

# The Dynamic Role of Small Business

We are constantly being involved with small business, for it is everywhere! When we think of “business,” we may think of large corporations—such as Fortune 500 companies—but if you look around you, where you work and live, you will realize that the vast majority of businesses are small. Not only are these small businesses numerically significant; they are also important as employers, as providers of needed (and often unique) goods and services, and as sources of satisfaction to their owners, employees, and customers. For these and many other reasons, there is hardly anyone who has not at some time or other been tempted to start a small business.

Part 1 of this text is designed to show what is involved in forming and/or owning a small business. Thus, the material covered should help you decide whether pursuing a career in small business is the right course of action for you.

The growing importance of small business is covered in Chapter 1. Chapter 2 describes the need for planned management succession and discusses family and manager problems. Then, the more popular forms of ownership available to small businesses are presented in Chapter 3. Chapter 4 looks at the relationship with government agencies and discusses the need for social responsibility and ethical practices. ●

# Starting Your Small Business

*The good health and strength of America's small businesses are a vital key to health and strength of our economy. . . . Indeed, small business is America.*

—Former President Ronald Reagan

*Guts, brains, and determination—key ingredients of the American entrepreneurial spirit—[have] sustained this nation through good times and bad, and launched it on an economic journey unlike any ever witnessed in history.*

—John Sloan, Jr., President and CEO, National Foundation of Independent Business

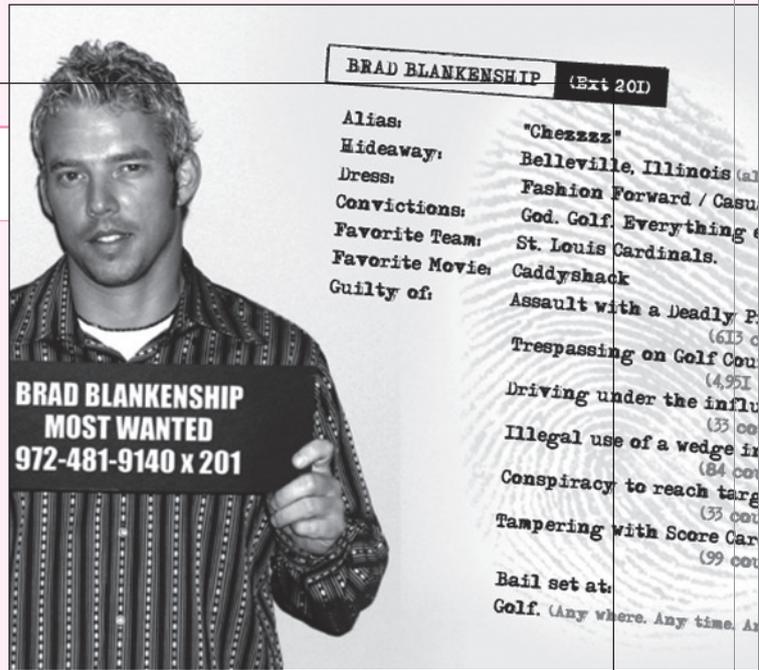
## Learning Objectives

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*After studying the material in this chapter, you should be able to:*

1. Define what is meant by the term *business*.
2. Name some of the unique contributions of *small business*.
3. Explain some of the current problems small businesses face.
4. Discuss some of the current trends challenging entrepreneurs and small business owners.
5. Explain why people start small businesses.
6. Describe the characteristics of successful entrepreneurs.
7. Describe where the opportunities are for small businesses.
8. Identify some of the areas of concern for small business owners.

## PROFILE



## LogoLink

Brad Blankenship grew up in Belleville, Illinois, and attended Illinois State University, where he earned a BS in marketing. He then began learning his trade—sales—at a company that sold collegiate merchandise, Famous-Fraternity Sportswear. After six years with Famous-Fraternity Sportswear, Brad went to work for an advertising and promotional agency in Dallas, Texas. He had only been residing in Dallas six months when the company he was working for was sold to a large ad agency. Brad made the decision to leave and start his own company, LogoLink. Most people would consider leaving a cushy job to start your own business, with zero clients, too great a leap of faith. Brad's income had been straight commission since his first job, so he was used to having to make a sale to earn a living.

LogoLink was started in September 1999 as an S corporation. Brad had startup capital of \$65,000, which he had saved while working at Famous-Fraternity Sportswear. The company has experienced growth, particularly in the last two years, now having a total of seven employees. Brad's main responsibility is strategic growth over the next three to five years, which is in great contrast to previous years. As far as strategic goes, Brad says their "Mission is to develop a respected promotional partnership with our clients by providing creative marketing solutions delivered with enthusiastic, dedicated, and knowledgeable service. We achieve this through dedicated account service,

superior knowledge of our industry, timely attention to details and deadlines, innovative turnkey solutions, and competitive pricing."

In the beginning, Brad learned that when starting a small business you have to be less strategic (long term) and more take-what-you-can-get (short term). There were and continue to be many learning curves for him. Another very important lesson learned was realizing that, in order to achieve growth, you cannot work alone. You have to learn to delegate responsibility and trust in the work of others. Being open-minded is also an intricate part of growth. You must realize there is almost always more than one way to do things. Instead of trying to mold your employees into a likeness of you, you must recognize their strengths and talents and use them in a maximizing manner. People often rise to the occasion if given the opportunity.

One very beneficial lesson Brad learned was not to be hesitant to ask for a prepay or half-down on sales. LogoLink's first order was for \$85,000 with a prepay (payment for services before delivery). "What a way to start." Many Fortune 500 companies have agreed to prepay LogoLink, but it is not always that easy. Brad said sometimes companies will say, "A purchase order is enough with 60 to 90 days to pay if you want our business." One time, LogoLink's biggest client ordered a large drop shipment of shirts in various sizes, colors, and

styles to several locations. The order was an absolute nightmare—there were too many variables to deal with in shipping 1,000 shirts to 300 different locations. Even after calling every location to make sure the orders were received, the clients all but fired LogoLink. After several months of keeping lines of communication open with the client, Brad decided it would be best for them to make a trip to the client's corporate headquarters. Although both companies were located in Dallas, there were many people who had never met. After a few meetings, lunches, and social gatherings, the handshakes turned into hugs. This was already LogoLink's largest client; sales grew even larger then—to five times what they were. This experience reaffirmed what Brad already knew: Business is about relationships and selling solutions.

Every bump in the road has not had such a pleasant ending for LogoLink. There is a picture in Brad's office of him riding a camel. He explains the picture as his \$3,500 camel ride. An advertising agency placed a \$7,000 order to LogoLink for a big "Re-Grand Opening" party. LogoLink received a 50 percent deposit and



delivered the order, including everything from an open bar to a camel, and of course several promotional items to give away. The agency ended up folding, and Brad was left short \$3,500, thus teaching Brad to always get a prepay from a new company.

Source: Correspondence and interviews with Brad Blankenship.

You have probably never heard of Brad Blankenship. But you have heard of companies such as Wal-Mart, Sears, McDonald's, Dell Inc., Intel, and Microsoft. All of them were started as small businesses by then-unknown entrepreneurs such as Sam Walton, Richard Sears, Ray Kroc, Michael Dell, Andrew Grove, and Bill Gates. By capitalizing on their imagination, initiative, courage, dedication, hard work, and—often—luck, these entrepreneurs turned an idea into a small struggling business that became a large, successful one.

Now it is your turn to see if you can start (or restart) your career as an entrepreneur—by converting an idea into a small business. According to Joseph Nebesky, who has served as an adviser to the U.S. Agency for International Development, the Small Business Administration (SBA) ([www.sba.gov](http://www.sba.gov)), and the National Council on the Aging, these small firms "are the backbone of the American economy." Apparently he is right: Firms with fewer than 500 employees employ 53 percent of the total private nonfarm workforce, contribute 47 percent of all sales in the country, are responsible for 51 percent of the gross domestic product, and produce around two out of every three new jobs each year. They also account for more than half of U.S. gross domestic product. In 2002, 11.5 million people were self-employed with another 140,000 unpaid family workers.

### It's an Interesting Time to Be Studying Small Business

This is indeed an interesting, challenging, and rewarding time to be studying small business. Owning and operating such a firm is one of the best ways to fulfill the "great American dream," and many Americans believe this is one of the best paths to riches in the United States.

The following are some reasons for the increased interest in small business:

- The number of small businesses is growing rapidly.
- Small firms generate most new private employment.

- The public favors small business.
- There is increasing interest in small business entrepreneurship at high schools and colleges.
- There is a growing trend toward self-employment.
- Entrepreneurship is attractive to people of all ages.

