DEFINITIONS OF SMALL FIRM FAILURE SIGNS AND FINANCIAL DISTRESS

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ABSTRACT

The enterprise crisis is an inherent phenomenon of the enterprise itself. Firms may encounter unknown situations during their existence just as any other organism and if they do not manage properly, firms will show the first symptoms of the crisis, which are as diverse as the causes of crisis. In this study, which is part of failure symptoms studies of small and medium privately owned firms, mainly in the form of Sole Proprietorship and low scale are explored and described some definitions of an organizational phenomenon in an financial approach in terms of symptoms and financial criteria of the firm failure.
The symptoms of a small firm crisis can signal financial disequilibrium problems of the company that can alert you to a potential enterprise crisis, certainly accompanied with symptoms and other factors[3]. What matters to me as an economist is to understand the financial causes and symptoms of SMEs failure, but we must first distinguish between firm failure[4] and bankruptcy which is the legal declaring of the company's failure. If we manage to discern the failure of the firm prematurely through signals we may save it without leading up to bankruptcy and a legal matter, being aware that bankruptcy does not always satisfy all creditors and stakeholders of the firm and that failure is also a social bell for some SMEs around which many stakeholders' interests rotate .

Keywords: *small firm crisis; insolvency firm, bankruptcy; small scale firm*
JEL Classification: *L20, M10, G33*

1. Introduction

Generally or conventionally speaking, the enterprise crisis from a financial aspect of symptoms is defined by a financial imbalance which implies the lack of funds and lack of liquidity reserves to meet firm liabilities. So the financial difficulty of the firm is a symptom of the small enterprise crisis, which is obviously a cause for the failure of small enterprises, despite the fact that firms have their own cycle of life, which besides the financial perspective also requires a healthy management perspective. Although the financial crisis of the company is implicated even by many external and internal factors, however this study reveals only a few definitions and aspects of the definition of the company's failure that will be part of a more comprehensive and interdisciplinary study in the future.
Theoretically and empirically speaking, the SMES crisis and the failure of the company are shown in similar perspective:

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[3] Internal and External Factors
[4]And its types

So according to Lipi: Odipo and Sitati 2008 have described that firms failure can be displayed as bankruptcy or insolvency, where the latter implicates the case when firms fail due to the fact that it is impossible to comply and liquidate their short term liabilities. This situation occurs when the firm's current liabilities are greater than current assets or in other words when the firm has a negative working capital and the failure signal starts to appear since the falling trend of working capital. While bankruptcy, which in most cases means a legal status of the company, implicates the case when the firm's total liabilities are greater than the fair value of its assets, so in order for the management to consider the firm's financial position and performance, it should normally compile and utilize the financial statements (2014, pp.2).

Following, Lipi (2014, pp.3) also explains that: If we refer to the experiences of different countries, we will say that the failure of firms is not a phenomenon that belongs to only a few countries, but is likely to be part of firms operating in developed countries and even more in developing ones. However, the reasons that push firms toward failure and financial difficulties differ in different countries, referring especially to the economic environment conditions, or political environment and with regard to their financing structures and methods (Ijaz, Hunjra, Hameed, Maqbol, &Azam, 2013).

Golin (2001) states that sufficient finances are necessary and essential for the survival and success of the firm (as cited in Seeletse, 2012), resultantly even for the failure and its regression.

Although there is not only one single definition to the firm crisis and failure, whether we see the crisis only in financial perspective, the enterprise crisis will be comprehended as insolvency and bankruptcy, which are conventionally defined as:

The Difference between Insolvency and Bankruptcy is that Insolvency is essentially the state of being that prompts one to file for bankruptcy. An entity: a person, family, or company becomes insolvent when it cannot pay its lenders back on time. In general, this occurs when the entity's cash flow in falls below its cash flow out. For individual debtors, this means that their incomes are too low for them to pay off their debts. For companies, this means that the money flow into the business plus and its assets are less than its liabilities (The Difference between Insolvency and Bankruptcy, n.d).

Bankruptcy is a legal declaration of one's inability to pay off debts. When one files for bankruptcy, one obliges to pay off what is owed with the government help. In general, there are two main forms of bankruptcy, reorganization and liquidation[5] bankruptcy. Under reorganization bankruptcy, debtors restructure their repayment plans to make them more easily met. Under liquidation bankruptcy, debtors sell certain assets in order to make money they can use to pay off their creditors (The Difference between Insolvency and Bankruptcy, n.d.).

