BUSINESSES BUILT TO LAST: HERE'S WHAT THEY LOOK LIKE

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A recent Statistics Canada report on successful new businesses contains some important insights for small business owners on what it takes to build a business that survives and prospers.[1]

In the spring of 1996 Statistics Canada surveyed firms that had commenced operations between 1983 and 1986 and were still in business. About 4,000 firms were surveyed. Eighty per cent responded. What makes this group of survivors particularly interesting is that they opened for business in the height of a boom and managed to survive a particularly nasty crash.

The survey was designed to try to find out why some firms prosper and grow when so many new businesses do not succeed. The study is not as useful for that purpose as it might first appear. After all, while the study tells us what the survivors are like today, it does not tell why these companies survived or why 80% of their compatriots are know longer around.[2] However, the study does tell us what a business built to last looks like ten years after starting up, and how the most successful businesses in the group are different from the rest of the pack.

The Survivors

As you might expect, only 20% of the new businesses begun in the mid-eighties are still around in 1996. This survival rate was roughly the same across all industries.

Ten years later the typical survivor is relatively small and stable. They average nine employees and $1.2 million in annual sales. They are still being managed by the same people who started them (84% for small companies and 65% for larger companies), and these managers held equity in the company itself.

By and large they do not have formalized business plans. They overwhelmingly rely upon the domestic marketplace, with only 3% of their combined revenues coming from outside Canada. They focus on keeping existing customers, avoid third party distributors, and are not particularly innovative. About 50% of their capital is permanent capital, consisting of retained earnings or shareholder investment.

While successful to the extent that they have survived and are stable, their average growth rate is only 6.6% per year. However, this is not unusual for owner managers, many of whom do not have ambitions to grow their firms or to accomplish much more than earning a good living while maintaining their independence, sense of control and freedom.

On the other hand, 2% of the survivors (or 0.4% of the original group) have grown to more than 100 employees. This group is interesting because it is possible to isolate the characteristics of the "over achievers" from the rest of the group.

The Over Achievers

According to the data resulting from this study, the key to higher growth in smaller businesses is investing in two areas which slower growth firms do not emphasize to the same extent: innovation and human resources. This is reflected in numerous statistically significant differences between ordinary survivors and over achievers, including:

- faster growing firms have more aggressive marketing strategies, including attacking foreign markets and using third party distributors
- faster growing firms are less focused on price of or customer service, they appear to try to build market strength on product rather than on a combination of price and service
- in mature markets their product strategy is more likely to be built around developing and maintaining a wide range of related products
- in new markets, their product strategy is more likely to be focused on developing a constant stream of new products
- in both cases they are more likely to have a product strategy involving customization of product for individual customers
- faster growing firms place more emphasis on using information technology
- faster growing firms place more emphasis on investing in research and development
- faster growing firms pay significantly more attention to human resources, including hiring skilled workers and training
- faster growing firms are more likely to have incentive compensation plans for their employees
- faster growing firms are more likely to have multiple sources of financing, have a higher percentage of permanent capital (retained earnings, equity investment) in their companies, and are more likely to invest their permanent capital in financing the acquisition of "knowledge assets".

In summary, faster growing firms out perform slower growing business in all areas, but emphasis on innovation and human resources appears to be the key difference their management team brings to the table.

More on Innovation

If you want to bring more of an "innovative" culture to your business, there are some things you can do. This study revealed some telling differences between innovative businesses and non innovative businesses:

- innovators see their market as more competitive and less predictable - whether their markets are truly more competitive is not as important as the fact that they see it that way, and that they do not feel a sense of security or complacency
- innovators see great competition in their market for product development, while non innovators see client service as the most significant competitive issue they must face
- innovators place more emphasis on product development, while non innovators place greater emphasis on price and client service

- innovators are more likely to invest in research and development, technology, market development and training
- innovators have a more flexible financial structure, including more sources of capital and more permanent capital (retained earnings, shareholder equity)
- innovators place more emphasis on business planning, and are more likely to have both a business plan and a financial plan
- innovators also place greater emphasis on monitoring all performance criteria, including market share, total company value and operating criteria, while non innovators are more likely to focus on traditional income statements and cash flow reports.

Conclusions

Growth for growth's sake is a common recipe for disaster. For most of us who do not desire the challenges of managing a high growth business the formula is again reconfirmed: stick at it, stay committed, run it yourself, do not over lever your financial resources, keep the business small enough that you can manage almost everything and everyone yourself, do business in your local market, stay away from being an innovation leader, have a strong client focus including good client relationships, sell direct to your clients, have a good understanding of your industry, hire good people and reward them modestly well, keep a strong eye on the profit and loss statement, and monitor your cash flow.

On the other hand, for those of us looking for bigger rewards, the guideposts for success require innovation and human resources, which means significant investment in technology and people, and trying to juggle the push for new products and product development while not losing existing clients and customers along the way. We must try to utilize a variety of financing methods, must manage our balance sheets and key operating indicators as much as our profit and loss statement, must be willing to attack foreign markets and use third party distributors, and, as the business grows, must plan to bring in professional managers, delegate, train, and let go of the constant need to have a finger in every pie. As is always the case in business, the risks will be greater, but hopefully the rewards will follow.

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1. ***Successful Entrants: Creating the Capacity for Survival and Growth***; Joanne Johnson, John Baldwin, Christine Hinchley; Statistics Canada, 1997; Catalogue no. 61-524-XPE; Price $35.00 Canadian; Order line 800-267-6677 or 613-951-7277 or fax 613-951-1584 with credit card information.

2. For more on this subject you should consider reviewing another Statistics Canada study: ***Failing Concerns: Business Bankruptcy in Canada***; Catalogue no. 61-525.