### The Number of Small Businesses Is Growing Rapidly

The development of small business in the United States is truly an amazing story. The value of goods and services they produce and the new jobs they generate make the small business sector one of the greatest economic powers in the world, accounting for trillions of dollars' worth of commerce annually. There are about 23 million small businesses in the United States. These organizations create 75 percent of the new jobs and employ 50 percent of the country's private workforce. They also represent more than 99 percent of all employers and 97 percent of exporters.<sup>1</sup> Forty percent of current new business owners are self-employed and do not hire any workers. Of the remaining 60 percent, only about two-thirds employ more than 20 people. In 2003 there were 1.9 men for every woman entrepreneur. Today's typical entrepreneur is young, male (ethnically diverse), between the ages of 25 to 34, and has specialty expertise. It is also interesting to note that 5 out of every 100 adults have invested in someone else's business within the last three years. In 2003 informal investors provided more than \$100 billion to 3.5 million startup and small businesses.<sup>2</sup>

### The Public Favors Small Business

Generally, small business owners and managers believe in the free enterprise system, with its emphasis on individual freedom, risk taking, initiative, thrift, frugality, and hard work. Indications of interest in small business and entrepreneurship can be explained by the large number of magazines aimed at that market. These include older ones, such as *Black Enterprise* ([www.blackenterprise.com](http://www.blackenterprise.com)), *Entrepreneur, Inc.*, and *Hispanic Business* ([www.hispanicbusiness.com](http://www.hispanicbusiness.com)), and many new ones such as *Fortune Small Business* ([www.fsb.com](http://www.fsb.com)). Some of these journals are targeted for specific markets. *Family Business* targets family-owned businesses; *Entrepreneurial Woman* aims at female business owners; and *Your Company*, sent free by American Express ([www.americanexpress.com](http://www.americanexpress.com)) to the millions or more holders of its small business corporate card, targets small firms. Other journals include *Journal of Small Business Management*, *Small Business Journal* ([www.tsbj.com](http://www.tsbj.com)), *New Business Opportunities*, and *Business Week Newsletter for Family-Owned Businesses* ([www.businessweek.com](http://www.businessweek.com)). Please note that the *BusinessWeek* site requires registration and a fee in order to view the entire file.

### Interest Is Increasing at High Schools, Colleges, and Universities

Another indication of the growing popularity of small business is its acceptance as part of the mission of many high schools, colleges, and universities, where entrepreneurship and small business management are now academically respected disciplines. Virtually unheard of 20 years ago, courses in entrepreneurship are now offered at hundreds of U.S. colleges. Many university classes explore startups and business plans. Today more students think self-employment is a safer haven than working for big corporations. As for universities, they have discovered that by teaching entrepreneurship they are able to tap into a vast pool of funds to support such programs.<sup>3</sup> One survey has indicated that even teens between the ages of 13 and 18 see business as an ideal job

Thirteen percent of males and 10 percent of females are already aiming toward a business career.<sup>4</sup>

The considerable interest at colleges and universities is shown by the formation of many student organizations to encourage entrepreneurship. For example, the Association of Collegiate Entrepreneurs (ACE), founded in 1983 at Wichita State University, now has hundreds of chapters throughout the world. Other organizations include the University Entrepreneurial Association (UEA) and Students in Free Enterprise (SIFE) ([www.sife.org](http://www.sife.org)).

Community colleges, especially, are now offering courses for small business owners. One study found that 90 percent of community colleges offer such courses, while 75 percent of public community colleges also provide training courses. This activity is one of the fastest-growing areas in the community college field. Many colleges and universities are now offering specialized business courses, such as programs in family business, franchising, and international operations, as well as job fairs and career days.

### Trend Is toward Self-Employment

The growth rate for self-employment is greater than the growth rate of the general workforce. Small business grew rapidly from the mid-1980s to the mid-1990s as investors became more willing to assume the risk of starting or revitalizing small businesses. Many of these were middle-aged executives from large corporations who were eager to put their management skills to work in reviving smaller companies in aging industries.

#### Real World Example 1.1

William Zinks retired in his early sixties from a very demanding job in New York. He moved to Colorado to slow the pace of his life and created the nonprofit Center for Production Longevity ([www.ctrpl.org](http://www.ctrpl.org)). Now at the age of eighty he is still working and says that he “is fortunate to own his own business and to be able to set his own work schedule.”<sup>5</sup>

This trend is still alive. For example, a national poll found that 55 percent of us want to be our own boss. Advances in technology have helped make this dream come true.<sup>6</sup> For example, there has been tremendous growth in the Internet and biotechnology industries, and they have attracted record amounts of venture capital financing.<sup>7</sup>

### Entrepreneurship Is Attractive to All Ages

Entrepreneurship knows no age limits! From the very young to the very old, people are starting new businesses at a rapid rate. Particularly heartening is the large number of young people who are entrepreneurs. For example, 15-year-old Laima Tazmin is president of LAVT LLC, a Web consulting company. She customizes computers and develops community-based online businesses. Laima turned her love for computers into a business plan that initially won a regional competition and then, with a few changes, won her top notch as “Young Entrepreneur” in a contest sponsored by Fleet Bank. This prize netted her \$25,000 and broad media exposure. Laima says “Entrepreneurship is about planning for the future. . . . I want to grow myself.”<sup>8</sup>

### Real-World Example 1.2

Age is not a requirement for success in starting small businesses. Megan Crump is a good example of a young entrepreneur. At age seven she found an exciting way to make money. After a successful evening of trick-or-treating, Megan took all her candy to school and sold it to her schoolmates for a handsome profit of \$3 the first day and \$1 the second day. She later held a yard sale where, among other things, she sold her sister's used bicycle for \$9. The resourcefulness of youngsters such as Megan should continue to stimulate our economy well into the twenty-first century.<sup>9</sup>

College entrepreneurs find many areas for opening a business. These include reselling textbooks, importing and selling crafts from home, renting mini fridges and microwaves, dorm cleaning services, and transportation. The most difficult problem for these students to solve is what to do with their business after they graduate.

Older people are also involved in forming new companies, as small businesses offer the most opportunities and flexibility to retirees or those terminated from their regular employment. For example, after spending 20 years climbing the corporate ladder, Andrea Papa was laid off in March 2001. With little severance pay and no future income, she started her own media and marketing consulting firm. Now she is at home to welcome her son home from school.<sup>10</sup>

Twenty-something entrepreneurs know no fear. This group believes “failure” is relative, and if you fail—learn from it—the lesson can speed you up the ladder of the next venture.

*More and more seasoned professionals, unemployed due to layoffs or early retirement, are turning to creating small businesses they can manage from home. This allows them to spend more time with their families.*



### Real-World Example 1.3

Jeremy Kahn and Henry Rich noticed that every time someone needed a cigarette the phrase “oral fixation” came up. One thing led to another and Oral Fixation Mints were born. This wacky idea has produced sleek tins of candy that can be purchased at Miami’s Mandarin Oriental Hotel and New York City’s Whitney Museum of Modern Art.

It is interesting to note that more than half of the million-plus independent workers in New York City are usually college educated and are 25 to 40 years old.<sup>11</sup> A recent survey of small business owners reinforces the boldness of new entrepreneurs. Eighty-four percent of those polled are certain they have properly planned for their businesses’ future needs. They are “not worried about the future.”<sup>12</sup>

Many groups, such as the American Association of Retired Persons (AARP) ([www.aarp.org](http://www.aarp.org)), colleges, and private consultants now offer classes—and, more important, support groups—specifically for retirement-aged potential and actual entrepreneurs.<sup>13</sup> Also, 40 percent of those who form new businesses each year already have some management experience, and one-fourth of them have managed or owned a business before.

A word of caution is needed at this point. If you start a business, you cannot just “turn it on and off” like a light switch; that is, you cannot take time off whenever you want. If your business is to succeed, you cannot shut down for holidays or vacations or when things are not going well. As one discouraged small business owner said at a recent conference, “A small business is wonderful: You only have to work half a day—and you get to choose which 12 hours it is that you will work!”

### Defining Small Business—No Easy Task

Now that we have seen how much interest there is in small business, what *is* small business? There is no simple definition, but let’s look at some definitions that are frequently used.

#### What Is Small?

At first, this question appears easy to answer. Many places of business that you patronize—such as independent neighborhood grocery stores, fast-food restaurants, hair stylists, dry cleaners, video or music shops, and the veterinarian—are examples of small businesses.

Qualitative factors are also important in describing small businesses. To be classified as “small,” *a small business must have at least two of the following features:*

- Management is independent, because the manager usually owns the business.
- Capital is supplied and ownership is held by an individual or a few individuals.
- The area of operations is primarily local, although the market is not necessarily local.
- The business is small in comparison with the larger competitors in its industry.

Perhaps the best definition of small business is the one used by Congress in the Small Business Act of 1953, which states that *a small business is one that is independently owned and operated and is not dominant in its field of operation.* We’ll use that definition in this text, unless otherwise indicated.

In an **entrepreneurial venture**, the principal objectives of the owner are profitability and growth.

A **small business** is independently owned and operated and is not dominant in its field.

