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COVID-19 AND BUSINESS FAILURES: THE PARADOXES OF EXPERIENCE, SCALE AND SCOPE FOR THEORY AND PRACTICE

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ABSTRACT

In light of growing scholarly works on business failure across the social science domains, it is surprising that past studies have largely overlooked how extreme environmental shocks and 'black swan' events such as those caused by the coronavirus (COVID-19) pandemic and other global crisis, can precipitate business failures. Drawing insights from the current literature on business failure and the unfolding event of COVID-19, we highlight the paradoxes posed by novel exogenous shocks (that is, shocks that transcend past experiences) and the implications for SMEs. The pandemic has accelerated the reconfiguration of the relationship between state and markets, increasing the divide between those with political connections and those without, it may pose new legitimacy challenges for some players even as others seem less concerned by such matters, whilst experiential knowledge resources may be both an advantage and a burden.

Keywords: business failure; paradox organizational failure; closure; exit; COVID-19; novel global crisis.

INTRODUCTION

Prior to the commencement of the 21st century, many of the challenges facing global businesses revolved around how to mitigate business failure (see Amankwah-Amoah & Syllias, 2020). However, in discussing both business ailments and remedies, a great deal of the literature rested on two fundamental assumptions: the increasing primacy of markets, and that much could be taken for granted about the global business ecosystem. Although the latter was not immune to periodic unexpected downturns, challenges took familiar forms (e.g. recessions), and a limited range of policy remedies, centering on generous central bank interventions to support and sustain borrowing and relieve debt, seemed capable of restoring growth. Recent developments, including the rise of right-wing populism in mature liberal markets, climate change, and most recently the novel coronavirus (COVID-19) pandemic have challenged these assumptions. Although climate change may have greater long-term consequences, the COVID-19 pandemic has had more immediate effects on the global business ecosystem. Accompanying the COVID-19 pandemic with reported more than 14 million cases and over 600,000 fatalities globally affecting countries across Africa, Americas, Eastern Mediterranean, Europe, South-East Asia and Western Pacific (Worldometers, 2020; World Health Organization, 2020) are multiple cases of foreclosures, massive unemployment, cars repossessions and waves of business failures ranging from retailers, airlines, and health fitness & wellbeing centers, among several others. In the UK, for instance, COVID-19 has exponentially led to an increase in number of financially distressed companies to around "half a million firms are at risk of collapse" (Cook, & Barrett, 2020, p. nd). This has caused widespread economic distress, with a likely long-term impact on the global economy.

According to report by the International Civil Aviation Organization (2020), COVID-19 is expected by the end of 2020 could lead to reductions of up to 71% of seat capacity and around 1.5 billion passengers globally exemplifying the precarious nature and effects of the pandemic on airline businesses and financial position of multiple firms that provide support services to airlines and airports. These demonstrate a looming problem facing industry and public policy and need for better understanding of conditions leading to business failure and how best to mitigate them. As recently observed by Walsh (2020, p. nd), "companies large and small are succumbing to the effects of the coronavirus" and 2020 has been projected to "set a record for so-called mega bankruptcies". Yet, we lack a systematic understanding of how the pandemic can create conditions leading to business failure. As many small and medium enterprises (SMEs) and multinational enterprises (MNEs) teeter on the edge of closure due to COVID-19, there is a need for deeper understanding of processes leading to business failure.

There is a growing body of research on business failure (see Amankwah-Amoah & Syllias, 2020; Boso, Adeleye, Donbesuur, & Gyensare, 2019; Habersang, Küberling-Jost, Reihlen, & Seckler, 2019;

Kücher, et al., 2020; Mellahi & Wilkinson, 2004; Rider & Negro, 2015; Shepherd, 2003). However, and as we have seen, past "shocks" of this nature have involved comfortingly familiar phenomena, making it challenging to theorize about challenges outside the realm of past experience (Wood, 2019); the last global pandemic, Spanish flu, occurred a century ago, when the global economy was in a very different place. Hence, although organizations can arguably learn from others' failure than success, (Desai, 2011), there is a lack of experience in dealing with failure brought about by novel events. Against this backdrop, the key purpose of is to highlight how misfits and misalignments can, over time, generate "knock-on effects" under such circumstances, and what this might tell us about challenges that transcend the resources of past experience.

