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Small Business Growth and Survival During the First Two Years

*Kurt B. Mayer and Sidney Goldstein**

I. Introduction

Americans have always valued individual enterprise. The great esteem in which economic independence is held today is firmly grounded in our historical experience. Early American history was a history of small entrepreneurs who established a society which differed sharply in its social characteristics from that of European nations. Unlike Europe, America never knew either the hereditary aristocracy or the servile peasantry of feudalism. Due to this absence of feudal restriction and privilege, most of the virgin territory was occupied by free farmers who owned the land they cultivated. From the beginning, the American farmer, in addition to being a husbandman and cultivator, has always been an enterpriser, capitalist and speculator.

The small agrarian producer had his counterpart in the early town merchant, a versatile businessman who often engaged simultaneously in trading, shipping, moneylending, speculating and even small-scale manufacturing. In addition, there were many craftsmen of independent means. Of course, in early America, there were people who owned no property, as well as those who were themselves the property of others.

The outstanding characteristic of this society was that the great majority of the population were owners of their own means of livelihood. It was truly a society of independent enterprisers. Rank and position rested upon the quantity and quality of property owned; income was derived from working on one's own property. Therefore, the American image as a society of individual enterprisers is firmly grounded in the social reality of these formative years. The high value which present-day society assigns to individual enterprise and independent opportunity reflects this image.

The impact of the industrial revolution drastically reduced the prominence of the small agrarian producer. The proportion of those gainfully employed in agriculture dropped from 72 per cent in 1820, to 51 per cent in 1870.[1] By 1910, only one-third of the gainfully

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1. Clark, The Conditions of Economic Progress, 519-20 (table 3) (3d ed. 1957).

employed Americans remained in agriculture, and, by 1963, agricultural employment had dwindled to 7 per cent of the total labor force. Moreover, only 60 per cent of those employed in agriculture today are independent farmers.

Although the fundamental transition of American society from an agricultural to an urban-industrial base has continued to reduce the

TABLE 1.—FARMERS AND BUSINESS ENTERPRISERS IN THE UNITED STATES, 1880-1960[2]

Year	Self-Employed Farmers		Business Enterprisers	
	Number (in thousands)	As a percentage of all gainful workers*	Number (in thousands)	As a percentage of all gainful workers*
1880	4,243	27.8	1,218	8.0
1890	5,304	24.6	1,719	8.0
1900	5,705	21.4	2,198	8.2
1910	6,132	17.6	2,682	7.7
1920	6,387	16.0	2,573	6.5
1930	6,012	12.7	3,101	6.6
1940	5,212	9.6	4,378	8.0
1950	4,558	7.3	5,439	8.8
1960	2,560	3.6	5,342	7.6

*For the years 1880-1930, gainfully occupied persons 10 years old and over; for 1940-1960, persons in the civilian labor force 14 years old and over.

relative position of the agricultural producer, the non-farm enterpriser has firmly stood his ground. As Table 1 indicates, the number of business enterprisers has grown from 1.2 million in 1880, to over 5 million in 1950 and 1960. Despite some fluctuations, the proportion of these enterprisers in the total gainfully employed population has remained nearly constant, between 1880 and 1960, ranging from 6.5 to 8.8 between 6.5 per cent in 1880, to 8.8 per cent in 1960. To be sure, the growth of non-farm enterprisers has not compensated for the decline of agrarian enterprisers, but the persistence of the former in the face of far-reaching economic and social changes is remarkable. During the middle decades of the twentieth century, five million businessmen carried on the tradition of economic independence. The traditional opportunity of "working for oneself," of "being one's own boss," of achieving a position of prestige and social standing is now identified with business ownership. Today, the small businessman is

2. The 1880-1950 data is from PHILLIPS, LITTLE BUSINESS IN THE AMERICAN ECONOMY, 4 (table 2) (1958), while the 1960 data is from 1 U.S. BUREAU OF THE CENSUS, 1960 CENSUS OF POPULATION (pt. 1) 1-215.

TABLE 2.—NUMBER OF BUSINESS FIRMS IN OPERATION PER 1,000 POPULATION AND PER 1,000 GAINFULLY OCCUPIED, 1900-1963[3]

Year	Number of Business Firms* (in thousands)	Total Population (in thousands)	Gainfully** Occupied Workers (in thousands)	Number of Business Firms	
				Per 1,000 Population	Per 1,000 Gainfully Occupied
1900	1,660	76,130	29,070	21.8	57.1
1910	2,100	92,270	37,370	22.8	56.2
1920	2,580	107,190	42,430	24.1	60.8
1930	2,950	123,090	48,830	24.0	60.6
1940	3,130	131,670	52,150	23.8	60.0
1950	4,000	150,700	59,590	26.5	67.3
1960	4,658	178,460	70,612	26.1	66.0
1963	4,797	189,380	72,975	23.2	65.7

*Data for the business firms are 10-year average centered on the indicated year, except for 1950, 1960 and 1963 which are the year-end figures for those years. With the exception of 1920, the number of business firms in operation is smaller than the number of business enterprisers shown in Table 1 because some firms have more than one owner. Data for the population are for the enumerated years.

**For the years 1900-1930, the figures represent gainfully occupied persons 10 years old and over; for the years 1940-1963 the data represent persons in the labor force 14 years old and over.

