Risk Factors and Business Models
Risk Factors and Business Models
Understanding the Five Forces of Entrepreneurial Risk and the Causes of Business Failure

D. Anthony Miles
Abstract

One of the primary concerns in a small business is the problem of risk. Many who begin the start-up process terminate it in less than one year. Of those that survive, many are unable to achieve sustained growth and profits. Small-to-medium business enterprises (SME) have a 50% to 90% chance of failure within the first five years. While there are measures of personal risk behavior of entrepreneurs, the literature contains no measure of risk orientation for the enterprise.

The purpose of this study was to develop and validate a researcher-designed instrument to measure the critical forces of business risk. The 37-item Entrepreneurial Risk Assessment Scale (ERAS) was developed from key theoretical concepts grounded in economics, marketing, management, finance, and entrepreneurship literature. It was developed and finalized through a process of reviewing literature, subject matter expert panels’ review, and a pilot test. The a priori assumption of the ERAS constructs were (a) personal characteristics, (b) intangible operations, (c) enterprise operations, (d) market climate, and (e) business environment.

This study utilized a quantitative methodology to establish construct, content, and criterion validity using Bryant’s (2000) framework found in Reading and Understanding More Multivariate Statistics edited by Grimm and Yarnold (2000). A sample (N = 276) was taken from an urban/suburban area in South Texas. A principal axis factoring (PAF) analysis was used to establish construct validity; a principle component analysis (PCA) was used to establish content validity; and a logistic regression was used to establish criterion validity. Reliability was assessed within the efforts to establish content validity.

What emerged from both the factor analyses were five new factors of entrepreneurial risk that were different from the a priori assumptions and thus renamed: (a) customer and resources, (b) security, (c) operations, (d) external pressures, and (e) other/alternate factors. The results of the PAF and PCA provided strong support for the content and construct validity of the ERAS instrument. In the assessment of criterion validity, the logistic regression analysis showed the endogenous factors, (a) customer and resources, and (c) operations reliably predicted risk behavior of both nascent and incumbent SMEs.
Acknowledgements

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Very special thanks to my brother Kevin Miles, who is following my footsteps with the goal of attaining a doctorate.

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All praises due to Allah, the beneficent, the merciful for all praises are due forever…
This section of this dissertation is dedicated to the people that were part of my journey and who are no longer here to share my accomplishment. I wish to acknowledge the following persons in chronological order who have been a key ingredient and special influence in this endeavor of your passing:

First, this dissertation is dedicated to my late father, Winston C. Miles. My father had enough foresight and made me go to college when I was 18 years and hated school. My father preached education. My father believed in me and said I can do anything if I put my mind to it. This was contrary to a high school counselor telling me I was not college material. My father often said to me, “Failure is not an option. Your younger brothers and sisters are watching you. Failure is unacceptable.” My father also taught me the value of a work ethic and made me get a job to put myself through college. My father was the trailblazer and the first person in the Miles Family to graduate from college at St. Mary’s University. Because of your words of wisdom, I do not have the luxury of entertaining the thought of failure. For all the obstacles and racism that you endured, you would not accept anything less than excellence from your children. I hope that one day I can at least approach the shoelaces of your greatness. I miss you dearly.

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down on us from the heavens. Thank you for being supportive in my endeavor. It just will not be the same without you. The Miles Family really misses you. Take care.