A **small business owner** establishes a business primarily to further personal goals, including making a profit.

The goals of an **entrepreneur** include achievement, profit, and growth, achieved through innovation and strategic management.

**TABLE 1.1** | Classification of Business by Size, According to SBA

Under 20 employees	Very small
20–99	Small
100–499	Medium
500 or more	Large

Source: Small Business Administration.

As will be shown in Chapter 7, the SBA, for loan purposes, uses different size criteria by industry. In general, however, it uses the size classification shown in Table 1.1. In Europe small firms are considered different from country to country. In the European Union (EU), about 34 percent of the work force is employed in firms with 10 or fewer employees.<sup>14</sup>

### Distinguishing between Entrepreneurial Ventures and Small Businesses

We also need to distinguish between small businesses and entrepreneurial ventures. The rapidity of the rate of growth of a business is one useful way to distinguish between small business owners and entrepreneurs.

An **entrepreneurial venture** is one in which the principal objectives of the entrepreneur are profitability and growth. Thus, the business is characterized by innovative strategic practices and/or products. The entrepreneurs and their financial backers are usually seeking rapid growth, immediate—and high—profits, and a quick sellout with (possibly) large capital gains.

A **small business**, sometimes called a micro business, on the other hand, is any business that is independently owned and operated and is not dominant in its field. It may never grow large, and the owners may not want it to, as they prefer a more relaxed and less aggressive approach to running the business. They manage their business in a normal way, expecting normal sales, profits, and growth. In other words, they seek a certain degree of freedom and—ideally—a certain degree of financial independence.

These businesses are often run from the owner's home. They account for more than 60 percent of the nation's 5.6 million employers and more than \$100 billion in annual spending.<sup>15</sup> A survey in 1999 found that 1 in 12 adults was trying to found a new business.<sup>16</sup>

It is not always easy to distinguish between a small business owner and an entrepreneur; the distinction hinges on their intentions. In general, a **small business owner** establishes a business for the principal purpose of furthering personal goals, which *may* include making a profit. Thus, the owner may perceive the business as being an extension of his or her personality, which is interwoven with family needs and desires. On the other hand, the **entrepreneur** starts and manages a business for many reasons, including achievement, profit, and growth. Such a person is characterized principally by innovative behavior and will employ strategic management practices in the business. Of course, the owner's intentions sometimes change, and what started out as a small business may become an entrepreneurial venture.

### Some Unique Contributions of Small Business

As indicated throughout this chapter, small firms differ from their larger competitors. Let's look at some major contributions made by small businesses that set them apart from larger firms. Smaller firms tend to

- Encourage innovation and flexibility.
- Maintain close relationships with customers and the community

- Keep larger firms competitive.
- Provide employees with comprehensive learning experience.
- Develop risk takers.
- Generate new employment.
- Provide greater employee job satisfaction.

### Encourage Innovation and Flexibility

Smaller businesses are often sources of new ideas, materials, processes, and services that larger firms may be unable or reluctant to provide. In small businesses, experiments can be conducted, innovations initiated, and new operations started or expanded. In fact, small firms produce 55 percent of all innovations,<sup>17</sup> and in 2003, there were 189,597 patents issued by the U.S. government.<sup>18</sup> If we apply the 55 percent innovation rate, we can say that more than 100,000 patents were issued to small businesses. This trend is especially true in the computer field, where most initial developments have been carried on in small companies.

#### Real-World Example 1.4

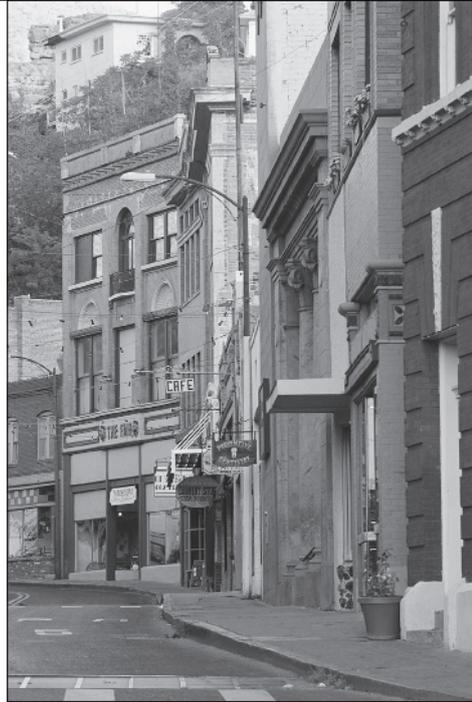
For example, it is no coincidence that IBM did not produce the first electronic computer, as it already owned 97 percent of the then-popular punched-card equipment, which the computer would tend to make obsolete. Instead, the Univac was conceived and produced by a small firm formed by John Mauchly and J. Presper Eckert. However, while they were design experts, they lacked production and marketing skills, so they sold out to Remington Rand, which controlled the remaining 3 percent of the punched-card business. Thus, the first giant computers at organizations such as the U.S. Census Bureau and General Electric's Appliance Park in Kentucky in January 1954 were Univacs. Nonetheless, IBM's marketing expertise overcame Remington's production expertise, and IBM soon dominated the computer industry.

Also, it is no coincidence that two design geniuses, Steven Jobs (age 21) and Steve Wozniak (age 19) essentially started the PC industry by founding Apple Computer in 1976 with capital obtained by selling Job's Volkswagen microbus and Wozniak's Hewlett-Packard scientific calculator. And Michael Dell (age 19) started Dell Inc. by selling computer parts from his dorm room at the University of Texas. He started out to "make it big."

### Maintain Close Relationship with Customers and Community

Small businesses tend to be in close touch with their communities and customers. They can do a more individualized job than big firms can, thereby attracting customers on the basis of specialty products, quality, and personal services rather than solely on the basis of price. While competitive prices and a reputation for honesty are important, an atmosphere of friendliness makes people feel good about patronizing the business and encourages them to continue shopping there.

There are more than 1,600 Main Street programs ([mainstreet.org](http://mainstreet.org)). These programs are designed to encourage community revitalization, economic development, historic preservation, and downtown revitalization. Each year the National Trust for Historic Preservation



recognizes only five cities as winners. One eye opener was when one small community was ready to give up when Wal-Mart opened; instead, they all pulled together and were able to compete—and survive—by providing better customer service and products that were unique.

### Real-World Example 1.5

For example, Mike and Carol Hamilton's Chutters General Store ([chutters.com](http://chutters.com)) has 111 feet of candy jars, making them the home of the world's largest candy counter according to the *Guinness Book of World Records*. Their store is one of the stars in Littleton, NH, which received the 2003 Great American Main Street Award.<sup>19</sup>

### Keep Larger Firms Competitive

Smaller companies have become a controlling factor in the American economy by keeping the bigger concerns on their toes. With the introduction of new products and services, small businesses encourage competition, if not in price, then at least in design and efficiency, as happened in the area of California now called Silicon Valley, where the personal computer was developed.

### Provide Employees with Comprehensive Learning Experience

A small business provides employees with a variety of learning experiences not open to individuals holding more specialized jobs in larger companies. Along with performing a greater variety of functions, small business employees also have more freedom to make

decisions, which can lend zest and interest to their work experience. Small businesses train people to become better leaders and managers and to develop their talents and energies more effectively. This reality has led more college graduates to seek full-time jobs with small businesses, according to a survey by the National Association of Colleges and Employers. The reason for this trend is that small companies “tend to offer broader experiences because of their small staffs.” Thus, employees “get more responsibility, more quickly,” according to one graduate applicant.

### Develop Risk Takers

Small businesses provide one of the basic American freedoms—risk taking, with its consequent rewards and punishments. Small business owners have relative freedom to enter or leave a business at will, to start small and grow big, to expand or contract, and to succeed or fail, which is the basis of our free enterprise system. Yet founding a business in an uncertain environment is risky, so much planning and study must be done before startup.

### Generate New Employment

As repeatedly emphasized throughout this chapter, small businesses generate employment by creating job opportunities. Small firms also serve as a training ground for employees, who, because of their more comprehensive learning experience, their emphasis on risk taking, and their exposure to innovation and flexibility, become valued employees of larger companies.

#### Real World Example 1.6

According to Brynn Albreten (profile, Chapter 5), “The best advice I can give as to how to start your own business: Be a student, always. Continue to learn new things, try new things, read new things, and stay current on business and technology. Be a sponge and learn as much as you can from those around you, teachers, business professionals, and others. Take off the blinders, do not get stuck in a rut of ‘this is how it has always been done,’ make a concerted effort to see things from different perspectives and challenge yourself to think outside the box.”

### Provide Greater Job Satisfaction

Small companies also provide greater employee job satisfaction. For example, an *Inc./Gallup* survey of American workers found that employees in smaller workplaces have higher job satisfaction than those in larger firms. But the greatest satisfaction comes to those who own their own workplaces.

