performance changes, or they deny or ignore disconcerting negative information. Because of their incompetence or inexperience in certain operational areas, they are simply not capable of recognizing weaknesses. Moreover, when there is either ineffective or nonexistent internal consultation, the owners might be less willing or less able to recognize a subtly declining situation. In such a situation, "a serious response is never triggered, or at least not until it is too late to respond" (Hambrick & D'Aveni, 1988, p. 4).

Second, the vulnerability of small firms to gradual decline might result partly from what Pettigrew (1987) referred to as contextual inquiry. According to Pettigrew, an organization's ongoing actions are largely rooted in its previous actions and experiences. Although such historical precedents might account for much of a firm's early success, they eventually foster rigidities, prevent effective adaptation to environmental change, and set the basis of decline and eventual death. Vulnerability might also result from the prior hypothesis bias (Hill & Jones, 1995). Owners with strong prior beliefs that certain

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actions make more sense tend to pursue them, despite evidence against their current efficacy.

Third, the weaknesses might be detected, but the owner, who is solely responsible for negative consequences, attempts to forestall negative outcomes. Such attempts might involve the escalation of resource commitment to an unsuccessful course of action, which, in turn, might lead to even worse consequences (Staw, 1976). Because of his ownership position, the owner often has complete control over all critical resources and makes decisions unilaterally. As an omnipotent administrator (Pfeffer & Salancik, 1978), he is *personally* responsible for all consequences and, therefore, tends to commit greater amounts of resources to a prior course of action. Implicit in this increased resource commitment is the perception that things are bound to get better. The owner digs a deeper and deeper hole by continuing to throw good money after bad in different operational areas, such as manufacturing, advertising, distribution, etc. Failure may thus appear to be due to lack of appropriate decision-making in specific operational areas but is, in fact, the result of managerial complacency.

Complacency, Stakeholder Support, and Recovery

In the face of organizational decline, the role of exchange partners or critical dependencies takes on added importance. An effective managerial response involves the extraction of critical resources from the firm's environment (Pfeffer & Salancik, 1978). This resource perspective highlights the need for small businesses to determine and manage critical dependencies effectively. One way of retaining control over the environment is to maintain the organization's legitimacy (Pfeffer & Salancik, 1978) through support from its exchange partners (Pfeffer & Salancik, 1978; Thompson, 1967).

In order for a firm to reverse its declining profitability, it must have the support—tangible and tacit—of a stable set of key external players. For a troubled firm, a deterioration in performance leads to an erosion of the loyalty and support of stakeholders who become increasingly sceptical. It is difficult to visualize a success scenario, especially after a decline, when financial backers desert, suppliers withhold credit, and deferrals on loan payments are not allowed. Therefore, a careful identification of key allies is crucial, as turnaround success is dependent, to a large degree, on the management of exchange relationships (Hambrick, 1985; Ramanujam, 1984).

Creditors (banks and suppliers) and government are the two most important sources of external support for a small business, creditors being the more important because of the critical nature of cash flow (Chowdhury & Lang, 1993; Gopinath, 1995; Hambrick, 1985; Khan & Rocha, 1982; Kierulff, 1981; Welsh & White, 1981). With a shortage of cash, it becomes difficult for the owner to pay off even existing obligations, much less to fund creative moves to ensure survival. Recent empirical research (e.g., Chowdhury & Lang, 1993) shows that decreasing liquidity increases the reliance of small firms on debt-financing for short-term performance improvement. As critical lenders to small firms in declining situations, banks intervene to boost the liquidity of such firms (Gopinath, 1995). Thus, outside stakeholders might hold the cards with respect to the turnaround of declining small businesses. By calling attention to the weaknesses stemming from managerial complacency, and often by suggesting or providing a solution, key constituencies might become a vital source of assistance for the turnaround of small firms.

Study Methodology

Since performance reversal can be studied only ex post facto, we attempted to gain some insight into the complacency and constituency support phenomena through a combination of hands-on experience and retrospective case studies. In collaboration with the Kentucky Small Business Development Center[1], we contacted 12 SBDC district directors of Kentucky. An open-ended questionnaire, along with a letter explaining the purpose of the project, was mailed from the central office to each director. To avoid ambiguity, key concepts pertinent to the research problem were defined in an appendix to the questionnaire. Two weeks later, interview appointments were set up with all directors.

