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Starting and Succeeding In Your Own Small Business

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**Starting and Succeeding
In Your Own
Small Business**



I once made a bet that every successful small businessman had received support and encouragement at home, that his family was very much involved in his small business and that, if asked, the small businessman would affirm it. I lost the bet because I wagered with a friend who loves to make me lose; he found a successful small businessman who was an orphan and a bachelor. Well, that's the trouble with making a bet.

Most small businessmen (to satisfy the doubting Thomases) must have a family life that provides them with part of the sustenance they need and will not find at work; affection, understanding, sympathy, encouragement and a place to relax. These things are usually provided by their wives, and it is they who are many times the unsung heroes of success in small business. They should be, because when they send their man out in the morning, they must keep his home for him while he fights his way. His successes may make life easier for them, but it is the wives who also pay the price during the lean years.

So I dedicate this book to all the wives of all the small businessmen out of respect for their quiet courage and their sacrifices—and to my own dear wife Nan.

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Small business is an important, essential, integral part of our economic system. There are over four and one-half million small firms in this country representing 95 per cent of all American business concerns, and employing over one-half of all employed persons. In the manufacturing area, assuming "small" means a company with fewer than 100 employees, 94 per cent of all manufacturing companies are small; these employ 21 per cent of all manufacturing employees. If the definition is broadened to include companies with 500 employees, 99 per cent of all manufacturing companies are small and employ 40 per cent of all manufacturing employees.

In spite of dire predictions that it cannot compete in a world of giants, there is strong statistical evidence that small business is here to stay. Although hundreds of thousands of small firms disappear each year for one reason or another, other hundreds of thousands are formed to take their place; and the net result is an average increase of about 50,000 small firms per year in the United States. Several scholarly studies have come to the conclusion that although the situation varies somewhat from year to year, the relative position of small business in the American economy has remained fairly constant since about 1900, whether measured in percentage of total number of companies, assets employed, or total income.

Although we speak of "small business" as a collective noun,

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it should be remembered that the phrase covers infinite variety, a hodge-podge in a state of flux, including both the one-man fruit stand on the corner and the sophisticated manufacturer of high technology items for the space program. There is also wide variation, much more so than among large companies, as to profitability. At one end of the spectrum are numerous weak firms, poorly financed, poorly managed, and of doubtful viability. If, however, we examine the well managed, successful segment we find a quite different picture. We find companies that are not only participating fully in our dynamic economy but contributing to progress and a higher standard of living. Some are generating important parts of our continuing technological revolution; many are at the leading edge of technological advance. Small companies are well represented among firms with the highest growth rates and firms with the highest return on invested capital.

If we compare small company results with those of large companies we find that generally a higher percentage of small companies than of large ones are unprofitable. Approximately 85 per cent of failures are small companies. Of all companies showing losses the evidence indicates that the smaller the company, the greater the loss as a percentage of equity. On the other hand, of all companies showing a profit, the small companies show a higher return on investment than large ones. The least profitable small companies do worse than the least profitable large companies, and the most profitable small companies do better than the most profitable large ones. The profitability of small companies as a group fluctuates more than that of large companies between good times and bad, and shows a greater dispersion within the category as to profitability at any one time. The point of all this statistical analysis seems to be that in spite of the notoriously high infant mortality and well publicized financial difficulties of small firms, the well managed segment produces favorable and satisfactory results.

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These results suggest that there are attractive opportunities to invest in and manage small businesses. The figures also show that in spite of a very high turnover within the area, small business as a whole shows remarkable vitality and a persistent hold on its position in the economy. In my opinion, there are two important reasons for this healthy ability to endure. Small business fills essential economic needs, and also fills essential personal needs.

As to economic needs, it was mentioned earlier that several hundred thousand small businesses disappeared each year. Only a small percentage are actual failures. Mergers and acquisitions absorb many. A large number are sufficiently successful to outgrow the "small" category. There are many voluntary liquidations, for a variety of reasons. Many corporations serve a temporary purpose. Age, sickness, death, or just discouragement cause many proprietors to close up shop. Small retailers, wholesalers, manufacturers may find that a continually changing economy has reduced or eliminated their economic justification for continuing in business, even though the economy as a whole and their industry may be thriving.