While Fatoki (2014) has explained that according to Titus (2008) a firm fails if it does not fulfill its liabilities to employees, suppliers, customers and owners.

In this case Fatoki (2014) explains that according to Pretorius (2009) business failure is a challenging theoretical issue for which there is more than one single definition. Pretorius (2009) research shows that based on the literature about the failure of the business and its definitions, it can be concluded that:

A venture fails when it becomes involuntarily unable to attract new equity or debt funding to reverse decline; consequently, you can't continue to operate under the current ownership and management. Failure is the endpoint at discontinuance (Bankruptcy) and when it is reached, operations cease and judicial proceedings take effect (as cited in Fatoki 2014, pp. 296).

[5]The Difference between Insolvency and Bankruptcy, Greenwaybankruptcy.com, Accessed in 15 November, 2015, prej http://www.greenwaybankruptcy.com/articles/the-difference-between-insolvency-and-bankruptcy/

By reading the first symptoms of the crisis makes you understand it at an early stage what may provide an opportunity to turnaround, not only for the firm but also for creditors, employees, public finance, as well as for other companies which firm interacts with and the whole entire economic and social network.
The role and potency of SMEs in the economy is generally known, especially in a country in transition, so small and medium enterprises have also an important role in the Albanian economy through economic growth and employment, by METE (n.d.) "The contribution of SMEs is more than 73% in GDP and more than 71% in employment (2011)".
Moreover, the potency and role of SMEs in the Albanian economy is best reflected in the statistics, so: "Statistical Register of Companies at the end of 2015 counts 152,288 active companies. Trade [6] enterprises represent 35.3% of total enterprises, while enterprises by "information and communication" economic activity represents only 1.6% "(INSTAT, 2015). Also it shows that about 37.3% of active companies were recorded this year at the end of 2015[7] (INSTAT, 2015).
Referring to active companies in 2015, it is noted that about 99.9% of the enterprises are those with 1-49 employees (INSTAT, 2015), which makes even clearer the importance of this study, which will introduce SMEs failure as an important issue in the Albanian context as well. Also about 68% of active companies are those in the legal form of physical person (INSTAT, 2015), enterprises which are regulated and controlled by the tax authority simpler than large businesses, rating so the fiscal authority as the first agent that can reveal the first symptoms of the small firm crisis, identify its financial difficulties and the failure risk or bankruptcy of the firm.
The problem of the firm failure and financial distress is not an issue that has the same phenomenology in all countries, as the economic context of the country is a key factor for the development stages of the company, including its failure thereof, especially for SMEs in developing countries. Another important issue that should not be forgotten is the uniqueness of small business in relation to big business, especially with regard to matters such as financial management, and even the firm the failure referring mostly by a financial perspective. Therefore, it is necessary to refer again what the theoretical definitions of small business failure are, as well as the causes, signs and factors that affect the firm's crisis and how they vary referring to literature about this optic. When we refer to small business we generally refer to small scale business, that according to Cole (1971) is defined as: “is a business that is owned, managed, controlled by one or two persons, is firmly influenced in decision making, has an undifferentiated organizational structure, has a relatively small share of the market and employs less than 50 people” (as cited in Chidinma, pp.20).
It is clear that, even theoretical and empirical studies about companies in developing countries and developed countries, draw out a set of definitions for small business failure.
Out of the multitude of literature and studies about this issue, we have selected some of the definitions that sound closer to the development of small business failure according to the perspective of firms in developing countries and developed countries too.
In many studies and theories of firms in developing countries is reviewed that:

1- “Business failure is defined as a situation in which firms cannot meet their liabilities and hence cannot conduct economic activities any more” (Honjo, 2000:559, as cited in Dias, 2014, pp.3).
2- “Business failure occurs when a decline in revenue and/or increase in expenses are of such magnitude that the firm becomes insolvent, and is unable to attract new debt or equity funding.

[6] Referring to the economic activity
[7] While according to the statistical register of enterprises in 2014 counted a total of 112,537 enterprises.

Consequently, the business cannot continue to operate under the current ownership and management" (Shepherd *et al.,* 2009:134; as cited in Dias, 2014, pp.5).

While the two definitions below are extracted from studies of firms in developing countries, where it is indicated that:

1- Failure can be the inability of a business to meet its financial obligations or the discontinuation of a business – that is, the entrepreneur no longer has the managerial capacity or the desire to continue operating, and the small business is not attractive enough to attract a purchaser to continue the operations (Engelbrecht, 2005:464; as cited in Ntema, 2014, pp.4).
2- Venture failure is seen as the opposite of success (Pretorius, 2006:226; as cited in Ntema, 2014, pp.4).