In addressing the deficit in our understanding in the light of COVID-19, the study makes key contributions to the literature. First, although COVID-19 remains a disruptive force with long-term implications on global and local businesses (see Wenzel, Stanske, & Lieberman, 2020), scholars are yet to articulate how it shapes the processes leading to business failures. In this direction, the study moves beyond the widely held view that business failure is attributed to either the deterministic view (environmental factors) or voluntaristic (firm-specific factors) perspectives (Amankwah-Amoah, 2016; Kücher, et al., 2020; Mellahi & Wilkinson, 2004) through highlighting the fundamental differences between genuinely novel shocks and those where there is a base of relevant experiential knowledge as to the challenges they pose., and the new set of paradoxes this leads to The remainder of the article is organized along the following lines: After presenting an overview of key strands of relevant literature on exogenous shocks and business failure, we set out the background to COVID-19 and its effects in triggering business failures. The final section sets out the implications of the analysis for business failure research and practicing managers.

BUSINESS FAILURE: A REVIEW

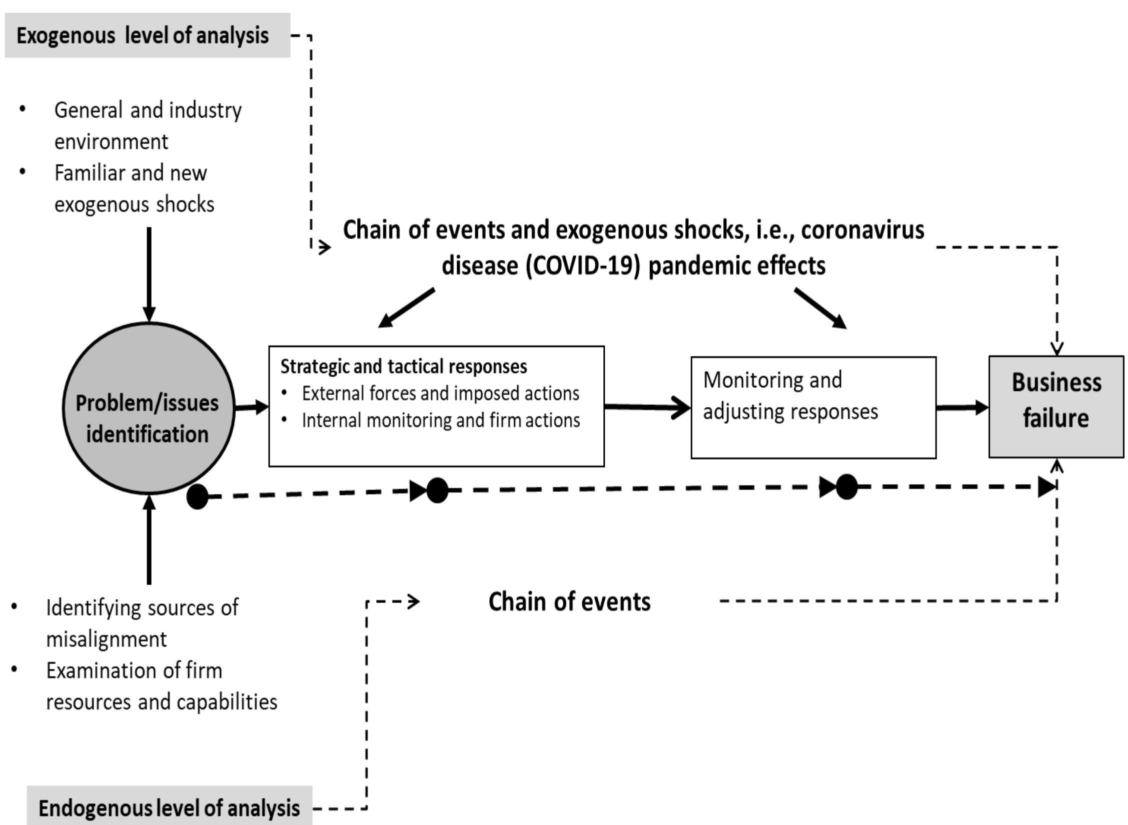
For analytical clarity, business failure refers to a situation where the business is no longer able to operate as a sustainable entity and is then forced to cease operations and lay off any employees (Fleisher & Wright, 2010; Sheppard, 1994). This not only prompts the retreat and exit from domestic markets, but also foreign ones. There are different types of business failure—one largely sudden, unpredictable and difficult to mitigate, the other largely protracted and punctuated by multiple events, stories, false starts and actions which ultimately leads to failure (D'Aveni, 1989a, 1989b; Hamilton, 2006). Thus, business failure is taken to means the gradual or sudden death of a business.