### Some Current Problems Facing Small Businesses

Just as small companies make unique contributions, there are special problems that affect them more than larger businesses. These problems can result in limited profitability and growth, the decision to voluntarily close the business, or financial failure.

There is a great deal of conflicting data on the failure rate of small businesses. Most statistics err on the optimistic side, which can be explained by the huge number of small

businesses that never make it into the reporting system. Today, the biggest worries facing small business owners, according to a 2003 survey, are

- Recession/current economic issues.
- Retirement or transition.
- Capital or financing issues.
- Unexpected growth.
- Succession.<sup>20</sup>

Over time we see repeated areas that create problems for small business owners and entrepreneurs. These areas include inadequate financing, inadequate management, and burdensome government regulations and paperwork.

### Inadequate Financing

In the preceding list, inadequate financing is the primary cause of new business failure. *It cannot be stressed enough that a shortage of capital is the greatest problem facing small business owners.* Without adequate funds, the small business owner is unable to acquire and maintain facilities, hire and reward capable employees, produce and market a product, or do the other things necessary to run a successful business.

### Inadequate Management

Inadequate management—in the forms of limited business knowledge, poor management, inadequate planning, and inexperience—is the second problem facing small firms. Many owners tend to rely on one-person management and seem reluctant to vary from this managerial pattern. They tend to guard their position very jealously and may not select qualified employees, or may fail to give them enough authority and responsibility to manage adequately. Most small businesses are started because someone is good at a specific activity or trade, not because she or he has managerial skill.

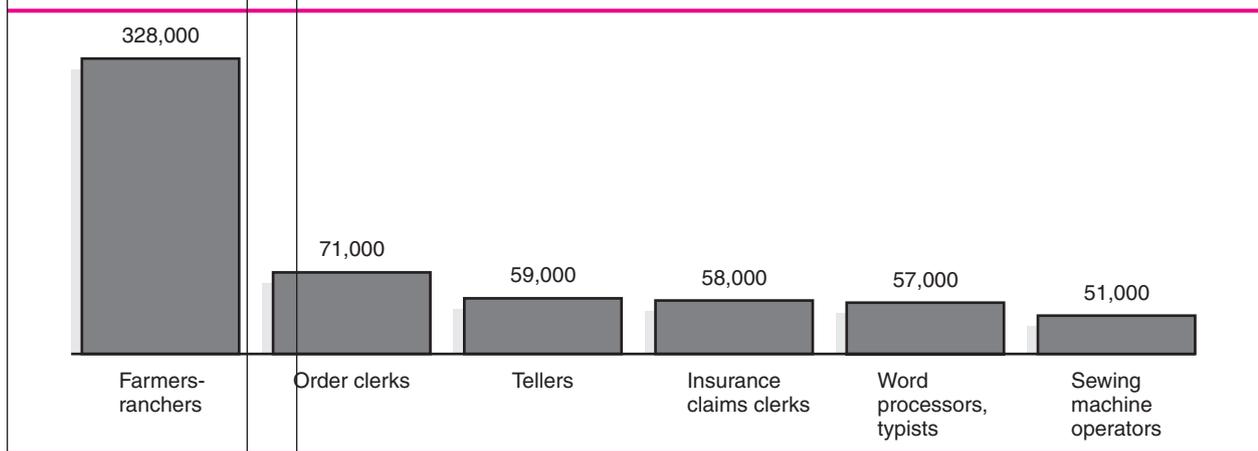
Managers of small firms must be generalists rather than specialists. Because they must make their own decisions and then live with those choices, managers are faced with a dilemma. Because the business's resources are limited, it cannot afford to make costly mistakes; yet because the organization is so small, the owner cannot afford to pay for managerial assistance to prevent bad decisions.

### Burdensome Government Regulations and Paperwork

If you want to upset small business managers, just mention government regulations and paperwork. That is one of their least favorite subjects—and with good reason. At one time, smaller firms were exempt from many federal regulations and even some state and local ones. Now, small firms are subject to many of the same regulations as their larger competitors. These regulations are often complex and contradictory, which explains why small business managers find it so difficult to comply with governmental requirements. While most businesspeople do not purposely evade the issues or disobey the law, they are often unaware of all pertinent regulations and requirements. As will be shown in Chapter 4, however, small businesses often benefit from many of these regulations.

### Some Current Trends Challenging Small Business Owners

Small firms, like large ones, are now experiencing fundamental changes and new trends in the way business is conducted and people are being employed. If small businesses are to overcome the problems just discussed, they must be prepared to recognize and cope with

**FIGURE 1.1** | Declining Job Types

Source: Sam Ward, "Jobs in Biggest Decade-Long Decline," *USA Today*, June 20, 2003, p. 1A. Used by permission of the Bureau of Labor Statistics. ([www.bls.gov](http://www.bls.gov))

current trends that are potentially rewarding but that will challenge them and require their best performance. The most important trends are exploding technology, occupational and industry shifts, and global challenges.

### Exploding Technology

Few jobs in small firms are unaffected by improvements in communications and computer technology. Small business management is being drastically changed as automated robotics are introduced in production departments, as accounting departments become heavily dependent on computer support, and as marketing people use computer-aided promotional and sales programs.

The primary challenge of exploding technology for small companies will be to improve the selection and training of workers and overcome their resistance to change. Therefore, owners and managers must keep up to date themselves on the latest technologies so they can effectively train their people to use these technologies, including telecommuting. Chapter 15 will introduce you to many examples of computer software and new technology available for the small business owner. According the Office of Advocacy, U.S. Small Business Administration, 38 percent of all jobs in the high-tech sector are through small business.<sup>21</sup> Figure 1.1 projects the areas of decline for the next 10 years.

### Occupational and Industry Shifts

Technological advances in automation, computers, robotics, and electronic communication, along with changing markets resulting from cultural, demographic, and economic changes, have affected traditional "smokestack" industries. These changes have caused a concurrent shift toward more people-related activities to which small business enterprise is exceptionally well suited, such as health care, banking and financial services, retail trade, transportation, and computer services.

Among these shifts, **reinvention**, particularly including a reduction in the size and markets for businesses, has led to fewer job opportunities for those who are less well-trained

**Reinvention** is the fundamental redesign of a business, often resulting in reduction in size and markets.

**Reengineering** is the redesign of operations, starting from scratch.

**Downsizing (rightsizing)** is reducing the number of employees to increase efficiency.

and educated. At the same time, many larger companies have **reengineered** their activities, which has involved wiping the slate clean as far as current operations are concerned and asking, “If we blew this place up and started over, what would we do differently? What should we eliminate? What can we do that would make things easier for our customer?”

The result is **downsizing** (sometimes called **rightsizing**), whereby an organization reduces the number of people it employs as it strives to become leaner and meaner and consolidates departments and work groups.

This movement is giving people more responsibility for making decisions and the chance to escape acting like automatons—but they must work harder, and they are under more pressure. *These shifts help smaller firms, as many highly skilled workers and managers leave to join the ranks of small business owners and managers.*

### Global Challenges

The trend in business is to become more active globally, and those interested in small business management need to understand at least what the challenge is and what the rewards may be. We are entering an age of global competition and a one-world market. Consequently, *we estimate that up to half of all today’s college graduates will work in some type of global activities in the future.* Small businesses today represent 96 percent of all U.S. exporters.<sup>22</sup>

One result of this global challenge is the growing number of large and small U.S. businesses that are or become foreign owned. These foreign-owned companies tend to have different management styles from their original American owners, which means small business owners and managers must learn to adjust and adapt to nontraditional styles. While foreign ownership may lead to new management styles, the American consumer may not realize the change.

#### Real-World Example 1.7

For example, few Americans know or care that consumer products for sale with RCA and GE brand names are owned by a French company, Thompson S.A. Magnavox and Sylvania are owned by Philips Electronics of The Netherlands, and Quasar is made by Japan’s Matsushita Electric Industries. Even Zenith, the last television sets to be “Made in America,” are now made in South Korea by L. G. Electronics. But it really doesn’t seem to make that much difference to consumers.

### Why People Start Small Businesses

One cause of the explosion of new entrepreneurs is the current trend of today’s corporate professionals who leave their large companies to start their own businesses. The changing environment in large firms is leaving employees frustrated and uncertain about their future. Thus, they leave to find a better job or—as many are now doing—to start their own company, using the expertise they learned at the larger firm.

As these employees who go out on their own are aware, owning a small business provides an excellent opportunity to satisfy personal objectives while achieving the firm’s business objectives. Probably in no other occupation or profession is this as true. But there are almost as many different reasons for starting small businesses as there are small

business owners. However, those reasons can be summarized as (1) satisfying personal objectives and (2) achieving business objectives.