The interviews were semistructured. Although the questions, their sequence, and their wording were fixed, each director was encouraged to refine the focus and ramification of any given question. The questionnaire thus ensured richness of detail and elaboration of responses. We also moderated questions when ambiguity or confusion occurred. Moreover, we incorporated into subsequent interviews insights derived from initial interviews. All interviews were tape-recorded and transcribed. Each interview lasted approximately 2½ hours. At the end of the interview, we requested the directors to send us one or more cases that would support the key theme(s) of their perspectives. Subsequently, we received a total of eight cases, all disguised, from the participating directors, each focusing on one or more issues covered in the interview. In each of the reported cases, the owner was about to file for bankruptcy under Chapter 11 immediately before the intervention of the SBDC. A petition for Chapter 11 bankruptcy clearly signals that the firm is unable to perform almost all of those

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functions that would be normally expected from it (Sheppard, 1994). This operational definition of death provided a consistent benchmark for the severity of the situations in all eight cases.

As the boundaries, intricacies, and dynamics of complacency are not clear, in order to develop insights into the phenomenon, we incorporated, through supporting cases, multiple distinct concepts into our investigation. As Kaplan (1964) pointed out, dividing the phenomenon in question into concepts that delineate the problems over the widest possible dimensions greatly enhances scientific knowledge. Because we are interested in developing the concept rather than testing it, our approach approximates to a grounded theory (Glaser & Strauss, 1967). Since a theory of complacency, or even elements thereof, are in a very early stage of development, inductive theory development efforts grounded in in-depth interviews and retrospective cases might be especially appropriate for the present study. Although some existing theories might seem peripherally appropriate to the study of complacency, complacency itself needs "theoretical elaboration" (Vaughan, 1992).

Analysis

As information directly relating to the research questions was uneven through the cases, a brief summary of each case is presented below. Each explains a situation illustrating one or more managerial weaknesses. In order to highlight those weaknesses and their contexts, relevant quotes from the SBDC director interviews are presented with the cases.

Capitalization from Cash Flow

> They have a hard time understanding that they have to have cash for meeting certain obligations. They see all the money on paper, although the chequebook's empty.

> It's really amazing that people involved even in quite large operations don't know how much money they have in a given month, say, June.

The owner of a fast food restaurant had withdrawn $73,000 from cash over an 18-month period and invested the amount in capital improvements and equipment purchases. When his bank refused to advance an operating loan of $40,000, he was getting ready to file for bankruptcy. An analysis of financial statements for three consecutive years by the SBDC revealed that the restaurant's sales exceeded its needed breakeven sales of $700,000. An excessive capitalization from the flow of cash resulted in severe shortage of liquidity, such that the owner was unable to meet his operating expenses. When the SBDC met with the owner and his bank representative with this analysis, the bank agreed to advance an operating loan of $60,000 on a five-year payback schedule. The owner was then able to even out cash flow and meet current obligations with this loan.

Credit and Collections

> Well, we'll carry him for another month or so. But the fact is that they have to have cash for certain things.

> There seems to be a tendency among small business owners to extend credit to people they know.

An electrical servicing firm had plenty of work orders but they were not kept current to show labour and material. Purchases were made without cross reference to jobs. The owner did not know how to prepare bills and collect receivables. The SBDC introduced a job control system, designed a billing manual, and stressed the basics of internal management.

After the implementation of these basics, the firm's financial situation improved for a while, but the owner remained lenient to the "good fellows down the street" with substantial accounts. Mounting bad debts were causing serious cash flow problems, and the owner was not keeping up with the payment of rents and employee salaries. Also, he was falling behind in the payment of scheduled bank loan instalments, which he had procured to increase inventory.

Finally, when the owner reached the point of bankruptcy, he approached the SBDC again for help. He agreed to drastic changes in his credit terms and policies. With a combination of streamlined collection of outstanding receivables and a small personal loan, the owner was able to come to terms with his bank, landlord, and employees. His business returned to modest profitability with smooth flow of cash.

Underpricing

> They don't understand pricing. They think they can't compete on price, so they're afraid of charging a fair price.