3. Compiled from Survey of Current Business, Office of Business Economics, U.S. Dep't of Commerce, Feb. 1951, vol. 31, p. 32. Ulmer, *Industrial Patterns of the Business Population*, Survey of Current Business, Office of Business Economics, U.S. Dep't of Commerce, May 1948, vol. 28, p. 15; U.S. BUREAU OF THE CENSUS, 1960 CENSUS OF POPULATION (pt. 1) 1-4 (table 2); U.S. BUREAU OF THE CENSUS, 1964 STATISTICAL ABSTRACT OF THE UNITED STATES 5 (table 2); U.S. BUREAU OF THE CENSUS, 1951 STATISTICAL ABSTRACT OF THE UNITED STATES 171 (table 202). Population figures are for the coterminous United States.

a substitute for the Jeffersonian ideal of the small agrarian producer.

The historical statistics on the number of individual enterprisers presented in Table 1 can be supplemented by further statistical data which trace the development of business firms during the present century. Changes in the number of firms closely correspond to changes in the number of enterprisers. Fewer than 1.7 million business firms were in existence in 1900 (see Table 2). Their number increased steadily until it reached 4.8 million in 1963. Comparing this increase in the number of business firms with general population trends, a close similarity between the patterns of growth of the human population and those of the business population is apparent. In 1900, there were approximately 22 business firms for every 1,000 inhabitants of the United States, and 57 firms per 1,000 gainfully employed persons. In 1963, there were 23 firms per 1,000 population and 66 firms per 1,000 gainfully employed. The net change in the number of business firms has kept pace with the general growth of our human population and with the increase in gainful employment.

The data on the number of business firms in existence demonstrate the remarkable resiliency of non-farm enterprises. Despite structural changes in the economy that have altered the character of business and despite the continuous trend toward economic concentration, the rate of industrialization and urbanization has been so rapid that, relative to total population, more business firms are in operation today than at the beginning of this century. However, the persistence and durability does not imply stability in the individual business unit. The growth figures conceal the turnover which annually characterizes the business world. While the total number of concerns has been continuously increasing, the composition of this aggregate number has been changing rapidly. For example, statistics on the business population reveal the following: From January 1, 1955, to December 31, 1962, the total number of firms in operation rose from 4,287,000 to 4,797,000, an increase of 510,000 units. During this eight year period, however, no less than 3,354,000 newly established business concerns opened their doors and 2,843,000 others went out of business.[4] Underlying the small net changes in aggregate numbers is a persistent succession of business entries and failures and a hard struggle for individual survival.

The high turnover rate of business enterprises is well known and has been of considerable concern for several decades. During the last thirty years, numerous studies of widely varying scope have investigated the survival patterns, the life span, and the causes of

4. U.S. Bureau of the Census, 1964 Statistical Abstract of the United States 487; U.S. Bureau of the Census, 1959 Statistical Abstract of the United States 485.

mortality of various enterprises.[5] The most comprehensive data have been assembled by the Office of Business Economics of the United States Department of Commerce, which has collected and published nation-wide statistics of business turnover since 1940. All investigations, official and private, emphasize the high incidence of "infant" mortality.

Since a large majority of the nation's business firms are small units, it is not surprising that they constitute a large proportion of the annual business turnover. In 1956, 75.3 per cent of the nation's 4.4 million business firms were small units with fewer than four employees.[6] Moreover, 65.3 per cent of all these were retail and service establishments. During 1951-1955, 87 per cent of the 1.8 million new businesses that opened had less than four employees. Of the additional 1.9 million enterprises that were transferred to new ownership during this five year period, 83 per cent had less than four employees.[7] Unfortunately, data on business closings by size of firm are not available for this same period. The most recent figures refer to the period 1940-1945. These reveal 91 per cent of the approximately 2 million firms that closed had fewer than four employees.[8]

The overwhelming preponderance of small units in the business turnover more than nearly reflects the fact that the great majority of all firms in operation at any one time are small businesses. It strongly suggests that the small companies are less stable than the large ones. As an illustration, in 1944-1945, when closures were unusually low due to war conditions, the mortality rate among firms with less than four employees was more than four times as great as among concerns with more than fifty employees. The birth rate was more than ten times higher for small firms than for larger concerns.[9] Some variation of experience does occur in different communities, in different fields of business, and under changing business conditions, but high mortality is not primarily a cyclical phenomenon. On the contrary, it is all-pervasive; the most striking fact is the regularity of failure and the

5. Almost 100 empirical studies undertaken during the 120's and 1930's are summarized in PROBLEMS OF SMALL BUSINESS (TNEC Monograph No. 17, 1941). For a more recent comprehensive analysis, see PHILLIPS, *op. cit. supra* note 2. Monthly data on failures are published in *Dun's Review* published by Dun & Bradstreet; this publication also contains occasional analyses of business turnover.

6. Churchill, *Size of Business Firms*, Survey of Current Business, Office of Business Economics, U.S. Dep't of Commerce, Sept. 1959, vol. 39, pp. 15-16.

7. *Id.* at 18.

8. Ulmer, *The Postwar Business Population*, Survey of Current Business, Office of Business Economics, U.S. Dep't of Commerce, Jan. 1947, vol. 27, p. 13.

9. Paden & Nielsen, *Recent Trends in the Business Population*, Survey of Current Business, Office of Business Economics, U.S. Dep't of Commerce, May 1946, vol. 26, p. 20.

persistence of high turnover rates.[10]

The results of these business studies have proved valuable in pointing to some of the main problems of business growth and survival. Most of these studies, however, have been subject to one major limitation: they have been based on the records of established or defunct concerns, thereby restricting analysis to statistical data. Since figures abstracted from statistical records serve merely as broad indicators of the continuous turmoil that characterizes the business population, they provide minimal insight into what actually occurs in the succession of business openings, transfers and discontinuances. They provide little concrete information about the precise circumstances attendant upon new business formations and the fate which new concerns encounter.