While weakening or disappearing in some areas, small companies spring into life in others: motels, drive-in movies, slot machine laundries, franchise operations, service industries, and many types of manufacturing. For every new industrial development or scientific program (space, computers, nucleonics, electronics, etc.) small companies materialize to supply critical needs. As gaps or niches open up, disclosing unfilled needs, small business moves in. Sometimes the required volume is too small to interest a large company. Frequently the alertness, flexibility, or initiative of the small company enables it to move faster than large companies. It may have conceived of some bright innovation no one else thought of. Not infrequently a small, highly specialized company is able to meet specifications others cannot. Small companies are frequently not only fully competitive on the

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basis of quality, price, and service, but may have definite strategic competitive advantages. This may explain in part why, in spite of our famous giant and near-giant corporations, such a large part of our country's business is transacted by small companies, and why large companies rely so heavily on small companies on both the supply and sales side of the business. As the economy and large companies grow, there is a logical reason for the small company segment to develop proportionally.

Perhaps even more important than the supporting role played by small business is the creative one. Small business is to some extent the seed bed of the economy. New ideas, inventions, all sorts of innovations are conceived and introduced by small companies or result in the formation of new companies. These new companies serve as replacements for those that fade from the scene. They revitalize the economy, frequently by being acquired by an aging large company. Some of these small companies develop into the giants of the future.

Small business also fills an important and basic human need. People differ greatly in their "need to achieve," their risk tolerance, self-confidence, desire for independence, their frustration tolerance, and their impatience to break away from routine and do something challenging and exciting. Different people seek different outlets for their different drives. Space exploration, the Peace Corps, scientific frontiers attract certain groups. Small business has its own attraction and provides an outlet for the energy of the man with entrepreneurial drive, who craves to be on his own, and wants to make his own decisions and take the consequences. A business of his own also appeals to the man who wants an opportunity to build an estate more rapidly than he feels is possible working for someone else. For one who might have been a prospector for gold in another time, small business provides the opportunity to "strike it rich."

Others may prefer a small company career for reasons

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quite different from those just given. They may like especially the atmosphere and personal relationships. Some people are concerned with concepts and values related to individuality, variety, democracy, freedom, need for self-expression, moral satisfaction, sense of dignity, etc. The attraction of small business for some people seems to be based on the belief that these concepts are more attainable in small firms than in large. The infinite variety found in small business certainly gives a wide choice to those with individualistic tastes.

Since small business provides opportunities for both profit and personal satisfaction but shows wide dispersion around the average as to profitability and life expectancy, perhaps we should look at some of the typical problems. Although no statement will be uniformly true of all small companies, it is not unusual for both capital and management to be spread dangerously thin. Decisions are critical, with little margin for error, and are frequently made by one man, who may have inadequate background, inadequate assistance, and inadequate time for proper consideration. The product line may be highly specialized, with little diversification. Sales may be highly concentrated in very few markets; some small companies have just one customer. Risk may be very high, putting a premium on judgement, planning, versatility, resourcefulness, and prudence.

In various studies and surveys for the purpose of determining the causes of failure of small firms the principal problems seem to be deficiencies in capital and management. In my opinion if a company has good management, it is not likely to have financial problems. Apparently there is adequate capital for worthy projects, from banks, venture capital firms, small business investment companies and the Small Business Administration. I suspect that the most usual causes of chronic shortages are poor planning, recklessness, and a desire to maintain maximum equity control. This reasoning brings the spotlight to rest on management as the critical variable in small business success.