### Satisfy Personal Objectives

Small business owners have the potential to fulfill many personal goals. In fact, owning a small business tends to satisfy most of our work goals. According to a survey by Padgett Business Services USA Inc. ([www.smallbizpiros.com](http://www.smallbizpiros.com)), the best things about owning a small business are independence (cited by 72 percent of those surveyed), control (10 percent), satisfaction (10 percent), and other factors (8 percent). The worst parts of such ownership are the long hours (mentioned by 23 percent of respondents), taxes (22 percent), risk (17 percent), responsibility (17 percent), and other factors (12 percent).

Similar results were found in a study by the National Bureau of Economic Research in Great Britain, where 46 percent of the self-employed were “very satisfied,” versus 29 percent of those working for others. In the United States, the numbers were 63 percent versus 27 percent. Victoria Neal said, “It is our youth who’ve happened upon the realization that they would be a heck of a lot better off just working for themselves.”<sup>23</sup>

The personal objectives of owners of small businesses differ from those of managers of larger firms. Managers of large companies tend to seek security, place, power, prestige, high income, and benefits. By contrast, the primary objectives of small business owners are as follows:

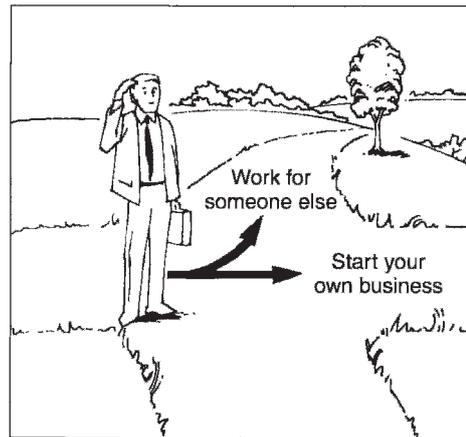
- Achieve independence.
- Obtain additional income.
- Help their families.
- Provide products not available elsewhere.

In summary, the personal objectives of small business owners tend to be achievement oriented, as opposed to those of managers of large firms, who tend to be power and prestige oriented. How these personal objectives are achieved depends on the knowledge, skills, and personal traits these owners bring to the business. A good checklist for aspiring entrepreneurs according to Duncan Cheatele of the U.K. includes these thoughts:

- Do it for passion not money.
- Do something you know about.
- Don’t give up too early.
- Have a mentor.
- Have appropriate funding.
- Be a good cash manager.
- Build sales first.
- Don’t try to rush.
- Be wary of bad advice or suppliers.<sup>24</sup>

**Achieve Independence** The new business owner’s primary motive is usually independence, that is, freedom from interference or control by superiors. Small business owners tend to want autonomy to exercise their initiative and ambition; this freedom often results in innovations and leads to greater flexibility, which is one of the virtues of small businesses. People who operate small firms know they are running a risk when they strike out on their own, but they hope to realize their goal of independence. In essence, owning your

**FIGURE 1.2 |**  
Which Road to Take?



own business provides a feeling of satisfaction that may be missing if you work for someone else. As you can see from Figure 1.2, this is the choice the prospective entrepreneur must make.

**Obtain Additional Income** Many people start a business to obtain needed income. This need obviously varies with different people in different life stages or situations. For example, a retired person may want to earn just enough to supplement Social Security payments and possibly provide a few luxuries. Such a person may be content with a business that provides a small supplement to retirement income.

On the other hand, owning a business can provide the opportunity to make a great deal of money and to take advantage of certain tax benefits. (You should consult your lawyers and tax accountants, though, to make sure you stay on the right side of tax laws, which have been modified to remove many of these benefits.) Not all small business owners and managers make a lot of money, nor do they all intend to.

As we said at the outset, people sometimes start small businesses after being unable to find employment elsewhere or after being discharged from a larger firm. Professional athletes, whose bodies are a wasting asset and who must retire early, often find a second career in small businesses they have formed. For example, Earvin “Magic” Johnson, the former Los Angeles Lakers star player, has invested in inner cities that have been ignored or abandoned by other entrepreneurs. His Magic Johnson Theaters have created at least 100 new jobs at each of their locations in Atlanta, Houston, New York, Ohio, and Los Angeles. His mission is “to revitalize the underserved communities.” The result has been one of the highest-grossing theater complexes in the nation. This group has now merged with AMC Entertainment, Inc., to create a combined total of 185 years of successful operations.

**Help Their Families** Small business owners are probably motivated as much by personal and family considerations as by the desire for profit. Students may return home to operate the family business so their parents can retire or take life easier. They may take over the firm on the death of a parent or form a business to help their family financially. According to a recent study, there are over 1 million women-led businesses generating in excess of \$300 billion in revenues, or about 3 percent of the U.S. Gross National Product ([info@nwbc.gov](mailto:info@nwbc.gov), 11/19/07). These companies play a big roll in providing flextime, allowing mothers to be “stay at home moms.”

**Objectives** are the goals toward which the activities of the business are directed.

**Profit** is the revenue received by a business in excess of the expenses paid.

The **profit motive** is expecting to make a profit as the reward for taking the risk of starting and running the business.

**Provide Products Not Available Elsewhere** The saying “Necessity is the mother of invention” applies to the beginning of many small firms. In fact, most American economic development has resulted from innovations born in small firms. Relative to the number of people employed, small firms produce two-and-a-half times as many new ideas and products as large firms. The first air conditioner, airplane, automobile, instant camera, jet engine, helicopter, office copier, heart pacemaker, foam fire extinguisher, quick-frozen foods, sliced and wrapped bread, vacuum tube, zipper, and safety razor—not to mention the first giant computer, as well as many other breakthroughs—either resulted from the creativity found in small companies or led to the creation of a new business, as the following example illustrates.

### Real-World Example 1.8

Lloyd Mandel recognized a need for more economical funerals. As most funeral homes began to offer more services, such as expensive seals and elaborate ceremonies, he identified a growing need for basic rituals. Mandel opened such a “funeral store” in a Skokie, Illinois, mall 12 years ago.

He was so successful that he was bought out by the huge Service Corporation International (SCI). He is now a regional vice president who does research and similar ventures for Service Corp.

### Achieve Business Objectives

One of the most important functions any business owner must perform is setting **objectives**, which are the ends toward which all the activities of the company should be aimed. Essentially, objectives determine the character of the firm because they give the business its direction and provide standards by which to measure individual performance.

Among the objectives that are important to a business are service, profit, social, and growth objectives. These objectives tend to be interrelated. For example, the service objective must be achieved to attain the profit objective. Yet profits must be made if the business is to continue to reach its social and service objectives. Growth depends on attaining both profit *and* social objectives, which are not necessarily incompatible.

**Service Objective** In general, the objective of a business is to serve customers by producing and selling goods or services (or the satisfactions associated with them) at a cost that will ensure a fair price to the consumer and adequate profits for the owners. Thus, a person who aspires to operate a small business *must set service as the primary objective—but seek to make a profit as a natural consequence*. The pragmatic test for a small firm is this: If the firm ceases to give service, it will go out of business; if there are no profits, the owners will cease operations.

**Profit Objective** **Profit** is the revenue received by a business in excess of the expenses paid. We expect a private business to receive a profit from its operations because profit is acceptable in a free-enterprise economy and is considered to be in the public interest. Simply stated, the **profit motive** is entering a business to make a profit, which is the reward for

**Social objectives** are goals regarding assisting groups in the community and protecting the environment.

taking risks. Profits are not self-generating, however; goods or services must be produced at a cost low enough to permit the firm to make a profit while charging customers a price they are willing and able to pay.

Profits, then, are the reward for accepting business risks and performing an economic service. They are needed to ensure the continuity of a business.

**Social Objective** As will be discussed further in Chapter 4, successful small businesses must have **social objectives**, which means helping various groups in the community, including customers, employees, suppliers, the government, and the community itself. Even small firms have a responsibility to protect the interest of all parties as well as to make a profit. Profit and social objectives are not necessarily incompatible.

**Growth Objective** Owners of small firms should be concerned with growth and should select a growth objective, which will depend on answers to questions such as “Will I be satisfied for my business to remain small?” and “Do I want it to grow and challenge larger firms?” and “Do I seek a profit that is only ‘satisfactory,’ considering my effort and investment, or do I seek to maximize profits?”

### Need to Mesh Objectives

Personal and business objectives can be integrated in a small business. In fact, there is often a close connection between profitability, customer satisfaction, manager satisfaction, and nonfinancial rewards. Also there is an increased chance of success when the objectives of the business—service at a profit—are meshed with the owner’s personal objectives.

### Characteristics of Successful Entrepreneurs

The abilities and personal characteristics of the owner(s) exert a powerful influence on the success of a small company. Also, the methods and procedures adopted in a small firm should be designed not only to offset any personal deficiencies the owner may have but also to build on his or her strengths.