Individual cases of small business have not yet been studied systematically in sufficient number or detail to provide answers to such crucial questions as:

> What prompted the individuals to set up a new business enterprise?
>
> What factors determined their timing, their choice of field, and their choice of location?
>
> What alternatives did they have from which to choose?
>
> What are the capital resources of the new enterprise, the credit arrangements?
>
> What are the major decisions facing the going concern?
>
> Is the business growing, holding its own, or declining?
>
> What seem to be the factors determining its development?
>
> If the enterprise is discontinued, what are the circumstances, what are the reasons, and what happens to the owners?

Questions of this kind can be answered only through a longitudinal field investigation that begins with a group of newly formed small business establishments and follows them through repeated interviews for several years. This report is based on a study which attempted such an investigation.[11]

II. THE RESEARCH DESIGN

The research design employed in this project involved the selection of eighty-one newly established retail and service enterprises in three

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10. Compare the Poughkeepsie study by Hutchinson, Hutchinson, & Newcomer, *A Study in Business Mortality*, 28 AM. ECON. REV. 497-514 (1938), which analyzes turnover data extending back to the 1840s.

11. MAYER & GOLDSTEIN, THE FIRST TWO YEARS: PROBLEMS OF SMALL FIRM GROWTH AND SURVIVAL (U.S. SMALL BUSINESS ADMINISTRATION, SMALL BUSINESS RESEARCH SERIES No. 2, 1961).

sectors of metropolitan Providence, Rhode Island, the central city of the metropolitan area, two rapidly growing contiguous suburban cities, and three old industrial satellite cities, which had been experiencing economic stagnation. The monthly lists of new businesses registered with the Rhode Island Division of Taxation or with the Department of Employment Security provided the roster from which the business concerns included in this study were serially selected. For the purposes of this study, a new business was defined as one which either had been newly established or had recently changed ownership.

In order to know who opens a business and why, as well as the specific circumstances which accompany its inception, development, survival or demise, information must be obtained through direct contacts with the business owners over an extended period. Reasons for success or failure cannot be identified completely through questioning a business owner. They may be identifiable only through direct observation of his business behavior and of the physical environment in which he operates. The need for these diverse types of information requires a combination of interviewing and observation techniques.

Following selection of the sample, the owner of each concern was contacted, and his cooperation for the study was solicited. In the initial interview, information was obtained revealing the owner's social background, circumstances underlying the establishment of the business, the type of business and its financial structure, and the enterpriser's own expectations. The interview was supplemented by observing the physical features and the population composition of the neighborhood, the appearance of the business proper, and the personal characteristics of the owner.[12]

Personal contact was maintained with each firm periodically for a two-year period to ascertain the progress of the business. The two-year period was selected since all previous studies have indicated that a high percentage of business discontinuances occur within a year or two after establishment. In the beginning, the periodic interviews were conducted at monthly intervals; thereafter the interval

12. At the time the initial interviews were completed, the data collected were used as a basis for predicting the fate of each firm by the end of the study period. The closure of 26 firms, 18 of which actually failed, was predicted. Of the remaining 8 which were expected to close but which in fact survived, 6 are in the "marginal survivor" category. Of the 55 firms which were expected to survive, 33 actually did so. Of the remaining 22, 8 were nonfinancial closures all of which could have survived on purely financial grounds. However, the prediction was in error in the remaining 14 cases which failed. While the record of prediction was better than mere chance, it is clear that the impressions gained from an early interview are not adequate for predicting future developments with a high degree of confidence.

between interviews was allowed to vary from four to ten weeks, depending upon the circumstances revealed by the previous contacts. At the end of both the first and the second year of the business' existence, the interviews were specifically designed to review the developments of the preceding year. In addition to solicited responses, changes in the business area, in the business establishment, and in the behavior and attitude of the owner, were recorded.

For all firms which closed before the end of the two year period, data were obtained to the point of discontinuance. In addition, a special interview was designed to collect information regarding the factors which led to the discontinuance. In order to evaluate more fully the circumstances underlying discontinuances and success, interviews were also conducted with leading suppliers and creditors of both the closed and the surviving firms.

III. CHARACTERISTICS OF THE OWNERS AND FIRMS

One of the findings of this study is the extent to which the goal of business ownership has been adopted by the working class. It is one of the few middle class occupations attainable by manual workers whose educational limitations preclude an executive or professional career. Of the 93 owners involved in the 81 firms, 64 had at some time been employed in manual work. In fact, 40 per cent of the total had only manual work experience prior to the opening of their enterprise. One third of the 64 enterprisers with manual work experience had also owned other businesses previously. Some of these had started their occupational careers as manual workers but had then consecutively operated a series of business enterprises; others had moved back and forth between manual work and self-employment. In eight other cases, the occupational career pattern had been even more complex, alternating between manual work, white collar employment, and business ownership. Twenty-eight of the enterprisers in the sample had no manual work experience. Their careers were restricted either to white collar employment, business ownership, or movement back and forth between the two. The conclusion to be derived from examining the prior occupational experience of the owners is that an important aspect of social mobility in American society consists of repeated crossings between the white collar, blue collar, and self-employed levels of occupation, with relatively little permanence at any level. This is further borne out by the fact that of the 45 owners whose businesses closed 18 are known to have subsequently returned to manual employment and 7 are known to have taken white collar positions.