Much of the literature tends to make mention of the challenges of coping with events. Broadly speaking, scholars have tended to adopt either the deterministic or voluntaristic perspectives to account for business failure (Heracleous & Werres, 2016; Mellahi & Wilkinson, 2004, 2010). The deterministic (environmental factors) perspective attributes business failure to uncontrollable or external factors over which managers have little or no control (see also Mellahi & Wilkinson, 2004). Rooted in the deterministic perspective is the focus on the general and industry environment conditions that may exacerbate business failures. Prior research in this area has typically considered business failure as an outcome of the process of "natural selection" and "survival of the fittest" (Andrews, Boyne & Enticott, 2006). One of the common threads in these studies is their emphasis on how factors such as liberalization, declining customer demand and intense competition can trigger the process of business decline, leading to failure (Amankwah-Amoah, 2016). Early studies of business failure often explored general environmental factors such as technological changes, recession, general environmental volatility, new government taxes and deregulation as primary causes of business failure (see Silverman, Nickerson & Freeman, 1997). Yet, as we have seen, this literature focuses on recurrent external challenges, that any business operating in a particular setting might have to cope with from time to time (c.f. Micelotta et al., 2017).

A distinct stream of research entrenched in the voluntaristic perspectives suggests that bundles of firm attributes such as leadership, management, resources and capabilities, and firm age are the root causes of business failure (Mellahi & Wilkinson, 2004; Kücher et al., 2020). By emphasizing the influence of resources and capabilities in determining the life chances of organizations, this stream of research has attempted to counterbalance the overwhelming emphasis on external factors as primary causes of business failure. For instance, the liability of smallness' perspective of business failure (Freeman, Carroll & Hannan, 1983) contends that business failure rates decline as the firm expands its scope of operations, for example, through internationalization. Accompanying firm expansion may be resource accumulation. There may also be gains through the increased geographical scope and scale that comes if the firm internationalizes, thereby spreading the risk of the business. Consequently, these buffer firms against sudden changes in their external environment and threats either at home or internationally (see also Baum, 1996). From this perspective, the essential difference between these competing views is the unit of analysis in examining causes of business failure. Many recent scholarly contributions have highlighted the interaction of firm-level and external factors as a potentially robust explanation for business failure (Amankwah-Amoah, 2016). Backing up the "commonsense" view that it is likely to be a combination of the two, there is a great deal of work that confirms a mix of external and internal factors (Dahlin et al., 2018). Yet, a limitation remains that in the realm of factors identified that might possibly causing failure, is that there is focus on those where past experience might aid present coping (c.f. Wood, 2019).

Business failure may stem from the mismatch between the organization and its business environment (Drazin & Van de Ven, 1985; Sabherwal, Hirschheim & Goles, 2001), that is internal and external misfits. Internal misfit stems from mismatch between the firm's resources, structure, practices, and strategy, whereas external misfit refers to the misalignment between the firm-specific factors, and the home, host, or global environment (see Gammeltoft et al., 2012). This suggests that over time a chain of events can turn a firm's competitive advantage into liabilities and become a source of errors and failure. As Thompson (1967, p. 234) recognized decades ago, alignment is "a moving target". This requires continuous upgrading and updating of resources and capabilities in a timely manner to avert environmental shift, rendering the current strategy obsolete. We now turn our attention to Figure 1 as our organizing framework.

Figure 1: A general model of processes leading to business failures



THE GLOBAL BUSINESS ENVIRONMENT AND COVID-19: AN OVERVIEW

According to the Organisation for Economic Co-operation and Development (2020), the COVID-19 pandemic is regarded as one of the largest concurrent public health and economic crises in modern times culminating in sharp decline in consumption and consumer confidence. Indeed, COVID-19 has been recognized as a major exogenous shock that has altered the competitive landscape for both small and large firms (Wenzel et al., 2020). In many instances, it has led to collapse in demand and disruption of supply of many products. In respond to the crisis, governments around the globe have embraced border closures, instituted social distancing measures, and issued directives and guidelines to small and large businesses. According to Opinium Research (2020), in UK for instance, around 7% per cent of SMEs have already permanently closed down due to the COVID-19 and many are teetering on the verge of closure and collapse. Besides the closures, many firms have introduced several mitigating measures such as remote working, reduced hours, furlough schemes, close offices and made redundancies (Opinium Research, 2020). These events have posed particularly severe challenges in specific sectors, leading to the rapid decline and eventual exit of different types of firms including small and large businesses.

