

1-1-1982

A Typology of Small Businesses: Hypothesis and Preliminary Study

Neil C. Churchill
Southern Methodist University

Virginia L. Lewis
Southern Methodist University

Follow this and additional works at: https://scholar.smu.edu/business_workingpapers



Part of the [Business Commons](#)

This document is brought to you for free and open access by the Cox School of Business at SMU Scholar. It has been accepted for inclusion in Historical Working Papers by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

A TYPOLOGY OF SMALL BUSINESSES:
HYPOTHESIS AND PRELIMINARY STUDY

Working Paper 82-103*

by

Neil C. Churchill

and

Virginia L. Lewis

Neil C. Churchill
Director, Caruth Institute of Owner-Managed Business
Distinguished Professor of Accounting
Edwin L. Cox School of Business
Southern Methodist University
Dallas, Texas 75275

Virginia L. Lewis
Senior Research Associate, Caruth Institute of
Owner-Managed Business
Edwin L. Cox School of Business
Southern Methodist University
Dallas, Texas 75275

*This paper represents a draft of work in progress by the authors and is being sent to you for information and review. Responsibility for the contents rests solely with the authors. This working paper may not be reproduced or distributed without the written consent of the authors. Please address all correspondence to Neil Churchill.

Often when you read about small businesses or listen to discussions of small business problems, you may experience a certain amount of bafflement. While one person may be discussing the problems of a 300-employee manufacturing company, another will be focusing on his neighborhood restaurant. Similarly, one person may be giving advice based on experiences in a 20-year-old, \$20 million business, while the listener is trying to relate those comments to a small business in a "post-start-up" phase of development. Consider the variety found in four businesses all considered by most definitions as "small companies:"

- a) A 25-year-old family-run automobile dealership with 60 employees and solid annual profits and positive cash flows;
- b) A brand new entrepreneurial effort by an ex-employee of a technological-based company that is manufacturing a new type of laser and skating on the thin edge of insolvency;
- c) A corner dry cleaning establishment operated by a husband and wife, with the help of two or three minimum-wage employees, that is just breaking even; and
- d) An oil and gas exploration and production company with 150 employees and sales of \$25 million.

All of the above are small businesses, yet they face quite different futures; encounter quite different managerial problems; and have quite different financial needs, organizational structures, computer systems and information requirements.

The fact that such considerable differences between small businesses go unnoticed produces some pernicious effects:

A governmental policy passed with one type of small business in mind may or may not be of benefit to the others.

- ° Counsel given by the manager of one business to the manager of another could be ill-advised.
- ° Tax and accounting regulations designed to benefit one type of business may be irrelevant or even harmful to others.

The research described in this paper is being undertaken to address these problems by:

- ° sharpening our understanding of the nature, characteristics, and problems of small businesses;
- ° providing a tool for evaluating present and proposed governmental policies; and
- ° developing a way of looking at small businesses which will facilitate small business and entrepreneurial-focused research.

THE ORIGINAL TYPOLOGY

The Basic Stage Approach

We began this research with a concept of stages of growth of small companies which grew out of the work of Steinmetz¹ and Greiner.²

Greiner, for example, described organizations as evolving through five stages of development (Exhibit 1), with each stage characterized by an organizational structure and a management style. Each stage adapted, or "evolved," as the organization grew to deal with emerging problems, and in doing so produced other problems and strains which resulted, in turn, in a "revolution" from which the next stage emerged. The things that changed from stage to

¹Steinmetz, Lawrence L., "Critical Stages of Small Business Growth -- when they occur and how to survive them," Business Horizons, February 1969.

²Greiner, Larry E., "Evolution and revolution as organizations grow," Harvard Business Review, July-August 1972.

stage in Greiner's formulation were the organizational structure, degree of managerial delegation, and extent and types of formal controls. The causal factors were sales growth and, implicitly, the time spent at each stage of development. This evolutionary and revolutionary stage model is a powerful aid in understanding large businesses at different points in their development. Thus we sought to adapt it to smaller, owner-managed enterprises.

The Initial Model

To apply the stage model to small businesses it was necessary to make two initial changes. The first was in the independent (vertical) variable, size, expressed by Steinmetz and Greiner as dollars of sales; the second was in the nature of the stages themselves.

Size in terms of sales dollars, or even to a lesser extent the number of employees, is not sufficient to capture the differences between smaller companies. Dollars particularly are an inexact measure as between manufacturers and distributors since the size and complexity of the former are much greater than the latter at the same dollar volume. Value added^{*} is a much better measure of the size of an enterprise and more closely related to the number of employees, the other most common measure of business size. While dollars of value added or number of employees are the best simple measures, they still are not a sufficient metric. A business geographically dispersed with two or more locations faces more complex management problems, particularly in the early stages of development, than one of similar size with only one location. Similarly, companies with several diverse product lines or companies whose product lines involve high technology in either process or product are more difficult to manage than companies with one product line in a stable

*Sales less outside purchases of materials, products, and services.

technologic environment. Thus we chose for our vertical axis an index encompassing size in employees or value added, geographical dispersion, and complexity of product and process -- an SDC index.

The second change was in the horizontal component -- the stages themselves. From extant research, particularly that of Welch and White³ we knew that a small company most often begins with a business concept held by an entrepreneur, who experiences an event of some kind which causes the entrepreneur to "do it" and start a company which, at the beginning, is usually totally absorbed in survival. We also knew that those businesses which survived and grew evolved toward decentralized line and staff organizations characterized as "big businesses" and the subject of most managerial studies.

We thus conceived of three stages between the point of start-up and the big business stage -- survival, break-out, and take-off -- through which a small business would evolve (Exhibit 2):

- ° Survival -- the period in which a company struggles to stay alive;
- ° Break-out -- a period in which the growing company breaks out of the resource poverty of the survival period, marshals its resources, and develops enhanced management capabilities before it takes off; and
- ° Take off -- a period in which the company grows and evolves towards a big organization.