A recent study found that almost one-third of all U.S. millionaires are entrepreneurs or business owners. And 57 percent indicate that the most important factors leading to their success were “being honest with all people” and “being well disciplined.”<sup>25</sup> Another characteristic of successful entrepreneurs is persistence. For example, the National Federation of Independent Business found that 16 percent of new business owners had been in business before. In fact, nearly 10 percent of them had had six or more operations.<sup>26</sup> Finally, even though the year 2000 was not a very prosperous time in the United States, nearly 1 out of every 10 Americans (9.8 percent) tried to start a business during the year.<sup>27</sup>

Entrepreneurship is not limited to the United States. In fact, the United States ranks second in the world. The top 10 best countries for entrepreneurs include

- |                  |                           |
|------------------|---------------------------|
| 1. New Zealand   | 6. Hong Kong              |
| 2. United States | 7. Britain                |
| 3. Canada        | 8. Ireland                |
| 4. Australia     | 9. Denmark                |
| 5. Singapore     | 10. Iceland <sup>28</sup> |

From these and many other sources, we conclude that the characteristics of successful owners of small businesses are that they

- Desire independence.
- Have a strong sense of initiative.
- Are motivated by personal and family considerations.
- Expect quick and concrete results.
- Are able to react quickly.
- Are dedicated to their businesses.
- Enter business as much by chance as by design.

### Desire Independence

As shown earlier in the chapter, those people who start small businesses seek independence and want to be free of outside control. They enjoy the freedom that comes from “doing their own thing” and making their own decisions—for better or for worse.

### Have a Strong Sense of Initiative

Owners of small businesses have a strong sense of initiative that gives them a desire to use their ideas, abilities, and aspirations to the greatest degree possible. They are able to conceive, plan, and carry to a successful conclusion ideas for a new product. This is not always true in a larger organization.

Another aspect of initiative usually seen in small business owners is their willingness to work long, hard hours to reach their goals. They tend to be capable, ambitious, persevering individuals.

### Are Motivated by Personal and Family Considerations

As shown earlier, small business owners are often motivated as much by personal and family considerations as by the profit motive. They start and operate their businesses to help their parents, children, and other family members. The flexibility afforded small business owners is a great advantage in planning family activities.

There now seems to be a trend toward children helping their parents—financially and otherwise—by putting them on their payroll. We will discuss this trend further in Chapter 2. This trend builds on the past practice of parents helping their children. As society enjoys longer healthier lives, many retirees are looking for new challenges and sometimes new careers.

### Expect Quick and Concrete Results

Small business owners expect quick and concrete results from their investment of time and capital. Instead of engaging in the long-range planning that is common in large businesses, they seek a quick return on their capital, and they become impatient and discouraged when these results are slow in coming.

### Are Able to React Quickly

Small businesses have an advantage over larger firms in that they can react more quickly to changes occurring both inside and outside the company. For example, one characteristic of a small business is its vulnerability to technological and environmental changes. Because the business is small, such changes have a great effect on its operations and profitability. A small business owner must therefore have the ability to react quickly. Also, we are experiencing a “Fifth” migration to new regions. These are bedroom communities within

commuting distance to large urban areas. Services follow these moves and create many needs such as house cleaning, day care, and transportation.

### Are Dedicated to Their Businesses

Small business owners tend to be fiercely dedicated to their companies. With so much time, energy, money, and emotions invested in it, they want to ensure that nothing harms their “baby.” Consequently, they have a zeal, devotion, and ardor often missing in managers of big companies.

### Enter Business as Much by Chance as by Design

An interesting characteristic of many small business owners is that they get into business as much by chance as by design. These are the owners who quite frequently ask for assistance in form of management training and development. This type of individual differs sharply from those who attend college with the ambition to become professional managers and who gear their programs toward that end.

#### Real-World Example 1.9

For example, 17-year-old Levi Strauss emigrated from Bavaria to America in 1847. After peddling clothing and household items from door to door in New York for three years, he sailed by clipper ship to California with a load of denim to make tents for gold miners. There was little demand for tents but great demand for durable working clothes, so the ever-adaptable Strauss had a tailor make the unsold cloth into waist-high overalls, called them “Levi’s,” and was in business ([www.levistrauss.com](http://www.levistrauss.com)).<sup>29</sup>

### What Leads to Success in Managing a Small Business?

Although it is difficult to determine precisely what leads to success in managing a small business, the following are some important factors:

- Serving an adequate and well-defined market for the product.
- Acquiring sufficient capital.
- Recruiting and using human resources effectively.
- Obtaining and using timely information.
- Coping effectively with government regulations.
- Having expertise in the field on the part of both the owner and the employees.
- Being flexible.

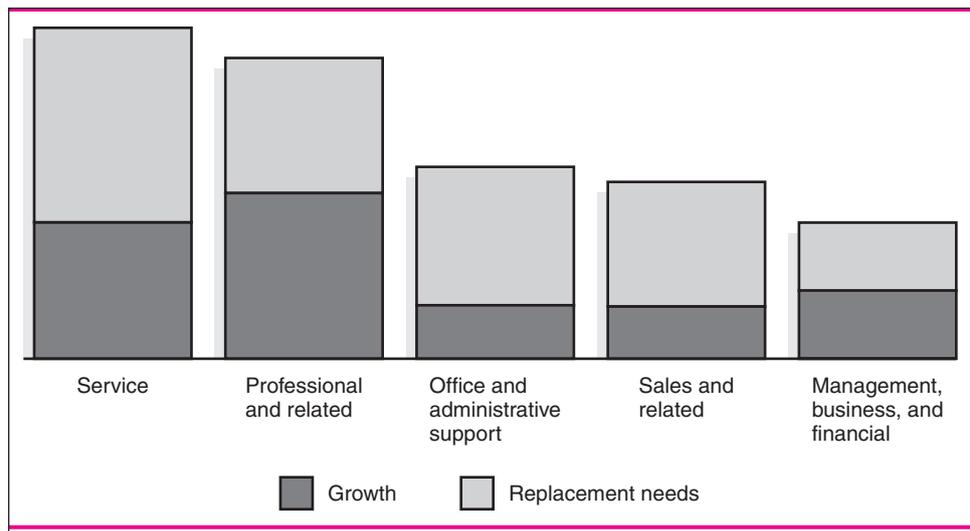
### Doing an Introspective Personal Analysis

Now that you have seen some characteristics of successful small business owners, do you think you have enough of those characteristics to be successful? The following personal evaluation will help you decide this important question. None of these items is more important than any other; rather, you need to determine whether the combination of qualities you have will help you succeed as a small business owner:

- Analyze your values.
- Analyze your mental abilities.
- Analyze your attitudes.

### FIGURE 1.3 | Where the New Jobs Will Be

*These industries are expected to produce the most new jobs by the year 2012.*



Source: U.S. Department of Labor, Bureau of Labor Statistics, [www.bls.gov](http://www.bls.gov), accessed May 5, 2004. Used by permission of the Bureau of Labor Statistics.

### Where Are the Opportunities for Small Business?

Up to this point, we have shown you the challenges of becoming an entrepreneur and explained the requirements for succeeding as the owner of a small business. Now it is time to explain what your opportunities are.

### What Are the Fastest-Growing Industries?

According to the Bureau of Labor Statistics ([www.stats.bls.gov](http://www.stats.bls.gov)), no industry is growing faster than services, and this trend is expected to continue well into this century. This trend is evident in both the number of new businesses being created and, as Figure 1.3 shows, in the number of new jobs being created. Most of the growing industries are dominated by small private companies. According to the SBA's Office of Advocacy ([www.sba.gov](http://www.sba.gov)), only construction and personnel/supply services tend to be dominated by larger businesses.

Service providing industries are expected to account for the 130,190 new jobs that will be generated through 2016. Education and health services are expected to be the fastest-growing segment. Health care and social assistance will grow by about 11.4 percent and add about 4.034 new jobs. ([www.bls.gov](http://www.bls.gov))

### Factors Affecting the Future of an Industry or a Business

Many changes are now occurring that will affect the future of an industry or business, and small business owners should study them intently in order to adjust to them. These changes can cause slow-growing industries to speed up or fast-growing ones to slow down. For instance, one recent study found that the more professional technicians or other "knowledge workers" an industry has, the greater the chance that it will create new jobs. The study defined such **high-knowledge industries** as those in which 40 percent or more of workers are high-knowledge workers.<sup>30</sup>

Another important reality to consider is that a change that provides an opportunity for one industry or business may pose a threat to others. For example, aging of the population may increase the need for retirement facilities but hurt industries supplying baby needs.

**High-knowledge industries** are those in which 40 percent or more of human resources are professionals, technicians, or other "knowledge workers."

**FIGURE 1.4** |  
Examples of Factors  
Affecting Industry and  
Business Trends

1. *Economics*—gross national product (GNP), interest rates, inflation rates, stages of the business cycle, employment levels, size and characteristics of business firms and not-for-profit organizations, and opportunities in foreign markets.
2. *Technology*—artificial intelligence, thinking machines, laser beams, new energy sources, amount of spending for research and development, and issuance of patents and their protection.
3. *Lifestyle*—career expectations, consumer activism, health concerns, desire to upgrade education and climb the socioeconomic ladder, and need for psychological services.
4. *Political-legal*—antitrust regulations, environmental protection laws, foreign trade regulations, tax changes, immigration laws, child care legislation, and the attitude of governments and society toward the particular type of industry and business.
5. *Demographics*—population growth rate, age and regional shifts, ethnic moves and life expectancy, number and distribution of firms within the industry, and size and character of markets.