A furniture retailer had been operating marginally since September, 1981. Beginning in May, 1983, profits started to decline, and the owner's bank was reluctant to advance him any more operating loans. At the owner's request, the SBDC conducted an analysis of his business. The furniture was of an excellent quality, but the prices were considerably lower than the Robert Morris Associates (RMA) industry average. Because of lower

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prices, customers were sceptical about the quality of the furniture, and demand for it remained static. The SBDC recommended a thorough overhauling of the pricing strategy. As a result, prices were raised. This price increase created a higher demand for the retailer's furniture, and the business went back to profitability.

Production Volume/Breakeven

> They don't understand breakeven analysis. They don't understand how much it actually costs to produce something. All they understand are the costs of raw materials. They never consider fixed overhead or any hidden costs.

Although there was a fair demand for landscape timbers in the local market, a timber supplier had been operating at a loss since he started. He was obsessed with the variable component of costs, and when any machine broke down, he would shut down operations for an entire day to save variable costs. He never tried to recoup fixed costs. When he was failing to meet his current obligations on an almost regular basis, the SBDC advised him to emphasize increased and steady production volume. The supplier started to recognize the relationship between production volume and breakeven, and based his production volume on this relationship. After the discovery of this relationship, the business started generating contribution margins to cover fixed costs, including a modest salary to the owner.

As the above cases suggest, decline in profitability is induced by lack of appropriate actions resulting from failure to recognize key operational problems, such as inadequate cashflow, collection of receivables, faulty product pricing, and inadequate understanding of the relationship between production volume and breakeven. Although the owners became aware of the problems soon after their emergence, the problems continued and manifested in several managerial weaknesses which, in turn, led the firms to the point of bankruptcy. Some cogent explanations for this decline came from the interviews. One director asserted that small business owners are loath to delegate authority and power. Since the owner does everything himself, the problem remains masked. According to another director, "Even the owner of a pretty big business tries to do everything himself. He is reluctant to delegate authority to a foreman or a supervisor. To see that the job is done, he would rather be out there hands-on." Such deliberate failures to delegate increase the burden of the owner, who is then forced to run the firm in a seat-of-the-pants style. Four directors asserted that some owners fail to detect problems because of their tunnel vision. According to one director, "An owner with a technical background considers a product only from a manufacturing point of view, that is, something that only he can make. But the same owner can't find out if there is a market out there for what he's made." It is not unusual for an owner to be capable of seeing problems well in his area of expertise only, although there may be more pressing problems in other areas.

High Costs

> Small business owners become sloppy about the day-to-day details of their business. They don't do their ordering, they don't check their inventory, and those kinds of things. They let the business run itself.

Both the food and operating costs of a restaurant were far in excess of the industry average, and the owner was delinquent in tax payments. Finally, with the help of the SBDC, he started exercising control on the ordering and carrying of inventory. He increased prices of food items by an average $.50 per entrée, to improve cash flow. He also scaled back on entertainment and other ancillary costs. An advertising plan was devised to attract Cincinnati convention attenders. With a lengthy negotiation through the SBDC, the IRS (Internal Revenue Service) agreed to an extended payments plan, and the taxes and penalties were finally paid off. Food costs decreased from 43% to 35% of sales. The business returned to a profitable position.

Equipment Updating

> They get too close to their employees, as if they're family members. This can be productive. But it can backfire as well. In bad times, it's really tough to tell employees you don't need them anymore.

The nailer of a pallet manufacturing shop was obsolete and old-fashioned. Personnel had to be pulled off other areas to operate the nailer, and it took eight people to operate it and four to load pallets. The SBDC recommended the purchase for $35,000 of a Morgan nailer, which needed two people to operate it and two to load. Although the owner was unwilling to replace his long-time employees with a modern nailer, he finally replaced the old nailer and upgraded and streamlined the entire production line.

In the previous two cases, the owners were aware of the problems right from the beginning and wanted to correct them. However, they also believed that the problems might correct themselves eventually, or a favourable event, such as the receipt of a big order or the help of a new investing "angel," would save the situation. They were therefore lax in addressing the problems. These cases demonstrate a form of complacency, where owners lacked necessary abilities and a sense of urgency

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for the timely solution of the key problems. One director commented, "Even when a business is confronted with difficulties, you can hardly find an owner who is willing to sit down and look at his problems for more than two hours."