The educational achievement of the owners was related to their

occupational experience, their age, and ethnic background. The median educational attainment of the owners was 11 years of schooling which compared favorably with the 9.3 median acquired by the population of Rhode Island 25 years old and over. Examination of the individual case records indicates that few owners had formal education or vocational training directly relevant to their business careers.

The road to business ownership tended to be lengthy. For some, the desire to establish their own business was the result of a prior work experience. For others, the fruition of an aspiration to be self-employed had to await the accumulation of the necessary capital. The average age of new owners was also raised by the fact that many older persons, unable to find a job because of their age, sought income through self-employment. The median age of the sample was forty years. If not for the fact that this study began in a period of recession, 1958, when young persons as well as older ones were seeking escape from unemployment, the age level would likely have been higher.

Reflecting the increase of married women in the labor force, 17 of the 93 owners were women. Observers seldom consider women as business owners, but tend to categorize them into factory, clerical or sales jobs. However, business ownership appears as an attractive alternative to employment for the working wife or the career woman.

Direct questions on reasons for going into business were generally answered in cliches such as "to be independent" and/or "to make money," rather than by basic motives. In many cases, it was apparent that the owners did not consciously know why they went into business; often they had no clear goals in mind, having little, if any, appreciation of the business world in general. The most striking fact revealed by the motivational analysis is the small number who sought maximum money rewards. Only 6 of the 81 openings conformed to the stereotype entrepreneur who attempts to isolate the most profitable opportunities by a careful calculation of costs, sales volume, location, competition, and, above all, the financial returns from self-employment as compared with the potential income from paid employment.

In the large majority of other cases monetary values were also present, but they had a different meaning. Thus, 21 openings were prompted by a desperate need for providing some income because of prospective or actual unemployment. Thirty-two owners were not under immediate pressure of unemployment but viewed business ownership simply as a means of livelihood. They were largely former manual workers who were satisfied if their incomes as business owners were comparable to the money earned as workers. They believed that self-employment offered greater security, higher prestige, and more

independence. There were only eight cases in which the desire for independence stood out as the major motive for entering business. In the remaining fourteen cases, the motivation included the desire to augment income from other sources, and the desire to build up a business as an eventual substitute for salaried employment.

The motivational analysis partly explains the frequent interchange between paid employment and self-employment. To the extent that these owners viewed self-employment simply as another means of making a living, it appeared to them as not fundamentally different from a paid job. Some of them made the transition to business ownership with no more effort or planning than they would in applying for a job. Some businesses were opened in a reckless, gambling spirit, "just to see what would happen."

This attitude applied also to the choice of a location, the timing of the opening, and the financial resources available at the time of opening. Very few owners gave consideration to locational factors. For most, the particular location was determined by such factors as a vacancy, a business for sale, or proximity to the owner's home. Only 8 owners made a traffic count, and only 14 obtained advice before selecting a location. No more rational consideration was given to the timing of the opening. Most persons in the sample opened at that particular time because suddenly there was an opportunity, such as a vacancy, and they took advantage of it.

The lack of planning, revealed by the minimal consideration given timing, is particularly noteworthy in view of the fact that the period during which all 81 businesses were opened was a period of pronounced economic recession. It is unknown, of course, how many potential enterprisers were deterred from going into business during this time. With respect to the 81 who did open, the recession was a contributory factor to those who resorted to business ownership as an escape from unemployment. However, none of the owners seriously considered the effects that the recession might have on their chances for survival. Only two persons in the sample even mentioned the recession as a factor influencing the timing of their opening, and they thought it was "a good idea to start in bad times and work toward better times." "If one can survive now, the rest will be O.K." To be sure, many of the owners were quick to complain about the recession when business did not progress as well as they had hoped, but it is significant that few of them had had the foresight to anticipate the adverse effects of the recession. Apparently, in most cases, the wish was the father of the thought; once a person had decided to open a business, he did not weigh with circumspection all of the factors which might affect his chances for success. Instead, he saw only

what he wished to see, the opportunity to realize his desire to be in business for himself. This is also evident in the selection of a location, a factor generally considered of primary importance.

Thirty-five of the 81 businesses involved a transfer to new ownership. Even though they had few illusians of great financial success, many of these 35 new owners apparently felt that they could succeed where others had failed. Even where an investigation of the performance of the previous owner was conducted, the results of the survey did not discourage the prospective proprietor. They rationalized the situation by blaming the financial difficulties of the previous owner on some personal deficiency, thereby justifying their own decision. The same kind of reasoning was frequently employed by owners who did not buy a going concern but established a new firm on a site previously occupied by an identical enterprise. This was typical in the case of service stations where new men acquired a station with knowledge that the previous occupant had been unsuccessful. In such cases, they generally traced the failure to the predecessor's lack of mechanical skill or inefficient business habits.

By any criteria, all 81 businesses were small. Twenty-five firms initially had no employees; 26 others relied exclusively on uncompensated assistants; and the remaining 30 firms employed a total of forty full-time salaried personnel. The average initial capital investment amounted to 5,000 dollars, ranging from 12 dollars to 37,000 dollars, with one-third of the investments under 2,000 dollars. Sixty per cent of the aggregate investment of 394,000 dollars was in the form of equity capital.