Test of the Model

Concomitantly with the formulation of this model we obtained a data base consisting of 83 responses to a questionnaire distributed three years previously to 110 owner-managers of successful smaller companies in the \$1 million

³ John A. Welsh and Jerry F. White, "Recognizing and dealing with the entrepreneur," Advanced Management Journal, Summer 1978.

to \$35 million sales range who were participants in a small company management seminar. The participants, who had read Greiner's article, were asked to:

- 1) fill in a chart identifying as best they could the stages or phases through which their companies had passed as they grew in age, size, and complexity. (By a stage or phase was meant a period of time in a company's development that, in some major ways, was distinguishable from the stages before or after it.);
- 2) characterize the major changes that took place in each phase and the events that led up to or caused these changes to take place; and
- 3) include an organizational chart of the company in the identified phases above.

The characteristics of the companies represented in the responses are shown in Appendix A.

Using this model we did a preliminary analysis of the data base. Three deficiencies in the model quickly emerged. First, the fail-or-grow hypothesis implicit in the model was invalid -- as least over any reasonable time period. Some enterprises had passed through the survival period but then plateaued, remaining pretty much the same size and reasonably to highly profitable over an extended period of time -- from five to eighty years. Many of these companies then joined the hypothesized evolutionary path and began to grow, some merged, a few failed and were revitalized, but a few continued on relatively small and quite stable in size.

The second result of our examination was the discovery of an early stage in the survival period in which the entrepreneur literally worked hard just to exist -- to obtain enough customers for the enterprise to become a true business and not just an unplanned avocation or, if customers for a new product were no problem, the task was to move the production process from a one or two

at a time, pilot stage to one that could steadily fulfill orders with a product of promised quality.

The third change in our thinking was that many of the responses dealt with enterprises that were not "started from scratch." Indeed, many entrepreneurs purchased enterprises that were in the steady-state, post-survival stage described above, and which were either mismanaged or managed for profits and not for growth. The entrepreneurs then placed these enterprises in a growth mode and went on from there.

The Revised Model

We combined our examination of the data with an additional review of the literature and produced a revised stage model of small enterprises. The revised model (Exhibit 3) encompasses three differences:

- 1) A split of the initial period of the enterprise into two stages -- existence with a concern for viability and survival with a concern for positive cash flow.
- 2) A recharacterization of the break-out stage from one of preparation for growth to one of success. A period in which profits are made, managerial base broadened, and the resource shortages and constraints of earlier years modified or eliminated.
- 3) A recognition that the success stage does not always precede a stage of rapid growth; rather there may be a stage of stable profits, corporate maintenance, the preservation of the status quo, and the withdrawal or disengagement of the owner-manager from a preoccupation with the business.

This revised model for small businesses delineates the different stages or, since a precedence relationship does not always exist, the different types

of small businesses. Each stage is characterized by the SDC index, the organizational structure and type of managerial style usually found, key problems facing the business, and the "closeness" of the business to the owner. Each stage is shown in detail in Exhibits 4 through 9 and is described narratively below.

Stage 1 - Existence

- ° In this stage the key problem areas are obtaining customers and delivering the product or service contracted for.
- ° The critical questions are (Exhibit 4):
 1. Can we get enough customers (and deliver our products and services well enough) to become a viable business?
 2. Can we expand from that one key customer or pilot production process to a broad enough base to enable us to stay in business?
 3. Do we have enough financing, enough cash, to cover this start-up phase -- a phase which usually has considerably more cash flowing out than flowing in?
- ° The organization is a simple one -- the owner-manager does everything and directly supervises everyone who works for him.
- ° The owner-manager and the business are practically synonymous. The owner is the business, does all the critical tasks, and is the major supplier of energy and direction and, with relatives and friends, capital.

A number of endeavors never achieve sufficient customer acceptance or product capability to become viable. They usually cease business when the start-up capital runs out and rarely are in a position to be sold for other than asset value. Those that do stay in business become Stage II enterprises.

Stage II - Survival

- ° To arrive at this stage the business has achieved existence as a viable business entity. It has customers and delivers its product or service well enough to retain them. The key problem area thus shifts from merely existing to existing profitably -- to the relationship between revenues and expenses.
- ° The critical questions now are (Exhibit 5):
 1. Can we generate enough profit, enough cash flow to stay in business and to finance our growth to a size that is viable in our industry?
 2. In the shorter run, can we generate enough cash to break even and to cover the repair or replacement of our capital assets as they wear out?
- ° The organization is still simple -- supervised supervision. There may be a limited number of employees supervised, perhaps by a sales manager or a general foreman, neither of whom make major decisions on their own but only carry out the rather well-defined orders of the owner-manager, who is involved with almost everything.
- ° The owner-manager is still synonymous with the business and involved in all its aspects.

The enterprise may become reasonably successful in this stage. It may also be unsuccessful but have developed enough economic viability to be sold at a small profit or a slight loss. It also may, as so many do, fail and drop from sight. Indeed, a large number of small businesses which survive the initial "existence" period stay at this stage quite a while, but ultimately go out of business. If successful, however, the company grows in size and profitability and moves to Stage III.

Stage III - Success

- ° In this stage the key problem is whether to exploit the company's success and expand or stay, instead, a stable, small, quite profitable company providing a comfortable life for its owner.
- ° The critical question (Exhibits 6 and 7) is whether to use the company as a platform for growth, a Type III-G company, or as a means for support for the owners as they completely or partially disengage from management and broaden their life style while maintaining the business more or less in the status quo -- a Type III-D organization.
 1. People -- The company has grown large enough to permit, and even require, hiring functional managers to take over some of the duties performed by the owner-manager. But the goal of the owner-manager governs whom shall be hired and when. Should there be truly professional managers to take over some responsibilities in order to effectively manage a growing company or more limited people to maintain the status quo? And how far ahead of current requirements should this hiring be done? Growth companies, as we shall see, require managers with higher potential to be brought on board a bit early than those companies which intend to maintain the status quo.
 2. Cash -- Shall we use the revenue and accumulated capital of the firm for a better standard of living and a broader life style, or take the cash and the established borrowing power the firm has developed and risk it all in financing a growth stage?
- ° The organization is often functional in design with a plant or operations manager, a marketing manager, and a controller instead of

a bookkeeper -- but with these positions still functioning under the relatively close direction of the owner-manager.

- ° The owner-manager: as the business grows, it and the owner-manager move more apart -- more distant in stable companies than in the growth-oriented ones where the owner-manager is still consumed by the company. Yet, even here, the company is beginning to develop a "personality" of its own due to the presence of other managers and is no longer synonymous with the owner.