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Fortunately many people agree that the small business sector is important to our economy. Although there are numerous approaches to improving the chances for survival of small business, it seems to me that the most important assistance that can be given is in the management area. There are various ways of helping the small businessman to be a better businessman. The Small Business Administration has an active program of management assistance. Many large companies have training and educational programs for their small business customers, particularly dealers. Trade associations, especially those made up largely of small companies, are adding educational features to their programs, frequently in conjunction with a nearby educational institution. For example, the Smaller Business Association of New England has an annual three-day "live-in seminar" at the Harvard Business School. Other educational institutions, frequently with the cooperation of the SBA, conduct courses, seminars, and workshops for management people in local small companies.

In view of the importance of better management training needed to take full advantage of the opportunities in small business, it is surprising that more colleges and universities do not offer courses for the purpose. Here at Harvard Business School there has been for many years a lively interest on the part of the students in courses in small and new business, and in associated research report courses. There is also an active New Enterprise Club, and a Student Small Business Placement Program to seek out job opportunities in small companies that do not send recruiters to the School.

This important book by Louis Allen is a unique and useful addition to the educational material available in the area of small business management. It should be useful not only to managers who want to be better managers, but as encouragement to those thinking about striking out on their own. Louis Allen, the author, has been through the mill. He makes no bones about the difficulties but recommends that others

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try it. He has spent his business life managing, analyzing, and financing small business. He is a firm believer in small business as a satisfying and profitable career, and there is missionary zeal in his efforts to raise the level of small business management. This is shown by his much appreciated annual lectures to students at the Harvard Business School, his encouragement and financial support of research and education in the small business area, his efforts beyond the call of duty to be helpful to small companies in which his firm has invested, and of course by sharing the results of his experience and observations in the pages of this very useful book.

Frank L. Tucker
Professor
Harvard Business School

Introduction

Small business defies a definition that can be widely accepted. Mr. Allen directs his original and thoughtful comments to prospective new and established manufacturing businesses of moderate size. I will attempt to do the same.

In the early years of the teaching of business in this country, many of the courses revolved around institutions, such as the bank, the manufacturing company, the wholesaler and the department store. Later, the functional approach was introduced and such topics as production, selling, personnel, finance, and like subjects were developed. Today, more attention is being given to the individual, and the roles of the employer, the middle management man, the white and blue collar worker are discussed.

In small business, the key person is the owner. It has taken students of the subject, bankers, government men and even the owners of small business themselves a long time to come to this conclusion. Now, however, more of us are coming to realize that success in small business is based on the ability of the business owner or manager to make sound decisions.

This conclusion contradicts the long-held belief that money is the main ingredient in the success of small firms. This opinion was strongly held by the Congress of the United States when it wrote the legislation setting up the Small Business Administration, giving millions to its loan

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programs and tens of thousands to its management programs. This opinion is held by many bankers who scan the profit-and-loss statement and balance sheet of a small firm with care but often give minimum attention to the character of the management which is to return the loan with interest. Additionally, most owners of small businesses confidently believe that a loan will solve almost every problem they have, provided some private or public agency will make the loan at a reasonable rate.

Today, thinking on this subject is turning. If the management of a firm—or the promoters of a prospective business—have the capacity to make sound decisions in some depth and the ability to carry them out, financing can usually be found at a reasonable rate, even in times of tight money. The important and often relatively unknown element in such a proposal is management itself.

Educational institutions, through their teaching, their counseling and their research, are leading the way in this swing toward emphasizing the owner-manager as the key to success. The Small Business Administration is currently strengthening its management assistance in Washington and throughout the field. Bankers are giving more attention to the character and experience of new and older owners of business firms in considering loans. Businessmen themselves, especially those operating modest-sized establishments, are taking advantage of management training available to them while offering appropriate training to more and more of their own employees.

One factor which retards the improvement of management perception is the fact that many businessmen and some trainers fail to distinguish between business administration and business operation. Too many managers are so busy with day-to-day operations that they do not—so they say—have time to administer their business.

Profits, however, come from administration, and without sound administration, profits can be fleeting or non-existent.

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What is meant by administration? According to Koontz and O'Donnell (*Principles of Management*), they are Planning, Organization, Staffing, Direction, Control.