The great majority of the owners had given little, if any, consideration to the minimum investment required for the successful operation of a new business. Generally, they had only vague notions about the amounts of cash, stock, and credit required to maintain operations until the business could support itself. Most of the owners committed all their liquid resources at the beginning of the venture. Coupled with the difficulty of obtaining loans, this commitment left them without reserves on which to draw when unexpected obstacles or emergencies arose. Moreover, most of the owners apparently did not separate their business and personal finances. Although direct access to the financial records was not available in most cases, it was clear from the answers given in the interviews that many owners used the same bank account for both their personal expenditures and their business operations. Similarly, grocery store owners would use their stock for family consumption without appropriate notation in the records. As a result, the owners in many cases were unable to determine whether the business was operating at a profit or loss.

Furthermore, as later experience in several cases indicated, this initial failure to distinguish clearly between business capital and personal finances resulted in financial disaster for the individual and his family. On the whole, the data suggest that the entire capitalization process of newly established retail and service enterprises is largely based on trial and error.

IV. GROWTH AND DECLINE

During the two year period the 81 firms followed different courses of development. Although the experience of each firm was unique, it was possible to classify them into eight categories. The basic distinction was between the 40 firms that dissolved and the 41 that survived. Among those which closed, a further distinction was made between 32 firms that failed financially and 8 that closed for nonfinancial reasons.

Among the 32 failures, the life span ranges from a minimum of three weeks to twenty-one months. These 32 failures were grouped into three categories: "stillbirths," 4 firms which closed within less than two months; "infant deaths," 19 firms which lasted from two to ten months; and 9 firms which struggled on, despite "the losing fight," from twelve to twenty-one months. The failure of these firms is illustrated by the fact that the 25 firms for which financial data were available lost 43 per cent of their total investment, considering cash withdrawals by the owners during the life of the business as well as salvage from sale or liquidation of the business.

Evaluation of the interview material of the 41 surviving firms suggested four types. Twelve firms were classified as "marginal survivors." These were mainly part-time operations, providing their owners with less than a minimum living. Although covering a considerable range financially, 21 firms qualified as "limited successes," yielding their owners sufficient income on which to live. These firms had reached a stable level of operations and displayed doubtful prospects of further growth. The remaining 8 survivors were more successful, 3 of them yielding the owners profits above their salaries, and the others showing a similar future promise. The aggregate growth of the 41 survivors was evidenced by increases in staff, sales, cash withdrawals, investment, and reduction in outstanding loans.

Even if all five firms classified as "potentially profitable" entered the "profitable" category, successful business would represent only 10 per cent of the total sample. Since no comparable statistics are available, this proportion cannot be classified as typical of new businesses in the retail and service fields. In view of the high rates of infant mortality which are known to prevail among such enter-

prises, the fact that only one of ten firms was a successful venture does not seem unusually low. Yet, if this proportion is typical, its implications for a potential entrepreneur undertaking a business venture are sobering indeed. For example, during the years 1951-1955, an annual average of 445,000 retail or service firms with less than four employees were started or transferred.[15] If the probability of success, based on the findings of this study, is applied to this national total, a maximum of 45,000 of these enterprises can be expected to be profitable ventures.

It should not be assumed that all owners of newly established firms expect "to make a killing." As the analysis shows, only a small fraction of the owners in this study entertained such aspirations. The great majority expected only to earn a livelihood. Of the 81 firms, only 6 were opened with the expectation of "making real money." One of these closed for nonfinancial reasons. The remaining 5 which survived were classified as either "potentially profitable" or "profitable." Moreover, of the 3 firms classified as profitable, all were originally motivated by the classic capitalistic spirit of making money. Obviously, then, motivation was a major factor in explaining success. However, motivation for success was combined in each instance with adequate resources, special training or previous business experience, and a generally rational approach to business conduct. In other words, those who opened a business in the expectation of "making real money" generally had solid reasons for such aspirations.

A comparison of the surviving and closed firms in terms of selected characteristics provides the following conclusions: (1) The rate of closure varied inversely with owner's age. Viewing business as an alternative to paid employment, the younger owners returned to paid employment more frequently. (2) The rate of closure varied inversely with amount of education. (3) Previous occupational experience as an employee in the particular type of business did not result in a higher survival rate. However, previous experience as a business owner, particularly in the same type of business, sharply increased the chances of survival and success. (4) Within the limited size-range covered by the sample, smaller firms were less stable than the larger ones. Those with initial investment in excess of 7,500 dollars had the best survival record—13 of 17 survived. Those with a capitalization of less than 500 dollars had the poorest record—6 of 8 closed. Within the middle range of 500 dollars to 7,500 dollars, 25 of 55 firms survived, with minimum variation of failure rates within this range. There was little evidence to support the expectation that those who relied more heavily on borrowed capital would have a

13. Churchill, *supra* note 6 at 18 (table 4).

higher mortality rate. (5) Failures occurred both in growing and declining sectors of the Providence metropolitan area, but the failure rate was somewhat lower in the rapidly developing suburbs than in the declining central city and satellite communities. Within each community, the survival rate was higher in new shopping and residential areas than in the older business sections. (6) There was no difference between the survival rate of the 35 businesses that had been bought as operating concerns and the 46 entirely new businesses. This was due to the fact that many of the transferred businesses were declining at the time they were bought. Their buyers were as unrealistic in evaluating their future prospects as were several owners who established new businesses. (7) As would be expected from the foregoing conclusions, owners' motivation and expectations were related to their survival experience. Those who were more rationally motivated and had planned more extensively had a better survival rate.