In the global airline industry, for instance, following the implementations of social distancing measures imposed by governments, withdrawal of international passenger services and lock-down measures, thus no passenger airline was left unaffected by COVID-19. In this industry, the effects of COVID-19 have manifested in mass layoffs, adoption of new costly processes, and bankruptcy/closures (Amankwah-Amoah, 2020). The downfall in passengers demand drained the financial resources and cash reserves of many airlines leading to collapse of some. Indeed, the travel and quarantine restrictions imposed by countries culminated in bringing about falling demand for air travel and international travel to a virtual standstill in early 2020 (Dunn, 2020). COVID-19 precipitated the collapsed of UK-based struggling carrier Flybe in March 2020 (Salaudeen, 2020) and Trans States Airlines collapsed (Wolfsteller, 2020). COVID-19 also contributed to bankruptcy of Miami Air International, which demonstrate the high economic cost of this global health crisis.

Around the world, many SMEs in 2020 have faced increased exposure stemming from the ongoing epidemic outbreak. According to the European Investment Bank (2020), COVID-19 has created a demand and supply shock leading to such businesses unable to raise revenue and pay rent culminating on financially weak firms. Indeed, SMEs are the backbone of the European economy accounting for around two-thirds of overall employment, and over 55% of the value-added in the non-financial business sector (European Investment Bank, 2020). The is partly due to the containment measures introduced by government around Europe and beyond that placed limit on travel and people movement halting or curtailing demands in several sectors such as air transport, tourism and automotive, as well, of course, the direct effects of the pandemic (see Dunn, 2020). The sudden “environmental shock” triggered by COVID-19 has exponentially depleting firms’ financial resources, insolvencies, creating financial distress organizations and weakening the financial position of many large and small businesses, and thereby forcing many to seek government support in form of subsidies, tax relief and other financial and non-financial support from the government (Cook, & Barrett, 2020). To a large extent, many sectors have been forced to “compete on sanitation” in marking their premises and settings to minimize potential for viral transmission.

Many of these effects have been made much worse by excessive corporate debt. Although to classical agency theory, corporate borrowing kept management on a tight reign, forcing them to concentrate on returns, rather than empire building (Jensen, 1986), it has been evident that proliferating debt is ultimately unsustainable. This especially so given that a focus on borrowing and distribution may distract managers from orthodox economic activities centering on the generation and sale of goods and/or services, resulting in core business capabilities withering away. In addition, borrowing models centered on assumptions that the future business environment would be sufficiently predictable to enable continued debt servicing. The pandemic has highlighted both the fallacy of the latter assumption and the excessive nature of corporate borrowing. Whilst in the UK and the US, governments were quick to institute measures to relieve corporate debt, a focus was on politically influential sectors, and insider corporations with close links to politicians. This process has left those SMEs without close ties to individual politicians in a difficult place. Again, promised help to small business proved partial, selective, and seemingly insufficient, especially when compared to the help lavished elsewhere. What the bailouts highlighted was the increasing reliance of markets on the state to sustain; even if temporary, this revealed the limitations of assumptions that markets would trump government, and the triumph of non-market strategies. Hence, this showed that managerial assumptions about predictable futures may be rendered irrelevant by events that transcend past experience.

ORGANIZATION-ENVIRONMENT FIT

Having set out the background of business failure, we now move on to examine the organization-environment fit/misfit shape by exogenous shock leading to business failure.

Institutional misfit

Existing work highlights the challenges posed by misalignments between firms and institutions (Gammeltoft et al., 20120). Such misalignments can manifest due to incompatibilities of the business processes, decisions and routines with external requirements such as government standards, regulations and directives. Often such misalignments stem from assumptions as to long regulatory continuity, and/or predictions that future government policies would tend towards ever lighter regulation. Stemming from COVID-19 have been government directives to close borders, and new directives to hospitality, airline and other industries aimed at curtailing people movement. It has also led to government interventions in the global trade of healthcare supplies and new tariffs to protect national strategic industries. Although COVID-19 pandemic is threatening many SMEs, they often lack the capacity to quickly change their business model to embrace new routines and processes. The financial pressures and strains on business model accompanying practicing social distancing and adhering to governments' new directives make failure more likely. In summary, predictions as to the future drift of government policies (e.g. Liberalization) have proven incorrect. Yet, whilst there has been much greater government regulation, it has been uneven, poorly coordinated internationally (leading to competing demands on MNEs), and, in the case of a number of major economies, ranging from the US to Brazil, chaotic. Accordingly, this would challenge memory informed firm strategic choices.