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<th>Full Form</th>
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<tbody>
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<td>BET</td>
<td>Black Entertainment Television</td>
</tr>
<tr>
<td>BPEA</td>
<td>Business Plan Evaluation Aids</td>
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<tr>
<td>CD</td>
<td>Compact Disk</td>
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<tr>
<td>CFA</td>
<td>Confirmatory Factory Analysis</td>
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<tr>
<td>DOS</td>
<td>Diseconomies of Scale</td>
</tr>
<tr>
<td>EFA</td>
<td>Exploratory Factory Analysis</td>
</tr>
<tr>
<td>EO</td>
<td>Entrepreneurial Orientation</td>
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<tr>
<td>ER</td>
<td>Entrepreneurial Risk</td>
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<td>ERAS</td>
<td>Entrepreneurial Risk Assessment Scale</td>
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<tr>
<td>ERO</td>
<td>Entrepreneurial Risk Orientation Behavior</td>
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<td>FA</td>
<td>Factor Analysis</td>
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<tr>
<td>IRB</td>
<td>Institutional Review Board</td>
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<tr>
<td>KMO</td>
<td>Kaiser-Meyer-Olkin Measure</td>
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<tr>
<td>LLC</td>
<td>Limited Liability Corporation</td>
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<tr>
<td>LLP</td>
<td>Limited Liability Partnership</td>
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<tr>
<td>NAIC</td>
<td>North American Classification System</td>
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<tr>
<td>PAF</td>
<td>Principle Axis Factoring</td>
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<td>PCA</td>
<td>Principle Component Analysis</td>
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<tr>
<td>ROI</td>
<td>Return on Investment</td>
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<td>SAS</td>
<td>Statistical Analysis System ®</td>
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<td>SBA</td>
<td>Small Business Administration</td>
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<td>SBDC</td>
<td>Small Business Development Center</td>
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<td>SEM</td>
<td>Structural Equation Modeling</td>
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<td>SME</td>
<td>Small-to-Medium Business Enterprise</td>
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<tr>
<td>SPSS</td>
<td>Statistical Package for Social Sciences®</td>
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<tr>
<td>SSL</td>
<td>Sum of Squared Loadings</td>
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<tr>
<td>UIW</td>
<td>University of the Incarnate Word</td>
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<td>USASBE</td>
<td>United States Association for Small Business and Entrepreneurship</td>
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<tr>
<td>BCL</td>
<td>Business Climate/Economic Location</td>
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<td>BET</td>
<td>Business Entity Type</td>
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<td>Capital Investment Intensity</td>
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<td>Competition Intensity</td>
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<td>CTO</td>
<td>Customer Turnover/Turnaround</td>
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<td>Diseconomies of Scale/Internet</td>
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<td>EDU</td>
<td>Education</td>
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<tr>
<td>ENC</td>
<td>Environmental Climate</td>
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<tr>
<td>EOS</td>
<td>Equipment/Systems Investment</td>
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<td>EXI</td>
<td>Expertise in Industry/Field</td>
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<td>GND</td>
<td>Gender</td>
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<td>GLB</td>
<td>Globalization Risk</td>
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<td>Government Regulation Constraints</td>
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<tr>
<td>INC</td>
<td>Income</td>
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<td>IFC</td>
<td>Inflation/Energy/Fuel Costs</td>
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<td>INT</td>
<td>Intellectual Capital</td>
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<tr>
<td>LBO</td>
<td>Length of Business Ownership</td>
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<td>MEB</td>
<td>Market Entry/Exit Barriers</td>
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<td>Market Potential</td>
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<td>Protection Mechanisms</td>
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<td>Security Risks</td>
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<td>TRF</td>
<td>Terrorism Risks</td>
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<tr>
<td>TDP</td>
<td>Time Intensity Dependence</td>
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<td>VOP</td>
<td>Velocity of Profit</td>
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Chapter 1

Introduction

The rate of survival for small-to-medium business enterprises has been and continues to be a challenging issue. A major problem with the pursuit of business ownership or entrepreneurship is the significant risks that are involved (Stanley & Danko, 1996). The problem is the high rate of failure of small-to-medium business enterprises (SME) and the often-ignored risk factors that act as strong antecedents. By nature, all businesses are risky; one’s capacity to assume those risks is the defining concept of entrepreneurship (Cantillon, 1732/2001; Kanbur, 1982). Entrepreneurship is the polar opposite of safety and the two do not mix.

The Small Business Administration (SBA) defines a small-to-medium business enterprise (SME) as a business that has less than 500 employees (SBA Advocacy, 2007). “Entrepreneurial risk” (ER) is operationalized as “the risks that are associated with the success or failure of a business enterprise” (Ahwireng-Obeng & Mokgohlwa, 2002, p. 33). The economics literature states there are two general subcategories within the concept of entrepreneurial risk: (a) endogenous variables, factors controlled within the firm such as price, advertising, and operations; and (b) exogenous variables, factors outside the control of the firm such as consumer incomes, competitor prices and the weather (Dollinger, 1999; Hirschey, 2006; Hirschey & Pappas, 1992).

Background of the Study

The inspiration for conducting this study was the 2006 United States Association for Small Business and Entrepreneurship (USASBE) Conference in Tucson, Arizona. The researcher had the opportunity to present the topic as a workshop on a related subject concerning entrepreneurial risk metrics and measurement. The USASBE Conference provided the researcher an impetus to pursue this subject matter further as a research study. During the question and answer period following of the presentation, a few of the researchers in the audience stated how much they enjoyed the presentation on the subject of entrepreneurial risk measurement. After the positive responses received from the presentation at the conference, the researcher decided this subject needed more exploration; and would make an interesting dissertation topic for research.

Notably, a remarkably large percentage of people who begin the start-up process terminate it less than one year later (Shane, 2008). The SBA Office of Advocacy’s general rule of thumb is that a new employer business has a 50% chance of surviving five years or more (Headd, 2003). The Small Business