Successful small companies can remain successful (a) by capitalizing on the strengths they possess and (b) by remaining in tune with and adapting to their external environment. With proper monitoring and control these companies can remain stable, profitable enterprises for considerable periods of time or, if desired, merge or sell out at a profit. They can of course, at a later point, join the others and move toward a Stage IV growth company.

Stage IV - Take Off

- ° In this stage the key problem is how to grow rapidly and how to finance that growth.
- ° The critical questions are (Exhibit 8):
 1. People -- Can the owner-manager bring himself to delegate responsibility to others in order to ease and make more effective the management of a rapidly growing and more complex enterprise? Further, will this be true delegation with controls on performance and a willingness to see mistakes made, that is, will it be delegation and not abdication as is so often the case?
 2. Cash -- Will there be enough cash to satisfy the high demands growth brings (often requiring a willingness on the part of the

owner-manager to tolerate a high debt-to-equity ratio) and a cash flow that is not eroded by inadequate expense controls or ill-advised investments brought about by owner impatience?

- ° The organization is decentralized, and at least in part divisionalized -- sales or production -- with delegated authority and with controls over the delegated responsibilities.
- ° The owner-manager and the business are reasonably separate, yet the company is still dominated both by his managerial presence and his stock ownership.

This is a critical period in a company's life. If the owner-manager rises to the challenges of a growing company both financially and managerially it can become a "big business." If not, it can usually be sold -- at a profit if the owner's limitations are recognized soon enough. Too often the person who brings the business to the success stage takes it unsuccessfully through Stage IV, either because he tries to grow too fast and runs out of cash (the omnipotence syndrome) or is unable to delegate and manage the delegation needed to make the company work (the omniscience syndrome). If successful, the company enters Stage V.

Stage V - Big Company

- ° The key problems of a company entering the big business stage are to consolidate and control the success brought on by rapid growth and not lose the advantages that smallness has given it.
- ° The critical questions are (Exhibit 9):
 1. Can we expand the managerial force fast enough to consolidate success?
 2. Can we eliminate the inefficiencies that growth can produce?

3. Can we professionalize the company by use of budgets, strategic planning, standard cost systems and the like without stifling creativity and initiative?
4. In short, can we deal with all the problems facing large corporations while maintaining the advantages of being entrepreneurial in outlook (informal in structure and adaptive in behavior) and enjoying the acquired fiscal and staff advantages of largeness?
 - The organizational structure is line and staff -- indeed a deep staff is what separates a Stage V, and to some extent a Stage IV, company from the others. Decision-making is decentralized and the key managers share in the development of strategy.
 - The owner and the business: quite separate both financially and managerially, although the founder and his family may continue to play a strong role.

The company has now arrived. It has the advantages of size and of managerial talent. If it can preserve its past advantages it will be a formidable competitor.

Test of the Revised Model

Using the revised model we again went through the questionnaire responses in our data base. We found the following:

1. We could not classify 8 companies (9.6%), six because of insufficient information and two because of unusual start-up situations. (One company represented a joint venture with a large company; another had been acquired by the current owner-manager at a relatively advanced growth stage; i.e., a complex organizational structure

already was in place, albeit plagued by lack of adequate financial and managerial controls.)

2. Seventeen companies (20.5%) seemed to be in the last stages of Survival (Stage II), and were rapidly becoming Stage III (Success) companies. These companies might be classified as Pre-Success companies.
3. Forty-eight companies (57.8%) had reached Stage III (Success) and most (33) were in various stages of growth. Of the remaining 15 companies, 5 were clearly maintaining the status quo, while 10 appeared to be at the point of transition from a state of disengagement to a growth mode.
4. The remaining 10 companies (12.0%) were Stage IV (Take-Off); that is, they had successfully mounted the growth platform and were, at least with regard to some parameters, being faced with the complexities of rapid growth (e.g., some companies had become divisionalized -- a Stage IV characteristic -- but still were grappling with problems of delegation or control).

It should be stressed that the data base used was not (nor had it been intended to be) representative of small business. It would be expected that owner-managers attending a three-week unit of a nine-week program would tend to come from successful companies and be oriented toward growth. Indeed all the respondents to the questionnaire viewed themselves as successful or just coming out of the survival stage.

A close analysis of the questionnaire data provided two basic unexpected results. The first was that few companies evolved smoothly from one stage to another. They rarely experienced alternate periods of evolution and revolution. Instead, companies would pause for a while -- for 80 years in one case

-- and then resume a march onward. Others would sell out, merge, or fold. The second result was that different components of a company evolved at different rates and the company changed when a "critical mass" of components reached a certain stage.

Results

Complex Patterns of Developments

The movements through the stages were not the smooth pattern reading the literature would lead you to expect (Exhibit 3) or the smooth pattern we anticipated (except for Stage III); rather they exhibited the pattern shown in Exhibit 10.⁴ The salient points of the pattern observed are as follows.

- ° In Stage I, the company either becomes a business or does not. It is rare that there is enough to sell except assets.
- ° In Stage II, the company can become successful and move to Stage III; it can also be marginally successful and scratch out an existence for a long period of time; or after it fails, fold or sell out at a net loss.
- ° In Stage III, the company can choose to prepare for growth, Type III-G, or it can remain a successful company as long as it adapts to changes in its environment, Type III-D. It has enough economic value so that it can be sold, or merged, at a profit. There were a number of instances where, after a period of years, a company moved from the disengagement stage to become a growth-oriented, Type III-G company.

⁴This pattern included a pre-start-up incubation stage made up of three separate phases.

- ° In Stage IV the company goes for broke. If it succeeds it becomes a big company; if it fails it may sell, merge or, alternatively, it may be able to retrench and be a quieter, successful company -- at least for a while -- and then shift again to the growth mode.

