

# THE ROLE OF EFFECTUATION AND CAUSATION FOR SME SURVIVAL AMIDST ECONOMIC CRISIS

## Abstract

The world has been severely disrupted in 2020 as a result of the COVID-19 pandemic (Davidsson, 2020). It was disrupted earlier (e.g., Global Financial Crisis, 2007/2008; The Great Depression, 1929), was disrupted after pandemic (War in Ukraine), and it will be disrupted again as “environmental change is one of the few constants for organizations” (Bradley, 2015, p. 135). During crises organizations have to readjust their strategies and behaviors with new realities in order to prevent performance declines and ensure business survival (McKinley et al., 2014; Trahms et al., 2013). Survival has long been considered a fundamental organizational goal, serving as a pre-condition for long-term performance and prosperity (Utterback and Suárez, 1993). Firm survival, failure and longevity have been extensively studied in different realms of literature, namely strategy (Becker and Huselid, 1998; Nag *et al.*, 2007; Nelson, 1991), entrepreneurship (Crick *et al.*, 2022; Benner and Tushman, 2003; Cefis and Marsili, 2006), and economics (Agarwal *et al.*, 2002; Agarwal and Gort, 2002), for various types and sizes of firms. In the spectrum of firm sizes, small and medium enterprises (SMEs) are believed to be the most prone to failure (after start-ups) in predictable and stable environments (Myles, 2010) as well as in highly unpredictable and dynamic settings (Marino *et al.*, 2008). A number of factors make SMEs more likely to fail, as compared to large firms, such as resource scarcity and deficiencies of tangible and intangible assets (Astebro and Winter, 2012; Klepper, 1996), lack of entrepreneurial knowledge (Deakins and Freel, 1998), insufficient R&D expenditures (Ortega-Argilés *et al.*, 2009), and the dearth of security mechanisms (Varum and Rocha, 2013).

Volatility in industries, policies, technologies, market demand, and economics exacerbate SMEs’ scarcities (Bhamra *et al.*, 2011; Carlsson, 1989; Sullivan-Taylor and Branicki, 2011) and consequently diminish their chances to survive even more (Storey, 1994). A prominent case of an abrupt rise in the volatility of the external environment is the situation of an economy-wide crisis (Osiyevskyy *et al.*, 2020; Shirokova *et al.*, 2020), usually combining shocks to the firm’s demand and to the ability to attract resources for business development (Osiyevskyy *et al.*, 2015). As such, to avoid business failure and increase the probability of survival through the economic crisis, SMEs need to be prudent and strategic in managing their resources. Should they pursue strict planning and thinking

in advance about what to do in each stage of their business? Or should they incorporate more flexibility and leverage limited resources in innovative ways?

Effectuation theory distinguishes between two behavioral strategies (causation and effectuation) for handling uncertainty (Sarasvathy, 2001). Causation is a structured approach to making decisions that relies on well-prepared plans and pre-defined goals. Firms using causal logic try to overcome the unexpected and uncertain through rigorous planning and analysis (Brettel *et al.*, 2014; Reymen *et al.*, 2015). Firms adopting the effectuation, on the other hand, apply entrepreneurial decision-making approach with the aim of creating new markets, products, and opportunities (Sarasvathy, 2001). Relying on principles of experimentation, affordable loss, and flexibility, firms create large amounts of business outcomes. Thus, both approaches are considered as behavioral strategies which include decision-making and actions to manage different types of uncertainty. However, effectuation theory still ‘lacks an exact specification of what that [*uncertain*] context entails’ (Arend *et al.*, 2015, p. 639).

Admittedly, the impact of effectuation and causation on firm performance outcomes has been extensively studied in the literature (e.g., Zhang *et al.*, 2022; Shirokova *et al.*, 2020; Deligianni *et al.*, 2017; Eyana *et al.*, 2018; Smolka *et al.*, 2018). However, to the best of our knowledge, the aspect of SME survival or failure as a consequence of effectuation and causation is not present in the literature, despite the importance of this performance facet in the medium and long terms.

Motivated by this gap in understanding of the role of effectuation and causation in SMEs’ survival during an economic crisis, in this study we focus on the following research questions: (1) *How do effectuation and causation affect the likelihood of SMEs’ survival during an economic crisis?* and (2) *What is the moderating role of firm’s environmental peculiarities (particularly, dynamism) in these relationships?*

To answer these questions, we develop a theoretical model based on the combination of the effectuation literature (Chen *et al.*, 2021; Scazziota *et al.*, 2020; Nicholls-Nixon and Valliere, 2021; Sarasvathy, 2001; Arend *et al.*, 2015) and the emerging variance-based perspective on entrepreneurial actions (Osievskyy *et al.*, 2022, 2020; Shirokova *et al.*, 2020; Wiklund and Shepherd, 2011). The authors tested the developed theoretical framework in the context of Russian SMEs during a major economic downturn (2014-2016) and subsequent recovery (2017-2019). The unique sample of 420 SMEs was assembled from two sources: (1) a large multifaceted survey of Russian SMEs conducted in 2015-2016 (Shirokova *et al.*, 2020; Osievskyy *et al.*, 2020);

(2) the objective survival data for the sampled SMEs for 2016-2019 from the Russian SPARK Interfax database.

The empirical results reveal that causation reduces the probability of firm survival in dynamic environments, while effectuation increases the chance of survival irrespective of the state of the environment. In a nutshell, the study provides evidence that the effectuation logic serves a viable way for SMEs to increase the chances of survival through the economic shock and subsequent recovery period.

We see two main contributions of our study. First, our study aims to contribute to the discussion about behavioral strategies (effectuation and causation) in uncertain environmental conditions in entrepreneurship literature. Looking at the relationship between effectuation/causation and firm survival in the context of an economic crisis, we embrace the different types of uncertainty that decision-makers are exposed to. In particular, our results show that causation reduces the probability of firm survival in uncertain crisis environments, while effectuation increases the chance of survival irrespective of the state of the environment. In a nutshell, the study provides evidence that the effectuation serves a viable way for SMEs to increase the chances of survival through the economic shock and subsequent recovery period.

Second, we intend to contribute to the SME survival literature and join the scholarly conversation initiated by Wiklund and Shepherd (2011) to demonstrate the power of variability-based theorizing for explaining and predicting the survival/failure implications of entrepreneurial actions. In particular, we demonstrate how explicit theorizing about the risk/variability effects of entrepreneurial strategies or actions (manifested in effectuation or causation in our case) can be effectively used in firm survival studies, allowing to zero in on the exact mechanism leading to organizational failures.

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