A large corporation can employ highly skilled people to head staff departments where these administrative functions are carried on, sometimes in great detail. In the small business, however, the owner often has to perform all these functions himself, while operating the business. One solution of this dilemma is to recognize the difference between administration and operation, to accept the importance and necessity of administration, and to set aside some time for administration.

Such action is particularly necessary for planning and controlling. A business without a plan is like a ship without a rudder. Before long, it will flounder and sink. Any business that is long without some controls will get out of hand. It may continue to operate but only at a loss and as long as its creditors permit.

BUSINESS GROWTH

Growth is a normal expectation for business as well as for people. With growth, comes greater service to the community, increased employment, and more substantial profits. Many firms, however, do not grow. Why?

There are probably many reasons, but here are a few:

(1) Lack of experience. It is not necessary to assume that in order to be successful in a particular kind of business the prospective businessman must have had long experience in managing that kind of business. In most instances, this would not be practical or possible. But the prospective operator certainly should know something as an employee about the administration and operation of the kind of business which he would like to start or buy. Businessmen have never found a sound substitute for experience.

(2) Lack of customer point of view. Even today, too many actual as well as prospective businessmen want to

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produce products which they have invented, which they need, or which they like. They give little or no attention to the broader needs of the public and its current desires, or to competition. In the buyers' market which is with us even today with tight money, the consumer makes the choice. The producer who has rightly anticipated the consumer's choice reaps the profits.

(3) Hesitation to hire others. Growth is handicapped sometimes by the inability of the owner to see the need of hiring a staff or line executive or his unwillingness to do so because of the additional cost involved. For example, he might see the wisdom of hiring another salesman but not a credit manager. He knows that he cannot do all the selling which has to be done but he may believe that he can handle credits, even though he is a trained engineer and creative product designer.

(4) Unwillingness to delegate authority with responsibility. Since many modest businesses start out as a one-man shop and since ownership and control belong exclusively to the originator of the firm, he often finds it difficult if not really impossible to delegate authority where it is needed to insure the growth of the business.

(5) Fear of the strange or new. Many busy operators shy away from the strange or new. Because they do not have time or take time to investigate, they ignore what may be some excellent policy, procedure, product, or employee. They operate to the exclusion of administration, and planning suffers.

(6) Fear of growth. Strange as it may seem, some new business owners are fearful of growth itself. They believe they are doing reasonably well with their present products and markets. They believe they and their staff, if they have one, are qualified to carry on a profitable business "as is." But if they try to grow, will they be equally successful? Maybe not. They are afraid to venture. They decide not to assume any additional risks. They are reasonably satisfied to remain just as they are.

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INGREDIENTS OF SUCCESS

The success of a business is measured in sales, employment, service to the community, and profits. The relative importance of each varies from case to case. Success, however, has to be earned. The question is, how do you earn it? Here are some factors that are involved:

(1) Experience. The promoter or owner of a business should have some experience in the same or a similar business as an employee. Inexperienced young people who want to open or buy a business of their own are often advised to first work for a time for a successful operator of the same kind of business and observe what makes him successful. Often such a businessman will take a personal interest in such an employee and later assist him to secure his own business when he is prepared to do so.

(2) Interest in people. Certainly, the owner or manager of any business, if he is to be successful, has to like people, like to be among them, enjoy group activities. He not only has to like people but be able to determine what these people—his potential customers—like and are ready to buy from him at the right price.

(3) Self-confidence. The foundation for success of any business is the owner's confidence in himself as owner, in the business which he has set up, in his policies, procedures, products, and services. A confident man will take the initiative, and a man with initiative will make decisions, the most important single action called for in business. If the confidence is based upon experience and knowledge, the results are apt to be profitable.

(4) Planning. The successful business has to be planned, just as the successful life has to be planned. It is hard to conceive that a businessman who does not plan can make many sound and profitable decisions over a period of time. The great value of planning is that it sets before the owner one or more goals toward which he can work. He may have to revise a goal now and then but he has something toward