Component Evolutions

The revised model characterized each stage of a company's development by three factors: basic characteristics and problem areas, management organization, and the intersection of the owner-manager with the business. Within each of these we included a number of dimensions: resources (cash and people), the owner-manager's goals, his ability to delegate, and the extent of his personal involvement with the business. We found that while a company appeared, in toto, to be at a given stage of development, a closer look at the diverse elements would show that while the company might have an abundance of cash (Stage 3), the owner-manager might be trying to directly supervise all personnel (Stage 2), or while the owner-manager would want to spend winters in Florida and summers in Maine (Stage III-D), he also would want the company to grow (Stage III-G). Companies would often be at one stage with regard to a particular factor and at another stage with regard to others, with one factor contributing to a movement from one stage to another and another factor holding this evolution back. Although it was quite feasible to determine where to categorize the company as a whole (if not precisely at least as between two adjacent stages) not all factors were at the same stage. It seemed to be their mix and their various strengths and importance that governed.⁵ It was

⁵For example, the owner-manager's goal of expansion would be helped by the company's financial capability for growth but limited by lack of qualified personnel to facilitate the expansion, or even by the owner-manager's proclivities against hiring such people.

rare however that a factor was more than one stage ahead or behind the company as a whole.

Conclusion

The result of the analysis of the questionnaire data base is four-fold.

1. The model developed is useful. It describes phases of small business development in the aggregate that can separate out and categorize small businesses with basically similar characteristics and problems. It is of less use in pin-pointing the degree or stage of development of the various economic and managerial factors involved.
2. While the pattern of evolution and growth of small businesses is less precise than that suggested for large companies, there are general stages, each with its own problems and characteristics by which a company can be categorized.
3. While individual components of a business may vary in the rate of development the factors seem to follow a reasonably consistent pattern of development from one point to another. Although the rate of movement cannot be predicted, if a factor does move, its path can be fairly well determined.⁶
4. The basis for further research lies not in refining the typological model, but rather in identifying the critical components of a business, examining the pattern of their development, the degree of interaction between these components, and patterns of precedence and/or dominance and relationships that may exist. Our efforts in this direction comprise the remainder of this paper.

⁶That is, we may not know whether a company will begin to grow or not, but if it does we seem to be able to predict the form the management will move to, the impact of growth on financial resources, etc., etc.

THE COMPONENT FACTOR APPROACH

The Factors

Our analysis of the questionnaire data base indicated a number of "components" of small business that were relevant to the success or failure of small business and hence were useful in understanding how small businesses function and identifying the problems and challenges their owner-managers face. We have tentatively identified eight such components in two groups: Resource Factors (R Factors) upon which the enterprise is based and Owner-Manager Factors (OM Factors) which drive the business in its early stages and which separate it from "big businesses" in its latter ones.⁷ The work to date has identified the following four R Factors and four OM Factors:

R Factors

Financial Resources -- cash and borrowing power

Personnel Resources -- numbers, depth, and quality of people, particularly at the managerial and staff level

Systems Resources -- the presence and degree of sophistication of both information and control systems

"Business" Resources -- the customers, suppliers, manufacturing and distribution processes, reputation, etc. that give the company a "position" in its industry and market

OM Factors

Owner's Goals -- the goals of the owner for himself and for the business

Owner's Operational Abilities -- the ability and skills of the owner in doing critical jobs such as marketing, inventing, producing, etc.

⁷There is a third set, the Environmental Factors (E-Factors), which affect the enterprise, but which are not focused upon here.

Owner's Managerial Abilities -- the ability to and proclivity for delegating responsibility and for managing and controlling the activities of others

Owner's Strategic Abilities -- the ability to and proclivity for looking beyond the present and matching the strengths and weaknesses of the company with its and the owner's goals and the environment in which it operates

The Factors and the Typological Model

If we consider the characteristics of the component factors as to their importance to a small business we find that as the business moves from one stage to another the criticality of the factors changes. This criticality can be viewed on three levels of importance to a business.

- ° Critical Factor -- a key variable that is absolutely essential for success and must be managed with high priority
- ° Managed Variable -- a variable that is clearly necessary for the enterprise's success but not critical in that its effects can be managed in the day-to-day course of events
- ° Modestly Irrelevant -- of little immediate concern -- either it is not present or is automatically dealt with

If we add these criticality dimensions to our typology we can examine the importance of the different factors at each stage of small business and see their changing importance as a small business grows and matures. This is done on Exhibit 11 for the eight factors drawn from our questionnaire analysis.

The result can be analyzed in two ways: first a factor approach which looks at the changing importance of each factor at the different stages of small business; the second is a stage approach which examines the criticality of the various factors for management at each stage of a small business's development.

The Factors

Exhibit 11 displays some distinct patterns of factor development:

- ° Some factors decrease in importance as the company grows; one example is the owner-manager's ability to do different tasks. At the early stages his ability to sell, to manufacture, or to initiate are critical. In the later stages other people join the firm to perform these tasks, and this characteristic of the owner-manager becomes less and less important for the business's survival.
- ° Some factors increase in importance as the business evolves; examples are the owner's ability to manage and delegate, and the importance of people, systems, and strategic planning.
- ° Some factors, such as cash, are critical at the start but become less important as the business evolves and then become critical again as it begins to grow rapidly.
- ° Finally, the factor "matching of the owner's goals with the company's performance" is irrelevant in the existence and survival stages. Here the owner and the company need exactly the same thing. It is also less important during the disengagement stage but becomes suddenly critical in the growth and take-off stages where the business changes rapidly.

Analysis by Stages

Looking at Exhibit 11 stage by stage shows some striking differences in the problems faced by managers.

- ° Stage I and II -- Existence and Survival

In the early two stages, cash, the owner's ability to do, and the business resources of customers, products, and technology are all critical. Money is tight (cash flow often is negative for a

long time, and after that what cash there is is needed to rejuvenate assets and keep the company going), and the entire burden of all aspects of the business is on the owner-manager's (or owner-managers' should there be more than one owner) shoulders. People on the other hand are modestly irrelevant for the numbers and skill levels of the people needed can be readily obtained. There is no question of delegation; the owner-manager retains responsibility for everything. Accordingly, matching of goals is unimportant, for the goals of the owner-manager are the goals of the company -- by definition. Systems (other than basic bookkeeping -- keeping track of receipts and disbursements) are neither needed nor appropriate in the early stages, and strategic planning consists of the owner-manager's creatively managing the firm's checkbook to pay for the next shipment of goods (in Stage II it may be a capital expenditure six months hence).