Obsession with Growth

A service firm started with two employees. After three years, it had 12. Since its inception, the owner of the firm had been making one mistake—he never wanted to be involved with the managerial and financial aspects of the business. He knew operations well and wanted to run that aspect of the business successfully. He wanted someone else to manage the business for him. He hired an accountant who was not a Certified Public Accountant (CPA). Ironically, the owner did not even know the difference between an ordinary accountant and a CPA. He fully trusted the accountant, and wanted him to do his record keeping, to take care of all his financial problems, and to keep him informed of anything that he needed to know. He also gave the accountant power of attorney to write cheques for his tax bills. When he received tax bills from the federal government, he simply passed them on to his accountant.

The owner was constantly bidding on jobs, and he always bid low enough to make sure that he won. He frequently asked his accountant for advice on bidding. By combining the cost of bidding with a margin for overhead, the accountant was supplying him with the aggregate cost. However, the owner never asked the accountant, nor did the accountant ever volunteer, to review the overall financial situation of the firm for three consecutive years. The overhead and other expenses changed, but the owner was pricing his work in the same way that he had been doing three years previously. His tax bills were mounting, but the accountant never told him that the taxes were not being paid. The business continued to grow and the gross sales kept increasing. The bottom line kept growing too, but in the negative direction, and the owner did not know why. The situation reached a climax when the federal government stepped in and threatened to seize all assets and close the business unless the bills were paid soon. The owner approached the SBDC for a loan for inventory and working capital, although he actually needed the loan to pay off the tax bill he owed the IRS.

Until the IRS entered the scene, the owner did not know that he had a serious problem. Before the intervention of the IRS, he was not concerned about the growing net loss. He was complacent because he was selling more service, his gross revenue was increasing, and he was hiring more people. Despite recommendations from the SBDC on several occasions to initiate certain changes, he paid no attention. He always wanted more cash to improve his cash flow. It was only when the IRS stepped in that he was willing to sit down with his claimants and initiate some drastic changes.

Personal Wealth Versus Business Effects

A wholesale supplier of nongrocery items for rural convenience stores had been successfully operating since he opened the business in 1968. It produced stable sales and net profits from 1968 through 1984.

In 1984, sales declined by about 10%. There was a 10% annual decline in subsequent years through 1987. In 1984-85, the supplier added $300,000 to his personal debt by buying and remodelling a home and buying a 302-acre farm. Two hundred thousand dollars of his personal wealth went into the home and farm.

In early 1987, he opened a grocery store chain with a secured bank loan of $430,000. Apart from numerous rural convenience stores, the chain had only one major competitor in the county. The chain was operating at an annual sales volume of $1.8 million. Although it was the sole supplier of grocery items to all nonchain rural convenience stores in the county, it did not respond to the three year sales decline, which was attributable to the following factors. (1) Alternatives to offset losses were either too costly to institute, or were considered dangerous due to adverse competitive reactions from contiguous geographic areas. (2) The business operated at a loss, primarily because of poor mark-up structure. As the preparation of profit and loss statements was usually slow, the low mark-up never received serious attention. Also, labour costs to sales appeared to be about 1% higher than the industry average. (3) After operating successfully for a long period of time, the wholesaler got used to a relatively high standard of living. He found it difficult to reduce his amount of personal debt as well as his level of spending. More importantly, he considered the slow decline of business and the gradual loss of sales as temporary, and lacked the adaptive initiative to improve the situation. This sense of complacency brought about a concomitant reluctance to cut down on spending and borrowing.

Four corrective actions brought the business back to profitability. (1) Changes to ensure an 18-22% mark-up of items were initiated. Pricing with an 18-22% mark-up matched the pricing structure of competitors, so that no loss of sales to competition was expected as a result. (2) The owner agreed to check labour costs carefully. Lowering labour costs from 8.5% of sales to 7% would reduce costs by $1,000 per month. (3) Creditors were made aware of the situation. With trade credit terms as high as 5%/30 days, the owner was advised to pay off the entire accounts payable. In some cases, payment sched-

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ules were extended much beyond 30 days, and the discount rate was lowered to 2%. This relaxed arrangement provided the owner with breathing space. (4) The owner was persuaded to lower his standard of living and sell the farm. The proceeds from the sale were to go towards paying off the bank loan. It was estimated that he could meet his obligations and live on a $3,600 monthly salary. An additional $16,822 would be saved annually by dropping one life insurance policy, the premium of which was being paid by the business.