V. Reasons for Failure

Examination of the case histories confirmed the expectation that a thorough analysis cannot rely on purely statistical techniques or on a reconstruction of the experience of either going or defunct concerns. By their nature, both of these approaches fail to consider certain intangible factors which become apparent only through direct observation of a business during the crucial stages of its early development. Repeated contacts with going concerns made it clear that success or failure could not be attributed to single causes, but was generally the result of a complex interplay of various factors. However, all factors are not equally important, and overall evaluation suggests that some elements are more basic than others.

As the preceding comparison of the characteristics of closed and surviving firms has shown, the fundamental factor underlying most of the differentials was the degree of rationality involved in the decision to open, as well as in the subsequent operation of the enterprise. The extemporized manner in which a number of firms were established predetermined their future. In some cases, the initial decisions were so erroneous that the owners recognized the mistake shortly after opening, and rapidly closed before extensive damage ensued. A number of owners, however, were oblivious to the inevitability of failure and continued in operation until their resources were exhausted.

Errors were manifested in several major areas of decision-making: faulty location, disregard of competition, inadequate capital resources,

overindebtedness, inept merchandising policies, careless credit policies, and organizational error. In most instances, the eventual failure can be traced to a combination of such factors, frequently compounded by deficiencies in the owner, such as a lack of technical sophistication, personality defects, or absence of sufficient perserverence. Although the following discussion considers these factors in greater detail, it should be reiterated that generally, more than one factor was involved in every case.

A. *Choice of Location*

The choice of location was frequently based on such reasons as vacancy of premises, proximity to home, familiarity with the neighborhood, and availability of a business. These reasons apparently appeared sufficient to some owners, for they did not objectively evaluate the various locations' potential as business sites. A proper investigation would have revealed that the area was declining in population, being bypassed by highway construction, or that it was unsuited for the goods or services offered. In some instances, the business was too specialized, and, in others, the same goods and services were already adequately supplied by different firms.

B. *Competition*

The evaluation of existing competition should always be a major consideration in selecting a location for a business. This elementary principle was overlooked by a majority of the prospective owners. Although this negligence is not necessarily fatal, it did play a major role in several instances of failure and was a contributory factor in other cases. Although several firms in the sample were adversely affected during the course of their operation by subsequently established competitors, all of them managed to deal successfully with this competition. In the cases where competition contributed significantly to failure, it was caused by existing competitors. The owners were either completely unaware of this threat or blithely assumed it would have little effect.

C. *Undercapitalization*

In view of the conditions prevailing in most of the firms, it was expected that financial problems would plague many of them from the start and play a major role in their demise. Although some owners had contemplated owning a business and had accumulated some savings, few of them had systematically explored the particular type of business and the amount of capital required for successful operation.

As stated above in the discussion dealing with timing the opening, most owners opened when they did simply because they perceived an opportunity, such as a vacancy or a business for sale. Spontaneously deciding to avail themselves of this opportunity, they proceeded with whatever financial resources they could muster. In so doing, they failed to realize the importance of adequate capitalization.

More specifically, the errors fell into three separate but related categories. Some owners attempted to establish their business without sufficient money to provide an initial stock. Others had what might have been a sufficient initial investment but exhausted their liquid assets at the opening, leaving no reserves to maintain the business until a sufficient sales volume was developed. Still others relied too heavily on borrowed capital and found that their new businesses could not retire the obligation.

D. *Credit Policies*

Some owners committed these errors simultaneously, while others combined these mistakes with inept merchandising practices and loose credit policies. Since consumer credit is often expected of the small neighborhood store and service station, many owners found to their dismay that the extention of credit was necessary to attract and hold customers. Extension of credit is obviously hazardous, particularly in businesses with a weak capital structure, and it requires careful control. This became a problem in a number of firms and, in some cases, contributed to failure.

E. *Personality Defects*

All of the factors considered above represent errors in specific managerial decisions. Underlying such misjudgments in many instances and compounding them in others were personal deficiencies of the owner. These deficiencies took several forms. Some owners lacked the technical sophistication necessary either to operate a particular type of business or any business at all. Others had the requisite technical knowledge, but could not attract customers because of their personality. Finally, some owners exhibited irresponsibility and alcoholism to such an extent that the successful operation of a business became impossible.

Obviously, these factors do not operate in isolation, and almost every failure exhibits a combination of mistakes and errors in judgment. The circumstances under which some firms were initiated precluded success from the beginning. A few others made fatal managerial errors during the course of their operation, and still others could have continued, objectively speaking, if the owners had not

been overwhelmed by difficulties and crises that generally beset newly opened businesses. They lacked knowledge of what to expect and as a result were psychologically unprepared to cope with the problems. Frustration, impatience, and discouragement also played a role in a number of failures and caused owners to succumb without having adequately tested the potentialities of their businesses. Conversely, the antithetic traits—determination, persistence and endurance—were decisive variables for the survival of a number of firms, which, objectively, were in no better condition at the beginning than a number of those that failed.

VI. Reasons for Survival

It is also possible to distinguish a number of factors which contribute to the survival of business enterprises. All of these factors are not always present in every case, but the more factors present, the greater the chances for survival, and the better the likelihood of success.