° Stage III - Success

In this stage a critical factor becomes matching the owner-manager's goals and the business operations and plans. If the owner-manager wants to take time off to run for and be governor, he can't at the same time expect to be able to make the investment in the company (either financial or in terms of commitment) that will allow it to experience rapid and sustained growth. And planning is important in the sense that the strategy of the business must be kept in line with the environment (e.g., the Lincoln dealer obtaining a Datsun franchise as oil supplies tighten). But once these two criteria are met (matching of the owner's goals with those of the business and matching of the company's strategy with the environment

in which it operates), a Success-Disengagement company can be managed more easily than a company at any other stage.

Even cash is no problem -- there's a steady stream of profits coming in.

As the company positions itself for growth, however, people, delegation, systems, and strategic planning all become important. For Stage III-G companies, cash is again critical, for it and the company's established borrowing power must be risked to finance growth. People with upward potential are needed, and needed in advance of the growth.

- Stage IV - Take-Off

While the consistency of goals is critical in the growth stage, in the take-off stage it and all the other factors are critical -- except the owner-manager's ability to do. Indeed one of the most striking aspects of Exhibit 11 is the indication that a Stage IV company is the most difficult of all to manage; everything converges to criticality at once. Here, it could be argued, the most important thing is for the company to maintain a balance of all the demands being placed upon it; resources must be balanced against needs; the company must plan in advance for required manpower and funds; the organization must be harmonized; and systems must be developed in front of requirements.

- Stage V -- Big Business

In the big business stage almost everything is a managed variable due to the resource advantages of largeness. Strategic planning and management controls are the critical factors -- a large company is like a large tanker: you have to decide where you want

to go considerably in advance, for it takes a long time to alter the entity's course. The second major concern of a Stage V company is to keep the advantages of an entrepreneurial-oriented business — flexibility, innovation, and adaptability to changing circumstances.

Summary

The component factor model has, we believe, two uses. First, as an explanatory instrument, it can demonstrate to owner-managers that they must manage different factors and develop different abilities and skills to successfully manage their companies at different stages of their development. What is critical at one stage may not be at another. Further, it demonstrates the importance of careful preparation before a headlong expansion is undertaken.

The second use is in research. The factor model provides a basis for empirically validating the nature of small business and its differences from, and similarities to big business and to other small businesses at different stages of development. We are currently in the process of:

- 1) formulating a more complete set of R, E, and OM Factors for empirical test;
- 2) refining the three-category criticality scale used above;
- 3) developing a set of financial and demographic factors to characterize the SDC scale used; and
- 4) preparing a research questionnaire to
 - a) empirically test the relative importance of R, E, and OM Factors for each stage of small business;
 - b) relate the stages to a size, dispersion, and complexity scale;and

- c) exercise and, hopefully, validate the typology use to managers by examining the clustering of factors at each stage.

We are, in essence, empirically extending the rows and columns of our typology-factor matrix.