Data Interpretation

The interviews and subsequent analyses of the eight cases illustrate the recurrent theme that managerial weaknesses induce decline. The interviews and cases corroborate the findings of other research (e.g., Berryman, 1983; Haswell & Holmes, 1989; Peterson et al., 1983; Wichmann, 1983) that decline is accelerated by managerial incompetence, coupled with an inadequate understanding of the basic business functions, especially accounting/finance and marketing. The SBDC directors unanimously maintained that managerial incompetence stems from a host of related factors, such as poor understanding of basic accounting and finance, inadequate accounting records, inadequate understanding of market and competitive forces, and limited access to pertinent information. "In a nutshell, the bottom line is poor management. Poor management, which shows up in all kinds of ways is what cuts into the profits in small firms."

More importantly, the interviews and the last two detailed cases demonstrated the pervasive role of complacency as a context of failure. The director interviews supported the boiled frog phenomenon. Owners accustomed to operating under stable conditions in the past simply refuse to accept that the situation has changed.

> He's very set in his ways. He doesn't want to introduce any new technology. He doesn't want to change his marketing mix. He's been doing one particular thing in one particular way for the last 10 years, and he's going to do the same thing the same way for the next 10.

> I think some owners just get stuck in a rut. You see the kind of person out there who gets plain bored. He's the start-up person, the guy who got the business going. Then he gets successful and soon he's tired of it.

The directors also considered decline as a low-level crisis which never triggers corrective actions until the situation gets to the point where the wolf is at the door. Small firm owners do not see any urgency for problem solving in such a situation. They think that tomorrow is going to be better, that time will fix the problem, or that it is best to wait and see. According to one director, "Decline is sneaky. You keep kidding yourself. After all, business wasn't that bad this year, and it's going to be better next year." Another director made this analogy: "Knee-deep water is not a threat, neck-deep water is." This analogy points out the tendency to concentrate on major, life-threatening problems, to the exclusion of currently minor but potentially crippling ones (Reece, 1994).

While these qualitative data illustrated the relationship between managerial weaknesses and decline/failure, they also illuminated complacency as the context of this relationship. Although the SBDC directors attributed decline to management incompetence, they emphasized the pervasive role of complacency, which the cases also illustrated.

Complacency also seemed to interact with stakeholder support. As affirmed by the SBDC directors, influential stakeholders tend to be concerned about the impact of managerial complacency on continued erosion of profitability. The concessions of key stakeholders, especially banks, are a function of their perceptions of the causes of their clients' problems (Gopinath, 1995). The involvement of a credible third party in the negotiation helps to improve communications and to create a favourable impression. Therefore, declining firms for which a competent third party negotiates have a greater potential for increased creditor commitment. The cases clearly illustrated that pressure on the owner was relieved by a deferred payment plan with the bank and the landlord, relaxed credit terms with the supplier, and a realistic payable schedule with the IRS. This, in turn, provided the firm with a basis for survival. As these cases demonstrated, the survival of such frail firms would have been stopped short if these concessions had not been negotiated by a third party, that is, the SBDC. The obsession with growth case also endorsed Hambrick's (1985) particular observation that banks are more amenable to concessions if the firm's key suppliers or customers are also major clients of the same bank. "Banks are the major creditors of small firms, so they play a big role in the failure/success of their clients because they can shut the light off at crucial times."

Implications and Conclusions

We examined the dynamics of complacency as a context of small firm decline and the role of third parties as intermediaries with key stakeholders in the reversal of decline. First, we showed how complacency as a construct might relate to existing theory and then illustrated situations in which complacency and its relationship to

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managerial weaknesses might explain the decline of small firms. Second, we showed examples of the relationship of complacency and the role of third parties in obtaining stakeholder support to facilitate recovery. Thus, we tried to arrive inductively at the centrality of complacency in the decline of small firms and to ground it in the reality of data from 12 detailed interviews and eight retrospective cases.

Our interviews and cases supported the theme that managerial weaknesses induce decline, thus endorsing the findings of other research (e.g., Berryman, 1983; Haswell & Holmes, 1989; Peterson et al., 1983; Wichmann, 1983). The decline of small firm profitability resulted from poor management that manifested in many operational weaknesses. However, the interviews and cases also pinpointed complacency as an important context of the relationship between managerial weaknesses and decline. Lack of interest and a lack of a sense of urgency caused problems to drag on and manifest themselves in several managerial weaknesses, ultimately leading the business to the point of bankruptcy. Operational weaknesses varied in type and intensity, depending on the degree of complacency under which they emerged and thrived.