A. *Persistence and a Low Level of Expectation*

The borderline between survival and failure is to some extent arbitrary. Several firms on the brink of failure qualified as survivors only because they were in existence at the end of the two year limit of the study. Basically, these enterprises differed from the failures only in the degree of determination exhibited by their owners. Two of the marginal firms failed within a few months after the period of observation ended. The other ten firms classified as marginal survivors continued in existence only because their owners had other sources of income and could be satisfied with minimal returns. Basically, only two factors—persistence and a low level of expectation—figured prominently in the survival of the "marginals." These two factors, combined with others, also appeared prominently in the "limited success" category. Persistence was also manifested by the owners of successful businesses.

Stamina and determination to surmount difficulties are crucial factors in business survival. New business enterprises need time to ascertain the potential volume of business and the financial returns obtainable. For many new firms, an initially satisfactory volume of business, generally associated with the novelty of the outlet, is followed by a slump in sales which may prove temporary. Such developments may have a depressing effect on the owners and lead them to consider dissolution. Not having been educated to anticipate such a slump, some owners assume prematurely that their enterprises are failures and close.

Owners without prior business experience are often inadequately prepared, both financially and psychologically, to withstand protracted initial difficulties. They are overly optimistic in their original expectations of the business' gross revenue potential and are unable to make adjustments to the ensuing reality. Therefore, their enthusiasm diminishes rapidly. Individuals with previous ownership experience anticipate the lengthy period that may be required to firmly establish the business.

In order to understand the survival of businesses with widely varying sales volume and size of operations, it is necessary to consider the initial expectations of the owners and the extent to which owners were able to adjust their original expectations to reality. The original expectations of the owners in the sample ranged from those simply seeking supplementary income to those expecting sizable profits from their business ventures. In most instances, the willingness to continue in business depended on the degree to which these goals were eventually realized. This explains the survival of most of the firms categorized as "marginal survivors" and "limited successes." The six owners who initially expected substantial profits from their ventures succeeded in realizing them and qualified as either actually or potentially profitable enterprises. On the other hand, some businesses survived only because their owners were willing to adjust either temporarily or permanently to a lower level of operations than they had originally anticipated.

B. *Acquired Ownership*

The survival rate of transferred businesses was practically identical to that of new businesses. The transferred businesses which failed were either enterprises that had been deteriorating prior to their sale or had been supporting the prior owners at a level lower than the minimum needs of the new owners. In either case, the buyers failed because their evaluations of the firms had been unrealistic. By contrast, the transferred firms which survived were enterprises that had generally proved their ability to provide a standard of living adequate to the needs of the new owners. In most cases the new owner was previously familiar with the acquired business, and was therefore competent to gauge the business potential realistically. All of these firms attained their maximum potential prior to transfer, and most of the new owners were able to maintain this level. It is therefore not surprising to find that 10 of the surviving 17 transfers were in the "limited success" category, although 6 were merely "marginal survivors" and 1 was a "profitable" firm.

C. *Occupational Experience*

An analysis of the relationships between occupational experience and business survival reveal several salient conclusions. (1) Work experience as an employee in the same type of business is not positively related to survival as a business owner. (2) Previous experience as a business owner is advantageous, particularly previous ownership of a similar business. (3) Whether an owner gains this experience through ownership of one or more previous firms is insignificant.

That work experience as an employee does not provide the ability required to operate a business is proven by the fact that most of the owners who relied exclusively on skills acquired by prior employment failed. By contrast, those with previous work experience who survived also had managerial skills, often, but not always, acquired through previous business ownership.

On the other hand, experience as a business owner, particularly in the same type business, was directly related to survival and success. Among the 33 firms in the "marginal" and the "limited success" categories, approximately half of the owners had previously been in business for themselves. In the "potentially profitable" and "profitable" firms, 60 per cent previously owned businesses. Moreover, the proportion of prior owners with experience in the same line increased from one-third in the "marginal" category to two-thirds in the "limited success" category and to 100 per cent in the two "profitable" categories.

D. *Capital Investment*

The average amount of initial capital invested in the surviving firms was greater than that in the firms which failed. Although this is significant, the wide range of investments in the surviving firms indicates that the amount of capital is not the only determinant. Equally, if not more important than the absolute figures, is the adequacy of the capital available in relation to the type and size of operation planned. In addition to the money invested in the venture, the adequacy of the capital structure of the business also depends on whether the owner has additional income to utilize. If necessary, he should be able to increase the business capital or to use his nonbusiness resources as a temporary substitute for withdrawals from the business, until the business can support him. This is of special importance if sizeable parts of the investment consist of short-term loans or trade credit. In such cases, the burden of repaying indebtedness usually permits only a minimal withdrawal for living purposes. Generally, the adequacy of capital resources is a necessary but not a sufficient reason for business survival. Unless a business is ade-

quately capitalized, it cannot survive, but capital alone cannot insure its success. Other ingredients, such as previous business experience, managerial ability, hard work, and persistence must also be present.

E. *Managerial Sophistication*

Perhaps one of the most important factors in business survival and success is managerial sophistication. Its importance to success appears most strikingly in the failures because a definitive relationship between the absence of this trait and failure is more apparent than in survival. This is somewhat analogous to the study of failure and success in marriage; it is much easier to pinpoint the shortcomings that cause a divorce than to identify favorable factors present in successful marriages. Despite this difficulty, the case materials illuminate some of the qualities which are critical in business survival and success. As most business manuals indicate, certain managerial abilities are indispensable to business success. Only one owner in the sample utilized the guidance of a business manual. Most manuals treat extensively managerial techniques, and discuss such aspects as purchasing, inventory control, pricing, salesmanship, display of merchandise, advertising, credit policies, record keeping, control of overhead, and employment practices. Few businessmen acquire expertise in all these areas, but most of the survivors in the sample had a basic knowledge of these managerial practices. In contrast, the failures were deficient in one or more of the essential managerial abilities.