GROWTH PHASES

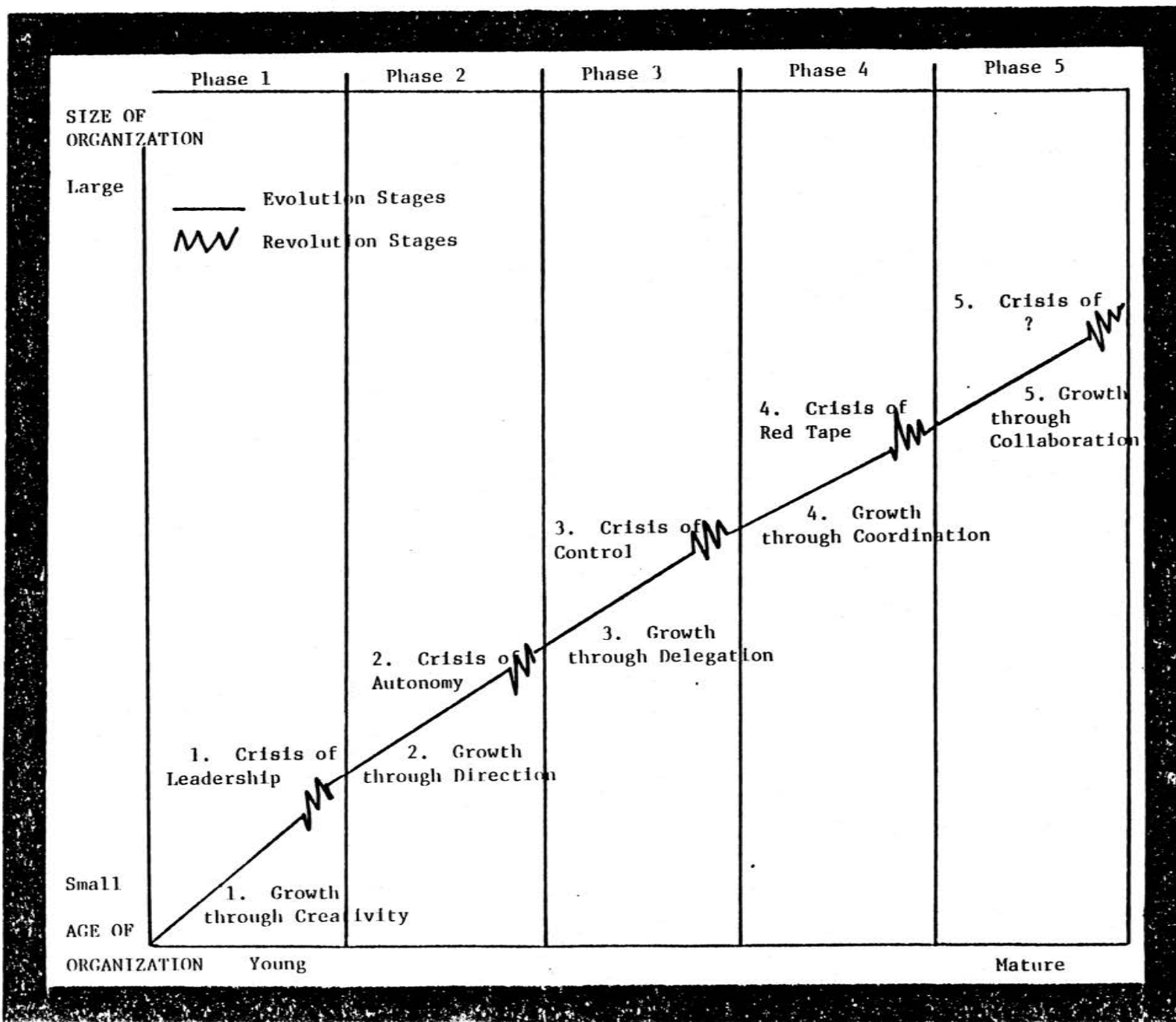
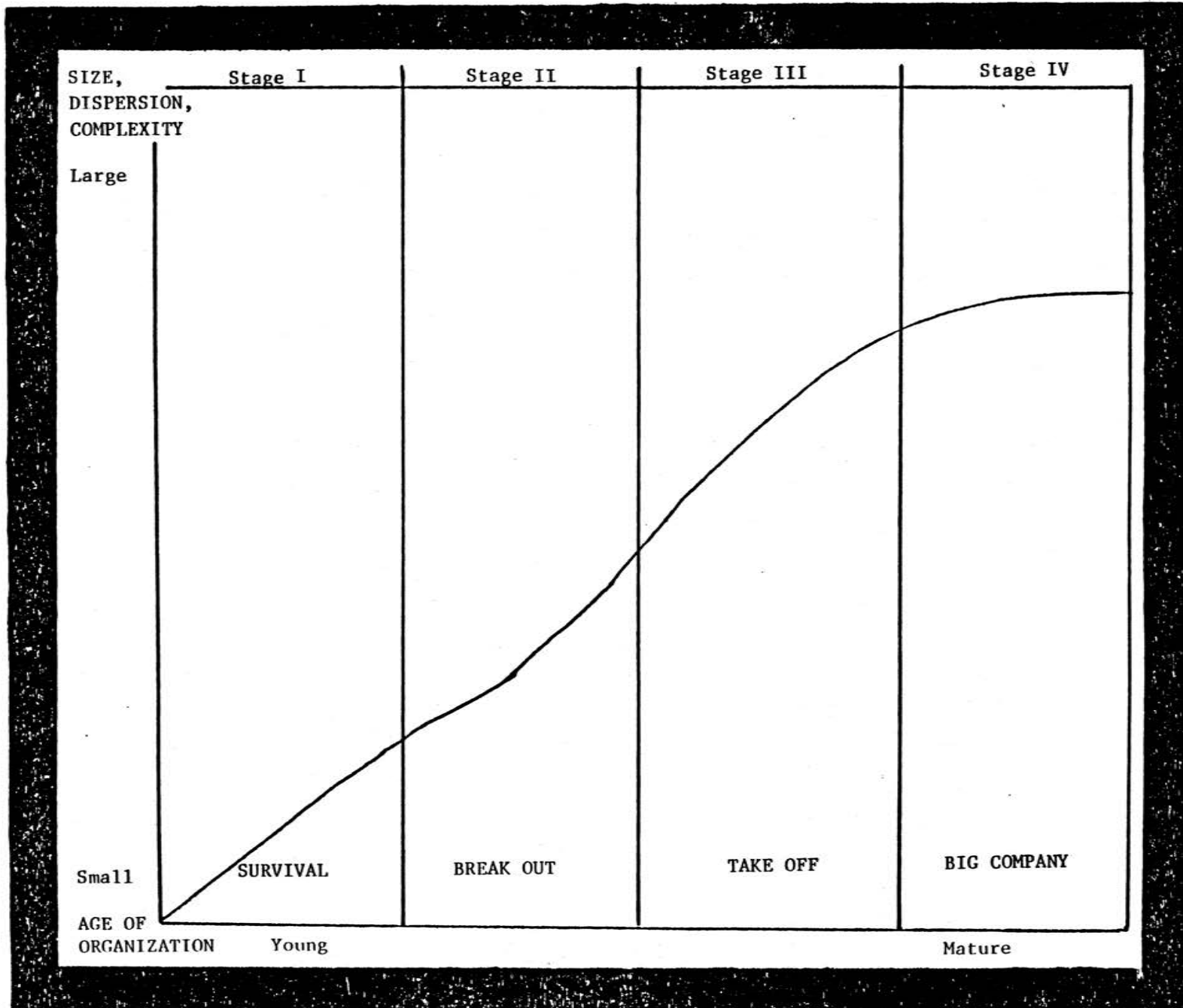