Generally speaking, it seems that key words around which the semantics of the firm failure vary around, is more or less about the most critical or acute issues like: can't meet liabilities, decline precedes failure, firm insolvency, and or signs of lack of success.
Jusino and Tengeh (2015, pp.571) have explained the factors that determine the failure of small enterprises referring to several studies by proving that:
Nemaenzhe (2010) defines small business failure as any small business that freely closes or is forced to, because either the owner's lawful right has been lost or it is no more profitable. Dasgupta and Sanyal (2010) argue that a small business failure rises in a gradual sequence of small particles of failures to a final failure (as cited in Justino & Tengeh, 2015, pp.571).
Referring to these definitions to the failure of small companies, it implies that the failure of the firm is a condition that can be avoided and managed if managers will be able to manage and care for the risks related to their business (Justino & Tengeh, 2015). Tengeh (2011) has listed a number of factors that are associated with the failure of the firm, such as: "lack of business knowledge, lack of capital, less market share and so forth that can be overcome with the entrepreneur's positive attitude to success and minimum effort" (as cited in Justino & Tengeh, 2015, pp.571). Despite the fact that good business practices are a very important factor to avoid the risk of failure, however, this key does not remain a determinant factor for its success (Hendrikse & Hendrikse, 2004; as cited in Justino & Tengeh, 2015).

In the literature summary that many researchers have conducted, it is also noticed a classification of a few definitions that relate to the early definitions of the crisis or its final stages, moderated with another term called turnaround, which means an opportunity to return to the business route and avoid the road to failure, especially the legal one named asbankruptcy, e.g. in his study, Pretorius (2009) after reviewing many studies has defined and quoted (pp.10-11):
Decline – A venture is in decline when its performance worsens (decreasing resource slack) over consecutive periods and it experiences distress in continuing operations. Decline is a natural precursor in the process to failure.
Failure – A venture fails when it involuntarily becomes unable to attract new debt or equity funding to reverse decline; consequently, it cannot continue to operate under the current ownership and management. Failure is the endpoint at discontinuance (bankruptcy) and when it is reached, operations cease and judicial proceedings take effect.
Turnaround – A venture has been turned around when it has recovered from a "decline that threatened its existence" to resume normal operations and achieve performance acceptable to its

stakeholders (constituents) through reorientation of positioning, strategy, structure, control systems and power distribution. Return to positive cash flow is associated with achievement of "normal operations" (Pretorius 2009, pp.10-11).

2. Literature Review

2.1. Signs of financial distress and reasonsof small business failure

Watson (2003) gives an extensive explanation of the concept of SME failure; he has summarized failure as (as cited in Fatoki, 2014, pp.924):
(1) Bankruptcy which is defined as discontinued operations with resulting losses to its creditors.
(2) Discontinuance which is defined as prevention from further losses.
(3) Not 'making a go of it' is the most subjective reason as it is based upon personal goals not being reached, and (4) Retirement due to bad health (as cited in Fatoki, 2014, pp.924).
Titus (2008) points out that failure occurs if a firm fails to meet its responsibilities to the stakeholders of the organization, including employees, suppliers, customers and owners.
From this point, a business failure is the termination of an entrepreneurial initiative that has fallen short of its goals. In addition, failure happens when there are significant losses in the capital of the business that ultimately lead to business discontinuance. Honjo (2000) observes that a number of firms continue to trade while earning low rates of return (as cited in Fatoki, 2014, pp.924).
Fatoki (2014) also explains that if we refer to business failure from the perspective of return, he has summarized and classified business failure according to some other Criteria (pp.924):
(1) Earnings Criterion: A firm has failed if its return on capital is significantly and consistently lower than that obtainable on similar investments.
(2) Solvency Criterion: A firm has failed if the owner, to avoid bankruptcy or loss to creditors after such actions such as execution, foreclosure or attachment, voluntarily withdraws, leaving unpaid obligations.
(3) Bankruptcy Criterion: A firm has failed if deemed to be legally bankrupt. Bankruptcy is normally accompanied by insolvency and/or liquidation.
(4) Loss cutting criterion*:* A firm has failed if the owner disposes of the firm or its assets with losses, in order to avoid further losses (Fatoki, 2014, pp.924).
Also Fatoki (2014) explains that the researchers argue that there are many reasons why small businesses fail, as shown in the study of Mudavanhu et al. (2011).
Pratten (2004) argues that one line of research developed by Stinchcombe (1965) suggests that the liability of newness is an important reason for the failure of new SMEs. This viewpoint proposes that new organizations fail from a combination of internal and external factors. The liability of newness framework identifies problem factors which inhibit new venture success (as cited in Fatoki, 2014, pp.924).
So if we need to make a distinction between the internal factors and external factors, we must remember that internal factors are factors that the firm keeps them under control, against organization external factors which firms cannot have under control.