Figure 1.4 shows some selected examples of factors that affect various industries and businesses. These factors will be discussed in Chapters 5 and 6.

### Some Practical Ideas for Small Businesses

Recent Bureau of Labor Statistics figures indicate that around 71 percent of future employment in the fastest-growing industries (such as medical care, business services, and the environment) will likely come from small businesses—and these are areas where small firms are quite competitive. One reason for this is that entrepreneurs tend to be innovative and to develop new ideas. Some innovative ideas currently being developed, such as the following, could lead to the big businesses of tomorrow:

- Career counseling.
- Catering.
- Computer and office machine repair.
- Day care.
- Educational services and products.
- Financial planning.
- Home health care.
- Marketing, promotion, and public relations.
- Senior fitness and recreation.
- Specialized delivery services.

#### Real-World Example 1.10

For example, Cuisine Express ([www.westchestermenus.com/cexpress/index.html](http://www.westchestermenus.com/cexpress/index.html)) provides fast, effective home or office delivery of meals from 40 restaurants in Westchester County, New York. Customers choose the restaurant and meal they desire and place an order with Cuisine Express's operator or via the Internet. The meal is ordered from the restaurant. A driver then picks it up, delivers it, and collects payments by cash, Visa, MasterCard, American Express, Discover, or Diner's Club.

### Some Areas of Concern for Small Business Owners

So far, we have indicated that opportunities abound for anyone with a good idea, the courage to take a chance and try something new, and some money to invest. That's what small business is all about. But, as shown in this chapter, the success of smaller firms tends to be limited by factors such as inadequate management, shortages of capital, government regulation and paperwork, and lack of proper recordkeeping. Two other concerns are poorly planned growth and the threat of failure.

#### Poorly Planned Growth

Poorly planned growth appears to be a built-in obstacle facing many small businesses. Clearly, if the owners are incapable, inefficient, or lacking in initiative, their businesses may flounder and eventually fail, or if the owners are mediocre, their businesses remain small. However, if the owners are efficient and capable and their organizations succeed and grow, but in a poorly planned way, they risk losing the very things they seek from their companies.

For instance, as small businesses succeed, their owners may begin to feel trapped. Instead of feeling on top of the world, they feel like prisoners of long hours and hard work. Todd Logan, who owned and operated a publishing and trade show company, cites five core symptoms that entrepreneurs must understand and change if they are to deal with this syndrome:

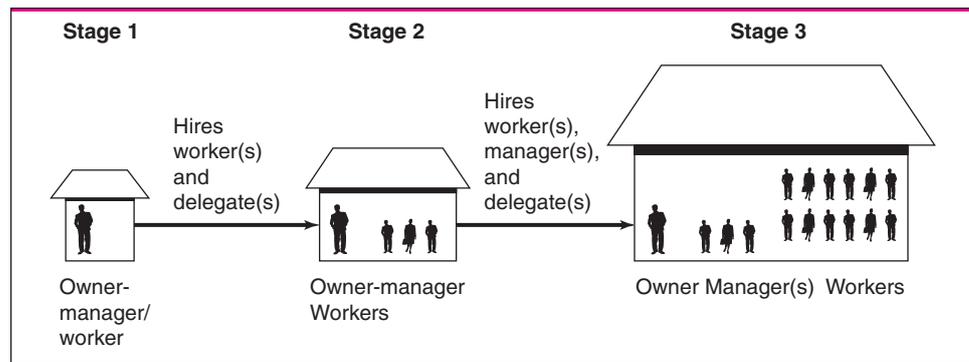
1. Despair over the loss of closeness in important personal relationships.
2. Unshakable anxiety despite accomplishments.
3. Anger toward family, employees, and customers.
4. Frustration that the lack of significant current progress is preventing forward movement.
5. The paradox itself: You own your business, yet you don't enjoy it.<sup>31</sup>

**Loss of Independence or Control** With growth, owners must please more people, including employees, customers, and the public. There are new problems, such as hiring and rewarding managers and supervising other people, exercising the very authority small business owners may resent in others.

Many otherwise creative entrepreneurs are poor managers. They can generate ideas and found the business but are unable to manage it on a day-to-day basis. If the firm becomes large enough to require outside capital for future success and growth, the owner may lose control over the company.

**Typical Growth Pattern** Historically, the ownership and management of small businesses have tended to follow a growth pattern similar to that shown in Figure 1.5. During stage 1, owners manage the business and do all the work. In stage 2, the owners still manage their companies but hire employees to help with routine and/or management activities. In stage 3, the owners hire managers to run the firms. The length of service of professional managers (as opposed to owner-managers) in small businesses tends to be relatively short; they move from one company to another as they progress upward in rank and earnings. Often, owners must give managers a financial interest in the business to hold them. Thus, the business takes on the form, the characteristics, and many of the problems of a big business. If entrepreneurs plan poorly, and fail to foresee these growth patterns, they may run into trouble.

**FIGURE 1.5 |**  
Stages in the  
Development of a  
Small Business



A **discontinuance** is a voluntary decision to terminate a business.

A **failure** results from inability to succeed in running a business.

**Formal failures** are failures ending in court with loss to creditors.

In **personal (informal) failures**, the owner who cannot succeed voluntarily terminates the business.

**Business incubators** nurture young firms and help them to survive and grow during the startup period when they are most vulnerable.

### Threat of Failure

The threat of failure and discontinuance is a reality for many small businesses. A **discontinuance** is a voluntary decision to quit. A discontinuance may result from any of several factors, including health, changes in family situation, and the apparent advantages of working for some else. A **failure** results from inability to make a go of the business; things just do not work out as planned. There are two types of failure: (1) **formal failures**, which end up in court with some kind of loss to the creditors, and (2) **personal (informal) failures**, where the owner cannot make it financially and so voluntarily calls it quits. Personal failures are far more numerous than formal ones. People put their money, time, and effort into a business only to see losses wipe out the investment. Creditors usually do not suffer, as the owners tend to absorb the losses. The owners are the ones who pack up, close the door, and say “That’s it!”

Studies of the behavior of people who choose careers in small business show that, all too often, discontinuance or failure results from one or more of the following weaknesses: (1) too much was left to chance, (2) too many decisions were based on a hunch or intuition, (3) crucial obstacles went unnoticed for too long, (4) the amount of time and/or physical effort demanded of the small business manager was not recognized and/or planned for, and (5) the amount of capital needed was either not estimated or grossly underestimated.

Underestimating the difficulty of business startups is one of the most common roads to disaster. Some say failure is usually caused by

- lack of managerial experience
- lack of financial backing
- poor location
- unexpected growth
- communication skills.

One source to help avoid startup disaster is the National Business Incubation Association (NBIA). **Business Incubators** nurture young firms and help them to survive and grow during the startup period when they are most vulnerable. Hands-on management assistance, access to financing, and orchestrated exposure to critical business or technical support services are provided. Incubators offer entrepreneurial firms shared office services, access to equipment, flexible leases, and expandable space—all under one roof.

The main goal of an incubation program is to produce successful graduates, that is, businesses that are financially viable and freestanding when they leave the incubator. While the usual incubation period is two to three years, 30 percent of incubator clients typically graduate each year.



Tom Segwald, Director  
Center for Entrepreneurial  
Excellence.

In 2006 there were more than 35,000 incubator startups that provided full-time jobs for nearly 82,000 workers in North America. These companies generated annual earnings in excess of \$7 billion. Today there are about 1,400 business incubators: 60 percent are self-sufficient; others are subsidized. In 1997 only 13 percent could stand alone. Incubators in 2007 had about an 80 percent success rate. It is also interesting to note that 84 percent of incubators are not-for-profit organizations. Incubators are sponsored by academic institutions, government, economic development organizations, and for-profit entities (Source: [www.niba.org](http://www.niba.org)).

The Center for Entrepreneurial Excellence ([www.ceeibic.org](http://www.ceeibic.org)) operates in a former school building. The classrooms are perfect for startup businesses and large

meeting rooms. It is a community partnership with the city, county, and chamber of commerce. It provides secretarial support, office equipment, on-premises business consulting, classes and seminars, conference and classrooms, shipping services, and graphic design with flexible rental space and controlled overhead.<sup>32</sup>

While looking for data on failure rates and trends in failure rates, the latest available information seems to indicate a decrease. The data available are sketchy at best due to the lack of consistent collection vehicles. For example, many hobbyists, mom-and-pop ventures, and other small undertakings open and close every day without any documentation for tracking their success or failure rate. Many fail to consult with the Small Business Administration, obtain licensing, or report results to the Internal Revenue Service, which makes tracking the nonsurviving entities next to impossible.