EXHIBIT 1

GROWTH STAGES



GROWTH STAGES

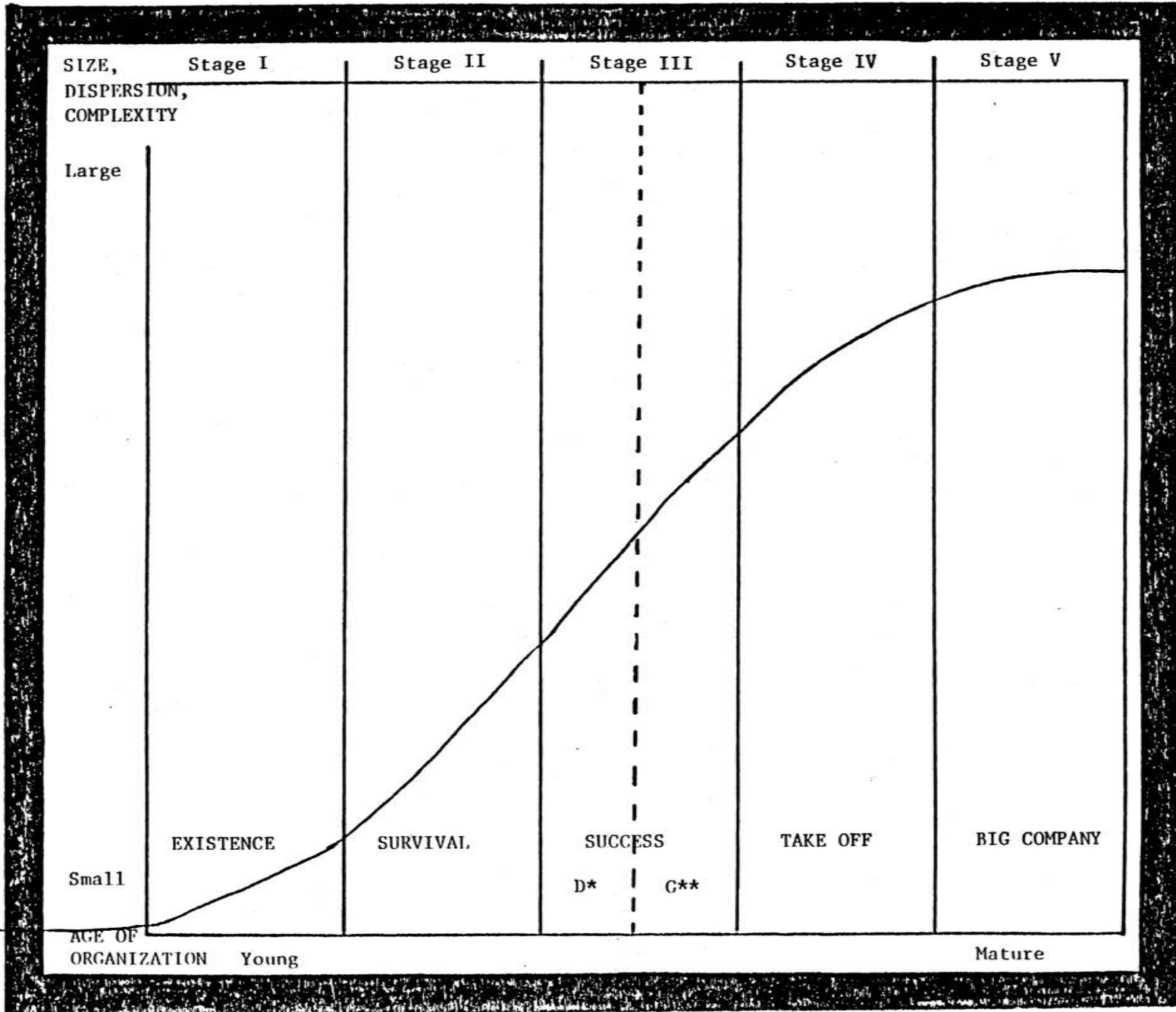


EXHIBIT 3

*Disengage

**Grow

EXHIBIT 4

STAGE I

EXISTENCE

KEY CHARACTERISTICS AND PROBLEMS:

- CUSTOMERS
- PRODUCTS
- SALES
- DELIVERY
- CASH BASE

ORGANIZATION AND MANAGEMENT:

DIRECT SUPERVISION

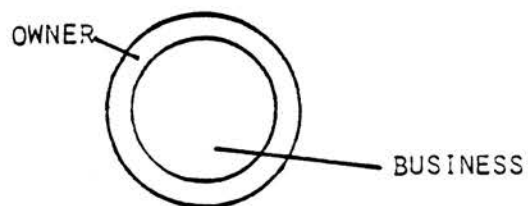
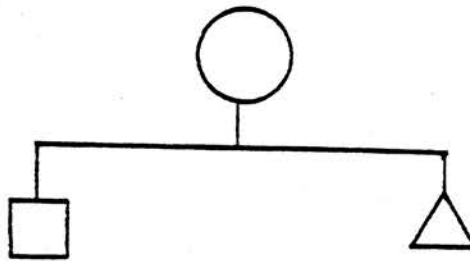


EXHIBIT 5

STAGE II

SURVIVAL

KEY CHARACTERISTICS AND PROBLEMS:

- REVENUES
- EXPENSES
- PROFITS
- BREAK-EVEN: CASH +
REJUVENATION OF ASSETS
- BUSINESS CYCLE

ORGANIZATION AND MANAGEMENT:

SUPERVISED SUPERVISION

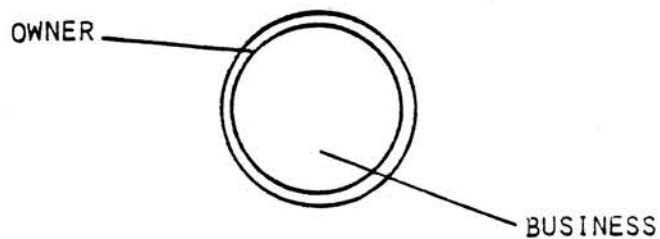
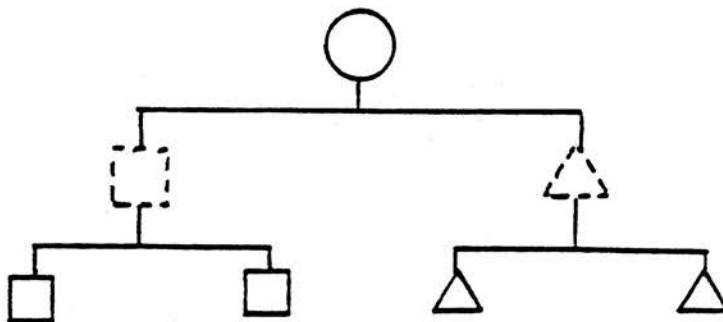


EXHIBIT 6

STAGE III-D

SUCCESS - DISENGAGEMENT

KEY CHARACTERISTICS AND PROBLEMS:

- PROFITABLE
- RESOURCES
 - CASH - USE FIRM'S REVENUES OR CAPITAL FOR BETTER STANDARD OF LIVING
 - PEOPLE - HIRE LIMITED PERSONNEL TO MAINTAIN STATUS QUO IN FUNCTIONAL AREAS

ORGANIZATION AND MANAGEMENT:

FUNCTIONAL

DELEGATION OF OPERATIONS

POSSIBLE DELEGATION OF STRATEGY

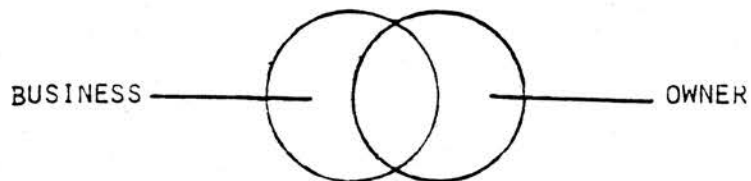
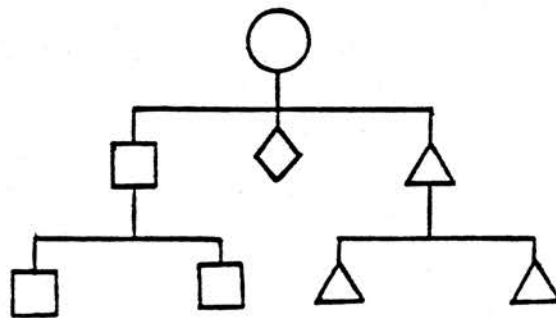