Traditionally, it has been held that misalignment with local institutional demands or multiplicity of the real-world local contexts of the organization can undermine its source of legitimacy (Lejano & Shankar, 2013). The firm's environment imposes pressures on firms to modify their behavior, processes, methods of operations and systems to achieve institutional fit. Firms in industries such as aviation benefited from government support, privileged access to resources and subsidies in many instances. By adhering to local institutional demands, organizations enhance their legitimacy claims as well as improve access to local expertise and resources (Volberda et al., 2012). The behavior of some of the tech giants, and, at the very least, sections of the oil and gas industry might suggest that at least some players are sufficiently confident in their oligopolistic market status and/or political clout to be able to be apparently less than troubled by legitimacy concerns. Those who lack such a market and/or political status (e.g. SMEs) would be under much greater pressure to demonstrate legitimacy in the face of institutional misalignment.

Strategic misalignment

Strategic misalignment occurs when the firm is unable to initiate change, upgrade and update its resources to respond to external environmental factors in a timely manner. Misaligned processes deviate from the requirements of the business environment at the time. This may stem from the inability to keep pace with technological breakthroughs and competitors' actions and moves. Although strategic alignment can lead to developing sustainable competitive advantage, inability to maintain the alignment can become a liability putting the firm "on the road to disaster" (Heracleous & Werres, 2016). Indeed, scholars have hinted that strategic misalignment can lead to failure (Miller, 1996; Sheppard, 1994). As Thornhill and Amit (2003) asserted business failure is more likely to occur when there is misalignment between the capabilities and resources of the firm and the environmental demands. Routines are identifiable patterns of activity embodied in how the firm interacts with internal and external parties/stakeholders (Nelson & Winter, 1982; Mitchell & Shaver, 2002). Old routines are often very difficult to change due to their deeply entrenched nature within the focal organization.

Resource misfit refers to the mismatch between the existing resources and resource and expertise required to neutralize or deal with the environmental threat. The arguments suggest that the processes inherent in assembling, marshalling and utilizing resources can be faulty, leading to not only misallocation of the resources but also exposing its vulnerabilities in the wake of new competitive threats. Indeed, business failure is argued to stem from misalignment between unique resources and capabilities of the organization and demands of the new business environment such as COVID-19 (see also Thornhill & Amit, 2003). The inefficient resource deployment and utilization can create conditions for business failure to occur. In addition, underestimation or overestimation of threats can lead to inappropriate action being taken, leading to misallocation of resources or resource misalignment. Table 1 highlights different dimensions of business failure research and some of the key research questions.

Table 1: Dimensions of business failure research and new research questions

Dimensions	Key insights	New research questions/agenda
Deterministic (environmental factors) perspective encompasses theories such as institution-based view and the industrial organization.	• Exogenous shocks such as technological breakthroughs and deregulations can precipitate business failures.	• To what extent can COVID-19 create novel conditions for business failure to occur? • How can organizations capture the positive effects of others' failure stemming from COVID-19? • How can businesses minimize the negative effects of others COVID-19-induced failures?
Voluntaristic (firm-specific) perspective encompasses theories such as dynamic capabilities, routine-based and organizational ecology.	• Resource-rich firms are able to buffer the effects of environmental changes. The possession and utilization of sub-optimal resources and capabilities that cause businesses to fail. • Inferior resources and capabilities, faulty routines	• What role do political resources play in buffering organizations against environmental shocks such as COVID-19? • To what extent can COVID-19 render firm current resources and capabilities obsolete? • To what extent can COVID-19 render firm routines obsolete? • How do firms renew their capabilities and resources to mitigate the impact of COVID-19 and black swan events?

	and processes, and unsuitable capabilities are sources of misfits. • Firms age and size play important role for failure	• Do firms with narrower experiential bases cope worse with novel crises. • How does industry life cycle moderate the impact of external crisis and firms' survival and superior performance?
An integrated perspective (internal-external interface)	• Misalignment is a powerful source of business failure.	• How does interaction of firm-level and external (COVID-19) factors determine the pace of business failure? • Howe does the uneven access to political resources affect how organizations cope with the effects of institutional misfit and COVID-19? • As legitimacy needs of organizations have apparently diverged, how do organizations that lack market dominance and/or political influence, cope?

Sources: synthesized from: Amankwah-Amoah & Wang, 2019a, 2019b; Amankwah-Amoah et al., 2018a, 2018b; Bradley et al., 2011; Habersang et al., 2019; Headd, 2003; Mellahi & Wilkinson, 2004; Thornhill & Amit, 2003; Zhang et al., 2019.