2.2. Signs of firm financial failure and poor financial management

Generally, the firm failure has two forms regarding to how it is displayed, and that is precisely classified as technical insolvency or bankruptcy. So in general, according to Danilov (2014):

A technically insolvent firm has more assets than liabilities on its balance sheet, but is unable to meet current obligations as they come due. If the company were to be liquidated, in theory there would be at least enough proceeds generated by the sale of assets to repay all of the creditors in full. Despite the fact that there may be net equity on the balance sheet, there is not enough cash to meet current financial obligations such as interest expenses or trade payables. In contrast, a “bankrupt” firm has a true value of assets that is less than its liabilities; its net worth is negative, and creditors would not be repaid in full if the company was liquidated. Either type of financial failure must be resolved by either a renegotiation with creditors or through formal bankruptcy proceedings (“bankruptcy” as defined in the legal sense), which may result in a reorganization or a liquidation of the firm (as cited in Danilov, 2014, pp.10).

3. Literature findings on poor financial management and small business failure

According to Peacock (2000) Berryman in his studies (1983, 1994) reviewed the literature and studies about small business failure, concluding that three factors that bring thus the failure of the firm are: "management inefficiency, behavioral aspects of owner-managers, and characteristics of the firm "(pp.9).
Based on references and studies review, Berryman has shown that 76% of causes of small business failure are attributed to management inefficiency (as cited in Peacock, 2000, pp. 9). According to Peacock (2000, pp.9) Berryman has revealed that:
The predominant aspect of management inefficiency (76% of references) responsible for failure was financial management in 45% of references. Within the finance function, accounting was the biggest problem (13% of references in 1983 and 5% in 1994), because of ‘inadequate or no accounting records’ and ‘deficiency in accounting knowledge’. Other key aspects of the finance function ranked in order of importance were:
1. Credit management;
2. Inventory control;
3. Cash flow analysis / liquidity;
4. Lack of initial capital;
5. Control of accounts payable;
6. Administration of fixed assets;
7. Lack of finance (as cited in Peacock, 2000, pp.9).

So generally, business failure is conventionally considered as financial distress, which according to studies it generally "can mean liquation, deferment of payment to short term Creditors, deferment of payment to interest or principal on bonds or the omission of a preferred dividend" (as cited in Memba & Job, 2013, pp.1186). However, a major problem that appears in literature about studies about the prediction of financial distress or failure is the standard or different criteria that the authors use to prove financial distress (Jamshed, 2012).
According to these Criteria is defined that "financial distress occurs when a firm is not able to meet its obligations" (Pandey, 2005; as cited in Membe & Job, 2013, pp.1186). Memba and Job (2013) also prove that according to Adeyemi (2011) financial distress is defined "as a situation in which an institution is having operational, managerial and financial difficulties" (pp.1186). While according to Jahur (2012) financial distress is considered "as the inability of a firm to pay its current obligations on the dates they are due" (Memba & Job, 2013, pp.1186).

4. Conclusions

Despite different definitions and criteria to describe small business failure by theoretical studies, literature or by the empirical studies reviews is pointed out that small business failure is mainly defined as the inability of small firm to meet its obligations. The failure of small business is a phenomenon that does not belong to the firm only, for the impact it has on the domestic economy, thereof the definition of this phenomenon and clarification of the underlying causes and symptoms is an important issue even if in a theoretical context. The failure of small business is an issue that should be explored theoretically and empirically as well, so researchers, business owner-managers, policymakers, accounting professionals, business advisers and even universities have to be aware of the impact that they have in shaping the entrepreneurial culture. Studies on small enterprises failure should be on the focus of many business stakeholders for the fact that there is a very slight difference between failure and bankruptcy of the firm, which means that the recognition of this phenomenon will help diagnose this situation before the firm enters the crisis stage.

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