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Business Failure and the Lottery Syndrome: A Note

Paul E. Adams

I. INTRODUCTION

The failure of a business touches many people: employees who lose their jobs, suppliers of goods and services that extended credit, investors who hoped to make a profit, and the most dramatically effected; the entrepreneurs. Many former owners of defunct businesses will struggle for years afterward in debt to creditors, lenders, and the Internal Revenue Service. Many will have lost not only their business, but their homes, personal possessions and their savings.

Perhaps, even more upsetting to the failed entrepreneur, will be the possible disruption of a marriage, the loss of self confidence, and the general sense of failure as an individual. The failure of a business may be even more tragic than divorce.

Consider this; you are reading your paper one morning and you spot the following ad: "Wanted 100 people to take a chance for possible fame and fortune. Guaranteed winners. Here is all you do to participate:

1. You must have a minimum of $100,000.
2. You may borrow against your home or cash in your savings.
3. You must give up your job as you will not have time to work.
4. You must be prepared to lose everything.

Great odds:

5. Of the 100 participants, 20 will be winners.
6. Of the 20 winners, 18 will win enough to cover their expenses and receive a modest income.

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7. The remaining two winners will earn substantial sums and possible fame.

Please note: the 80 participants who lose, will lose everything and may be liable for future penalties."

I doubt if you would answer such an advertisement. You may even wonder why anyone would even consider such a gamble. To risk all you have, with only a two percent possibility of winning, may cause your friends and family to consider you insane. Yet, the odds offered in the "ad" are precisely the odds of success in starting your business. Eight out of 10 new business ventures fail and only two out of 100 new businesses become successful enough to earn the investors and entrepreneurs substantial rewards. Most small businesses that do survive; remain small businesses, earning the founders a modest income.

There is an alarming rate of small business failure in the United States, ultimately traced to ineffective management, according to Gobeli and Seville (1991). The authors surveyed 148 small businesses and found poor management the main factor in small business failure.

Angela Morgan (1990) stressed that small companies find it more difficult to survive during economic downturns than larger firms as management seems less able to cope with decreased sales due to the absence of "belt tightening" experiences.

The *Journal of Small Business Management* published a study by Stephen Haswell and Scott Holmes (1989), which concluded that:

> There seems to be a reasonable consensus within the literature that the main causes of business failure are management incompetence and inexperience.

If the odds are so much against success, why do so many of us throw caution to winds and rush to risk everything in hopes of "scoring big"? We read about fame and fortune every day, we are told this is the age of the entrepreneur, we are reminded of the riches that await us if we succeed. But, we know only the success stories; the business failures are not presented to us as examples to avoid. In fact, business failure is rarely discussed or written about unless it is a major company with thousands of stockholders and employees. The small manufacturing company with 10 employees that fails is of little consequence, except to those directly effected. If this is the age of

the entrepreneur, then it is best not to focus on the failure; but consider only the winner, lest you frighten away the eager and potential new business owner.

Perhaps, failed entrepreneurs may have been a bit more cautious if they had realized the risk factor. No one goes into business with the thought of failure. Fear may exist, but never failure. It will be the other person who shall fail as we are all invincible. Auto accidents happen to other people, and our friends lose their jobs, not us. We don't purchase lottery tickets with the understanding we shall lose. If we did we would not take the chance. We all believe ourselves to be winners. After all, misfortune is for others, not us.

If the possibility of failure is so common, should we understand why so many business start ups never make it beyond the second year of existence? I think so.

It is always those external forces, such as: market conditions, competition, lending policies of the banks, etc., that account for the failure of a new business, not the owner, as many a failed entrepreneur will tell you. Yet it is precisely the personality of the entrepreneur that is responsible for most failures. Sharon Nelton (1992) states that:

> The 10 biggest threats to the success of a business are: not knowing how to manage or operate a business, lack of money, growing too fast, poor interpersonal relationships, lack of planning, failure to innovate, trying to be independent, poor communications, failure to understand weaknesses, and failure to respond to criticism.

With the exception of the "lack of money", Nelton's list of threats to success suggest personality problems are the cause of failure; not external economic forces.

A would be entrepreneur will bring to the new organization their personality and character, with all their respective problems and weaknesses. If an individual is disorganized in life, that disorganization will carry forth to the business. Poor personal habits will become poor business habits. The lack of discipline in daily living will be an undisciplined management style. Procrastination at home will translate to procrastination on the job. As psychology is quick to point out, wherever we go we take ourselves, with all our baggage.