DISCUSSION AND IMPLICATIONS

Although business failure is more prevalent in the 21st century, the expanding body of research is yet to translate into improved understanding of how novel shocks (i.e., exogenous shocks which transcend past experience and knowledge) like COVID-19 might precipitate business failure. In this direction, our analysis also underscores the point of alignment between firm-level resources and capabilities, and external environmental that transcend past experience as sources of external misfits. More specifically, although a great deal has been written about exogenous shocks (Micelotta at al., 2017), most of the existing literature focus on those whose form assumes familiar shapes (Wood, 2019). Yet, currently, there are a number of high probability novel shocks: this would not only include the present pandemic, but future ones of different causes and scopes (e.g. antibiotic resistant bacterial ones), and those posed by climate change as well as by unprecedented political instability in large developed countries such as the US. It might be argued that none of these developments are novel, in that there have been innumerable attempts to raise awareness as to their high probability and the risks they bring with them. Yet, because their happening transcends the past body of recent experience, and because dealing with them will require fundamental economic, political and environmental changes, discarding (even if failing) past certainties for the unknown, there is a strong inertia.

SMEs differ from their larger counterparts in that their more limited range of scale and scope – and human resources - would limit the range of organizational specific experiential knowledge. This paper highlights how this may place them at a disadvantage when compared to their larger counterparts. However, paradoxically, this may also confer real advantages. A large repository of experiential knowledge may lead to strategy informed by comfort, involving a regression to trusted past remedies; those organizations that are experientially lighter may be better equipped to deal with novel shocks. Yet, the paradox posed by knowledge resources and experience may be rendered less important by other paradoxes. Although the 1990s and early 2000s were seen as an age of market supremacy, this period saw a gradual move towards non-market strategies by large players in the liberal markets (Wood and Wright, 2015). Again, pressures towards greater competitiveness were offset by the rise of oligopolies in growing areas of the economy, such as internet technology, and a reliance on debt, rather than genuine competitiveness in the generation and sale of goods and services to secure shareholder value (Lazonick and Shin, 2019). In addition, all these would favor larger players and those with richer political ties, over smaller and emerging players. Indeed, even SME orientated bailouts in the US and the UK have favored insider, and some surprisingly large, players. Although regulatory shifts to cope with corona virus have worsened institutional misalignment, it is larger players that are in a much stronger position to remake rules to their own liking (McDermott, 2019). Moreover, whilst institutional misalignment is commonly seen as driving legitimacy seeking behavior by firms (Desai, 2011), a contemporary phenomenon has been of large players in specific sectors seemingly becoming less troubled by legitimacy concerns. The latter may have ripple effect across an economy, as others mimic such behavior; yet organizations with more limited resources may become even more dependent on those that legitimacy might confer.

Theoretically, we extend the discourse around COVID-19 effects on businesses (Amankwah-Amoah, 2020; Pereira, Temouri, Patnaik, & Mellahi, 2020) by extending and providing insights on the paradoxes generated by novel shocks around knowledge resources, strategy and legitimacy. From a practical standpoint, it is worth noting that the risk of business failures is likely to increase given the uneven and capricious nature of government bailouts in many mature and emerging markets; quite simply, there is no rulebook or set of best practice for guiding policy interventions. To bridge the alignment gaps, it is well known that renewing and upgrading a firm’s resources in a new environment is essential in ensuring its long-term success (Eisenhardt & Martin, 2000). More challenging is understanding the basis of such a renewal, given the high likelihood of further novel shocks, and the rapidly shifting boundaries between state and market.

In addition to questions posed in Table 1, several promising avenues for future research are apparent. First, a promising avenue would be to explore why firms strive to learn from COVID-19 and firm failures linked to COVID-19. It might also be interesting to explore the effects of national and organizational cultures in learning from COVID-19 related policy and firm failures. Furthermore, although scholars have recognized failure as an integral feature of entrepreneurship (Aldrich & Martinez, 2001; Baù et al., 2016; Shepherd, 2003), much of the existing research overlooks the continuous effects of business failure beyond the focal firm. Often small business owners leaving the industries stemming from COVID-19 often go unnoticed, but this presents promising avenues to explore how these entrepreneurs re-emerge with new firms. In addition, future studies could explore how firms adapt and scale up their business models when faced with extreme external shocks. It is our hope that our analysis would help in revitalizing interest in business failures in the context of COVID-19.

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