1. *Advertising.*—In this era of mass communication, an essential business practice is effective advertising. Any new business must inform the public of its existence, and acquaint prospective customers with the merchandise it sells or the services it offers. Most owners in the sample advertised in some manner the opening of their businesses. Some of those who acquired an established concern, however, assumed that the existence of the business was already well known in the neighborhood and that advertising would be a waste of money. In several instances this was an error of judgment. These owners failed to realize the importance of advertising the change of ownership as a means of surmounting the poor reputation the business had acquired under the previous ownership.

Although most of the owners realized that advertising their opening was essential, many had difficulties in judging the effectiveness of their advertising and in determining the desirability of continued advertising. The majority of the firms were too small to employ an advertising agency and relied on trial-and-error processes that often amounted

to a waste of money. A few businessmen in the sample did, however, exhibit considerable skill in advertising.

Generally, advertising tends to be more of a continuous routine business practice in large enterprises than in small ones. Eight of the 41 surviving firms drew their customers from a wide area, while the others catered largely to the particular section of the city where they were located. Strictly local businesses require a minimum of formal advertising. Aside from advertising their opening and an occasional special sale, they can rely on repeat business from regular clientele. On the other hand, more specialized firms which depend on a larger market must continuously present their name to the public. Since only a fraction of the firms in this study fell in the latter category, advertising did not play a major role among the managerial practices that contributed to survival and success.

2. *Staffing–Overhead.*–Staffing was mentioned repeatedly as a major problem by the business owners. This was particularly true in restaurants, gas stations, and similar businesses that operate for long hours and are run by employees, at least part-time, in the absence of the owners. Here the ability to select high quality employees can play a crucial role in survival and success.

The recognition of the desirability of coordinating overhead with business volume was another manifestation of managerial ability. Rent is frequently the most important overhead item in small businesses, and efforts to adapt overhead to business volume usually focus on this expense. Thus, four of the six owners who changed the location of their enterprises did so to reduce rent. Other owners were either planning or in the process of building their own premises on the assumption that this would materially reduce their overhead and increase the profitability of their enterprises.

F. *Positive Personality Traits*

Managerial ability is more valuable if it is supplemented by certain personality traits. This is particularly evident under stress, because crises test not only the owner's ability to maneuver skillfully but also his stamina and resilience. In several cases, the survival of the business could be credited largely to the owner's personality traits. Especially important was the willingness of several owners to expend personal energy, not confining their efforts to supervisory operations. The distinguishing characteristic of these owners was the determination and tenacity with which they pursued their goals of business ownership. These owners did not view their enterprises as merely employment, but were serious and enthusiastic about business owner-

ship and were therefore willing to sacrifice personal comfort to survive and succeed.

In contrast to the failures, where irresponsibility was manifested in several cases, the survivors conducted their enterprises in a responsible and reliable manner. Customers could depend on the businesses operating at the stated hours. In the case of one television repair shop, operated as a part-time business, the owner installed a telephone-answering service which recorded messages and orders from customers. Creditors could rely on prompt repayment of loans. The owner's sense of responsibility also was expressed in better housekeeping practices. Although this cannot be measured statistically, the impressions gained from comparative examination of case histories of failures and survivors indicate that the survivors were more conscious of the need for neat displays, clean premises, and quality service. The result was that in most instances the survivors had good reputations in their communities.

VII. CONCLUSION

In summary, analysis of the businesses observed in this study reveals that certain conditions are more likely to have fatal effects on a business venture than others. Undercapitalization, managerial incompetence, and personality defects appear to be insurmountable liabilities which cannot be mitigated by the presence of the other assets. Although adequate capital and managerial competence are indispensable for survival, they are rarely sufficient in themselves to insure it. They must be supplemented by other factors, such as motivation, hard work, persistence, and flexibility.

There are certain factors which are highly desirable but whose absence is not necessarily fatal. In this category are such features as a favorable location, accurate record keeping, good housekeeping, and advance planning for opening and developing the business. Unlike capital and competence, the absence of one or more of these factors can be surmounted by hard work, managerial ability, and positive personality traits. Like many of the failures, some of the survivors never separated business assets from personal finances, but this did not seriously interfere with their operations. No doubt, this was due to the limited operations of most of the firms. As operations expand, adequate records become an indispensable requirement.

The ideal combination of the above factors adds up to a high degree of rationality. The greater the rationality of the owner's approach to the opening and conduct of the business, the higher is the survival rate and the greater the degree of success. Perhaps the major conclusion of the study was the absence of rationality exhibited

by all but a few owners. Most owners made instantaneous decisions, influenced by chance occurrences, and conspicuously failed to seek expert advice. Besides the importance of rationality, the conclusions illuminate the significant role of a personality trait, persistence. Several firms which could have survived, closed "unnecessarily" because their owners lacked the stamina required to endure the initial difficulties which beset new firms. On the other hand, a number of firms survived because of the owner's determination and endurance. If there is any formula for business success, the ingredients consist largely of the ability to evaluate objectively, to plan carefully, and to be prepared emotionally to persist long enough to overcome temporary setbacks until the business reaches its full potential.