While this study emphasized construct development, it also has an important managerial implication. As influential stakeholders tend to be concerned about the impact of managerial complacency on profitability, small firm owners should be particularly careful in maintaining relationships with them. In a declining situation, the relationships between key stakeholders and small firm owners are asymmetrical (Gopinath, 1995), as the latter is dependent on the former for concessions and support for survival. Again, the concessions and support are functions of the perception of the stakeholders about the nature and severity of their clients' problems (Gopinath, 1995; Hambrick, 1985). Therefore, when decline shows a consistent pattern, owners should seek institutional help to persuade outside constituencies, such as banks, suppliers, and government agencies, to provide concessions and support (Boyle & Desai, 1991; Chowdhury & Lang, 1993; Gatewood & Hylton, 1994; Good & Graves, 1993; Robinson, 1983; Welsh & White, 1981). Since knowledgeable third parties are likely to be more credible to stakeholders, they can help small firm owners to create a more favourable impression. This effort might encourage key stakeholders to work harder with their clients toward a turnaround.

Key allies might also assume a pseudo-vigilante role in a gradually worsening situation, and might provide the most timely something-is-wrong signal. In some cases, an appropriate timely signal could prompt a mutually beneficial change of course before the business runs afoul of the requirements of less closely vested players, such as the government. Therefore, it might be worthwhile to formalize systematic outside interventions, on an ongoing basis.

This study also raises an interesting question for further empirical research: Can an individual be successful in founding a firm, and in managing its growth, maturation, and success as well? Some of our interviews and cases suggested (consistent with popular opinion) that entrepreneurial skills are different from the ones needed to manage a firm successfully. One director commented, "When the business succeeded beyond his wildest dreams, he just started to let it run itself." This behaviour might be explained by the fact that "entrepreneurs miss the challenge of innovation, imagination, and risk-taking associated with the start-up situation once the business is past that stage" (Berryman, 1983, p. 54). If this is so, long-standing businesses that are still run by their originators might be more prone to complacency. However, this conclusion is contradicted by recent research findings that "no neat set of behavioral attributes" separates entrepreneurs from nonentrepreneurs (Bygrave, 1994, p. 8). This latter conclusion points to the need for a better understanding of the link between complacency and the internal locus of control of small firm owners who manage their operations themselves.

Conclusions based on interviews with 12 directors of the SBDC and 8 retrospective cases are somewhat tentative. However, given the purpose of this study to ground complacency for theory formulation, this approach was appropriate. Broad patterns of the nuances of complacency across the interviews and cases seem to have established "its relevance to an evolving theory" (Corbin & Strauss, 1990). The SBDC directors had the opportunity to test and share complacency and related concepts with colleagues, who had considerable experience in the failure and success of small firms. This opened up avenues for contradiction and reinforcement.

The study has certain limitations. Since the supporting cases were prepared by the SBDC directors, their reliability could not be ascertained independently. As the cases were made available only through the SBDC, it was not possible to determine how significant outsiders would rally to support failing businesses in the absence of a third party, such as the SBDC. Moreover, it was not possible to ascertain the motivations behind individual actions.

Second, the disguised cases prevented independent examination of the aftermath of the SBDC intervention. Did it lead to a sustainable growth of the firms? Or, did it merely result in a temporary remission before complete collapse? Interviews with the owners of the firms would have provided answers to these questions. There was, however, a substantial body of convergence across the interviews and cases. Whenever an opportunity

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occurred, the directors referred to the case(s) in their interviews. As a result, we could compare incidents and identify their congruence with complacency, and thus were able to accumulate the basic grounding for a concept and subsequent theory of complacency.

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Note

1. For effective management assistance and counselling to present and prospective small business owners, the U.S. Congress initiated the Small Business Development Center (SBDC) program in 1977. In 1980, Congress enacted the SBDC program into law and entrusted the U.S. Small Business Administration (SBA) with the oversight of the program. There are now more than 700 service locations organized into 57 SBDC territories—one or more in each of the 50 states, as well as in the District of Columbia, Puerto Rico, and the Virgin Islands. (For a detailed account of the SBDC program, see Gatewood and Hylton, 1994).
Located at the University of Kentucky in Lexington, the central office of the Kentucky SBDC program administers and coordinates program services to small businesses through a network of 12 subcenters across the state.

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