## What You Should Have Learned

1. Defining *small business* is difficult because the definition of smallness varies widely. In general, a small business is independently owned and operated and is not dominant in its field of operation. It is difficult to draw a clear distinction between a *small business* and an *entrepreneurial venture*, as the distinction depends on the intentions of the owners. If they start a small business and want it to stay small, it is a small business. If, on the other hand, they start small but plan to grow big, it is an entrepreneurial venture. Although small businesses generate only 12 percent of the total receipts each year, according to the IRS, around 96 percent of U.S. businesses are small, and firms with fewer than 500 employees account for 80 percent of existing jobs.
2. Small firms differ from larger ones in many ways, but their unique contributions include (a) flexibility and room for innovation; (b) the ability to maintain close relationships with customers and the community; (c) the competition they provide, which forces larger companies to remain competitive; (d) the opportunity they give employees to gain experience in many areas; (e) the challenge and freedom they offer to risk takers; (f) the employment opportunities they generate; and (g) the job satisfaction they provide.
3. Some current problems that plague small companies more than larger ones—and limit their development—are (a) inadequate financing, (b) inadequate management (especially as the firm grows), and (c) burdensome government regulation and paperwork.
4. Some current trends challenging small businesses are (a) exploding technology, (b) occupational and industry shifts, and (c) the move to global operations.

5. People start businesses for many personal and business reasons. While income is an important consideration, the primary reason is to achieve independence. The need to exercise initiative and creativity also leads entrepreneurs to take the risk involved in striking out on their own. Many small business owners are also motivated by family considerations, such as taking over a family business to permit parents to retire or starting a family business to have more time with their families. Also, some people start businesses chiefly to provide a product or service not readily available elsewhere. Finally, some entrepreneurs start businesses to achieve business objectives such as providing services to their customers; making a profit; providing social benefits to society; and growing into large, profitable organizations.
6. The characteristics most typical of the more successful business owners are that they (a) desire independence, (b) have a strong sense of enterprise, (c) tend to be motivated by personal and family considerations, (d) expect quick and concrete results, (e) are able to react quickly to change, (f) are dedicated to their businesses, and (g) often enter business as much by chance as by design.
7. There are many opportunities for prospective small business owners, especially in eating and drinking establishments, offices of health practitioners, and nursing and personal care facilities. The best opportunities are found in small firms, limited in scope, that involve long, hard hours working to satisfy basic human needs.
8. Poorly planned growth and the threat of failure should concern small business owners. Failure to grow can mean the death of a business, but poorly planned growth and the failure to foresee the stages of growth a typical company may go through can also pose a real problem.
- Some businesses discontinue for health, family, or other personal reasons, while others fail. Although relatively few failures are formal failures, personal failures resulting from unprofitability or general discouragement can be just as devastating for small business owners.

## Key Terms

- |                              |                                  |                          |
|------------------------------|----------------------------------|--------------------------|
| business incubators •••      | formal failures •••              | profit motive •••        |
| discontinuance •••           | high-knowledge industries •••    | reengineering •••        |
| downsizing (rightsizing) ••• | objectives •••                   | reinvention •••          |
| entrepreneur •••             | personal (informal) failures ••• | small business •••       |
| entrepreneurial venture •••  | profit •••                       | small business owner ••• |
| failure •••                  |                                  | social objectives •••    |

## Questions for Discussion

1. Do you agree that this is an interesting time to be studying small business? Why are you doing so?
2. How did you make out with the self-test in Figure 2.3? Do you think the results accurately reflect your potential? Explain.
3. All of us have had personal experiences with small business—as an owner, employee, friend, or relative of an owner, or in other relationships. Explain one or more such experience(s) you have recently had.
4. What comes to your mind when you think of a small business? How does your concept differ from the definition given in this chapter?

5. Distinguish between a small business and an entrepreneurial venture. If you were to start your own business, which would you wish it to be? Why?
6. How do you explain the growing interest young people have in small business? Relate this to your personal small business experience.
7. What are the unique contributions of small businesses? Give examples of each from your own experience of owning or working in a small business or from small businesses that you patronize.
8. What are some problems facing small businesses? Again, give example from your experience.
9. Discuss the four personal objectives that people seek when starting a new business.
10. Explain the interrelationship between the *service* and *profit* objectives.
11. How does success cause concern for small businesses? Can you give examples from your experience or suggest ways to avoid the problems of growth?

## Case 1.1

### The Big Wash

Henry Gibson, a 68-year-old retired file clerk, enjoyed sitting on his front porch on Belmont Street in Washington, D.C., on summer evenings watching his neighbors go by. But the sight of them lugging their laundry to two coin-operated laundries a half-mile on each side of him—one uphill, one downhill—caused him distress. With no business education or experience, nevertheless he had an idea: Why not start a laundry in the neighborhood?

Gibson knew he could not do this alone, especially raising the \$250,000 needed to set up a good-sized coin laundry business. So he sought the help of Reuben McCornack, an adviser with Hope Housing, a nonprofit group located in the same block. Together they formed the Belmont Investment Group (BIG) and started selling 300 shares at \$100 per share. Many investors came from the Community of Hope Church, where Gibson is an usher. Two shareholders sing in its choir. Some bought only one share, while others bought up to 50. (One neighbor invested his life's savings in 50 shares.)

Once the two men had sold 600 shares (\$60,000), McCornack raised \$60,000 in grants from seven foundations. With this backing, the two men were able to get a loan from a local bank and a District of Columbia government agency for a total of \$300,000.

The Big Wash (the "Big" comes from the initials of their investment group) opened during the summer of 1995 in a well-designed and refurbished building on the same block where Gibson lives. (Even with its inner-city location, but without bars or a roll-down iron fence, the place had not been robbed or vandalized by early 1998.) The laundry has much going in its favor, especially the official criterion for success, according to the Coin Laundry Association: a densely populated neighborhood, with lots of kids and renters.

With 30 washers, 28 dryers, and 8 staff members—four of whom are paid attendants—operating from 7 A.M. to midnight, Big Wash usually grosses over \$20,000 a month. This puts it in the top ranks of all the 35,000 self-service coin-operated laundries in the United States, which gross between \$15,000 and \$300,000 a year.

Since its opening in 1995, each of the laundry's shareholders has received \$175 back on his or her \$100 investment. For most of them, this is the first experience receiving dividend checks, which are issued quarterly by the investment group.

## Case 1.2

**Questions**

1. Evaluate Henry Gibson's approach to starting a new business.
2. Could there have been another source of funding? Explain.
3. How do you explain the fact that Big Wash has not been robbed?

Source: Prepared by Leon C. Megginson from various sources, including "Odds and Ends: It Took a Laundry to Clean the Area," *Mobile (Alabama) Register*, February 13, 1998, p. 2A. Used by permission of Newhouse News Service.

**The American Dream**

Ugo and Gina Benincasa own and operate a small upscale hotel and restaurant in Lexington, Virginia. The both immigrated to the United States from Italy in the early 1960s.

Several years ago Ugo renovated an historic building on Main Street in Lexington and opened an Italian restaurant. After a few years he and his wife had the opportunity to purchase the old abandoned livery stable across the street. The old circa 1887 structure was refurbished and converted into a small upscale hotel with nine rooms and three suites.



Interestingly, the original builders of the livery were also immigrants; they were from Ireland.

The restaurant, outdoor café, and lounge are housed in the rear of the hotel overlooking an open courtyard with a beautiful overhead vista of the local mountains. It also has a large banquet room for special occasions and meetings. Frankie Benincasa, who is Ugo and Gina's son, is the head chef. The restaurant features lunch and dinner seven days a week and has a varied menu of appetizers, soups, salads, and entrees to satisfy all tastes. A continental breakfast is served to guests of the Inn.

The Sheridan Livery Inn is truly the culmination of the American Dream. It is a successful small business that is family owned and operated. The Benincasa family work hard and give meaning to the phrase “24/7.” As natives of Italy, they have felt the effects of cultural diversity. Mr. Benincasa attributes his success to hard work and a policy of political un-involvement.

It is located in the heart of the historic district and within walking distance of Washington and Lee University and Virginia Military Institute.

Mr. Benincasa believes that small business is a “spider web” and can fall down at the whim of big business. He also believes that the American Dream is diminishing.

#### Questions

1. Do you believe in the American Dream? Why? Or Why not?
2. Do you think ethnicity is still a problem for small business owners in the mainstream? Why? Or Why not?

Source: Interviews and correspondence with the Benincasa family, October 2007.

## Experientials

1. Ask your professor to plan a trip to the nearest business incubator. If you do not have one nearby, go to the chamber of commerce and inquire about startup facilities.
2. Talk to your fellow students and see what services are needed on your campus.