Many failed small business owners are obsessed with the trappings of success, but not with the effort to create lasting achievements. They believe in shortcuts to prosperity. What I call the "lottery syndrome"—little effort big reward. To have a small successful business does not create the image they wish to portray. They are not interested in small steady growth with future rewards, but immediate gratification that all can readily see, equating success

with showmanship and recognition. Impatience, envy, and ego enhancement work against any possibility of success.

Also, many confuse dishonesty with business smarts, taking advantage of others is what successful businessmen do to stay ahead, not recognizing that business relationships are built on trust, not deceit. Any management guru will agree that a business deal must be profitable for all parties if it is to be successful and conflict free. You cannot view business deals as an extension of gambling with winners and losers, but rather as an arrangement where all players win.

Years of teaching management have taught me that too many students believe successful business people are not honorable, but clever, conniving and dishonest. Many outright believe you can not be successful and truthful. Authors and playwrights have done a marvelous job of creating the fictitious tycoon or mogul, who is hard driving, ruthless, ambitious, and always looking to take advantage of those he or she deals with. Not much of a role model for the would be entrepreneur.

Recently, *Forbes* interviewed 50 founders from their 1992 list of the 200 Best Small companies and found that the most successful entrepreneurs seem to share the following traits:

1. Self-confidence: The ability to overcome fear of failure and inspire confidence in customers, investors, and associates.
2. Persistence: Remaining inwardly optimistic and not shattered by frequent turndown.
3. Resilience: The inner strength to return after suffering frequent defeats.
4. Vision: The ability to see where the company should go and how it should get there.
5. Independence: Getting satisfaction from being responsible to oneself and not to superiors.
6. Daring: The ability to evaluate risk and not be afraid of it.

A significant number of new business failures can be traced to the fact that the founder(s) missed the mark on many of these traits required for success. They may not have inspired confidence in anyone, including themselves. They may have been easily upset by problems. They may have had difficulty in maintaining any internal optimism with no clear vision or realistic goals. Lastly, they may have succumbed to wishful thinking and the need for instant gratification with the material trappings of the business; thus creating an emotional foundation for failure.

Too few would-be business owners consider the ramifications of failure and the slight chance of success, as they blindly pursue what may be an unrealistic dream.

> A failure is a man who has blundered, but is not able to cash in the experience.
> —Elbert Hubbard.

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Entrepreneurship Theory: Possible Contributions to Small Business Finance

Rassoul Yazdipour

These are summary papers originally presented at the Fifth Annual Small Firm Financial Research Symposium, April 29–30, 1993 in Long Beach, CA.

I. INTRODUCTION

It is no secret that the modern theory of the firm—and naturally the modern theory of corporate finance—has almost completely neglected the existence of the entrepreneur and its vital role in any meaningful form of economic analysis. Such conscious omission, no doubt, has helped our profession to make monumental inroads in understanding and solving the problems of the large publicly-held company. However, this has also disallowed us to understand and analyze the numerous problems faced by the small, privately-held firms. The theoretical vacuum becomes even more noticeable when we consider the structural and technological changes that have especially taken place over the last decade or so. Today, entrepreneurial ventures are the driving force in the U.S. economy and elsewhere. With new technological breakthroughs, emergence of new industries and the restructuring of old ones, as well as the obvious trend towards a service/information oriented economy, the need is greater today than any other time to shift the attention towards the small privately-held firm.

Given the new technological realities and the advent of the "Virtual Corporation", the entrepreneur is being brought back into the picture in all areas of economics and finance. Consequently, theories that give the entrepreneur the deserved central role are back in vogue. As a matter of fact, major steps toward building theories of small business finance have already started.

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II. THE PURPOSE AND THE OUTLINE

The present research pursues two main objectives. The primary goal is to bring to the attention of the finance theory builder and empiricist the expansive developments that have taken place over the years in the now fast-growing field of entrepreneurship and venture creation. This is an attempt to refocus the attention on the "central figure in economics"—the entrepreneur. The secondary objective is to attempt to provide a framework and a sketch of what an entrepreneurship-based theory of small business finance might look like. This involves attempts to distill, synthesize and integrate theories across the two areas of financial economics and entrepreneurship.

Given the numerous definitions, concepts, theories, and models in the field of entrepreneurship, identifying and successfully defending a theory as the basis for the intended integration would be a challenge by itself. However, the consensus now seems to center around Schumpeter's theory—and generally the Austrian Theory of Entrepreneurship (Cheah, 1990; Gibson, 1992; and Kirchhoff, 1992). On the finance side, the leading works by Ang (1991, 1992) and Petty and Bygrave (1993) have set the stage for developing new concepts, frameworks, theories, and empirical works in the area.

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