EXHIBIT 7

STAGE III-G

SUCCESS - GROWTH

KEY CHARACTERISTICS AND PROBLEMS:

- PROFITABLE
- RESOURCES
 - CASH - RISK FIRM'S ESTABLISHED BORROWING POWER TO FINANCE GROWTH
 - PEOPLE - HIRE PROFESSIONAL MANAGERS TO ACCEPT RESPONSIBILITY FOR FUNCTIONAL AREAS

ORGANIZATION AND MANAGEMENT:

FUNCTIONAL

DELEGATION OF OPERATIONS

NO DELEGATION OF STRATEGY

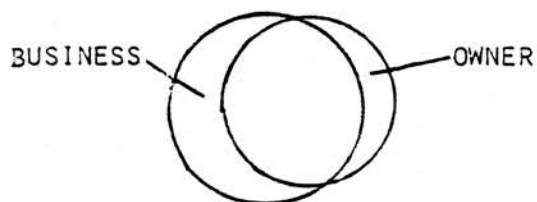
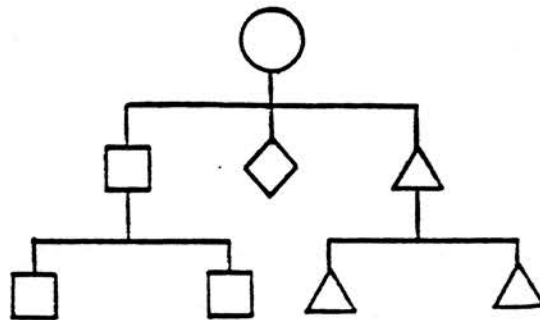


EXHIBIT 8

STAGE IV

TAKE OFF

KEY CHARACTERISTICS AND PROBLEMS:

- EXPENSE CONTROL
- DELEGATION
- MATURING MARKETS
- CASH FOR GROWTH

ORGANIZATION AND MANAGEMENT:

DIVISIONAL :

CONSIDERABLE DELEGATION OF OPERATIONS

SOME DELEGATION OF STRATEGY

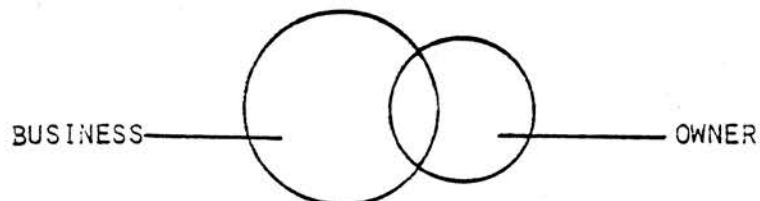
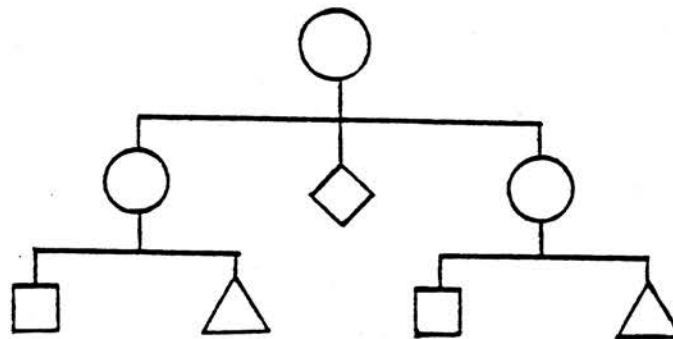


EXHIBIT 9

STAGE V

BIG COMPANY

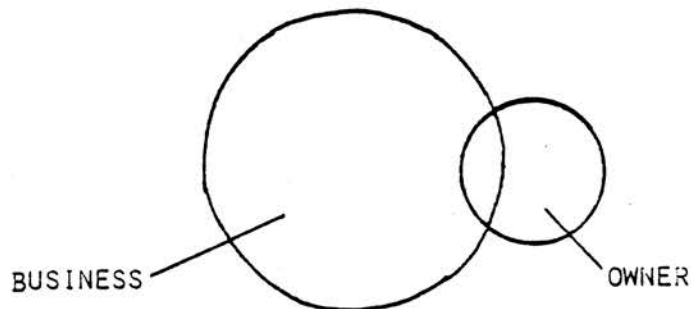
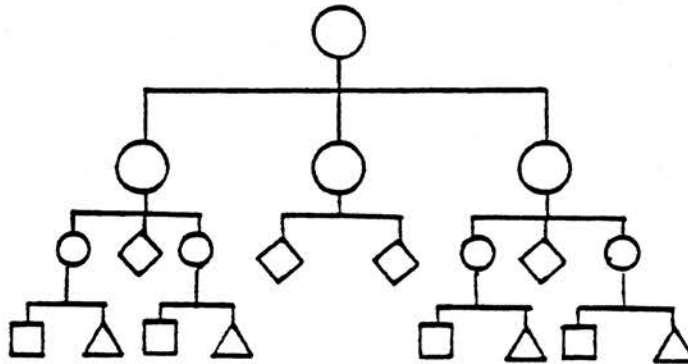
KEY CHARACTERISTICS AND PROBLEMS:

- CONSOLIDATING AND CONTROLLING SUCCESS
- "ALL THE NORMAL PROBLEMS OF BIG COMPANIES"
- MAINTAINING THE CREATIVITY AND ADAPTABILITY OF PREVIOUS STAGES
- SUCCESS

ORGANIZATION AND MANAGEMENT:

LINE AND STAFF

DELEGATION AND CONTROL



EVOLUTION OF SMALL COMPANIES

- Never Come into Being
- X— Cease to Exist
- X R— Sell Assets
- X -— Sell at a Loss
- X +— Sell at a Profit
- X ++— Sell at a Greater Profit
- >— Adapt and Continue as is Temporarily or Permanently
- - - Change in Strategy
- X B Bankruptcy

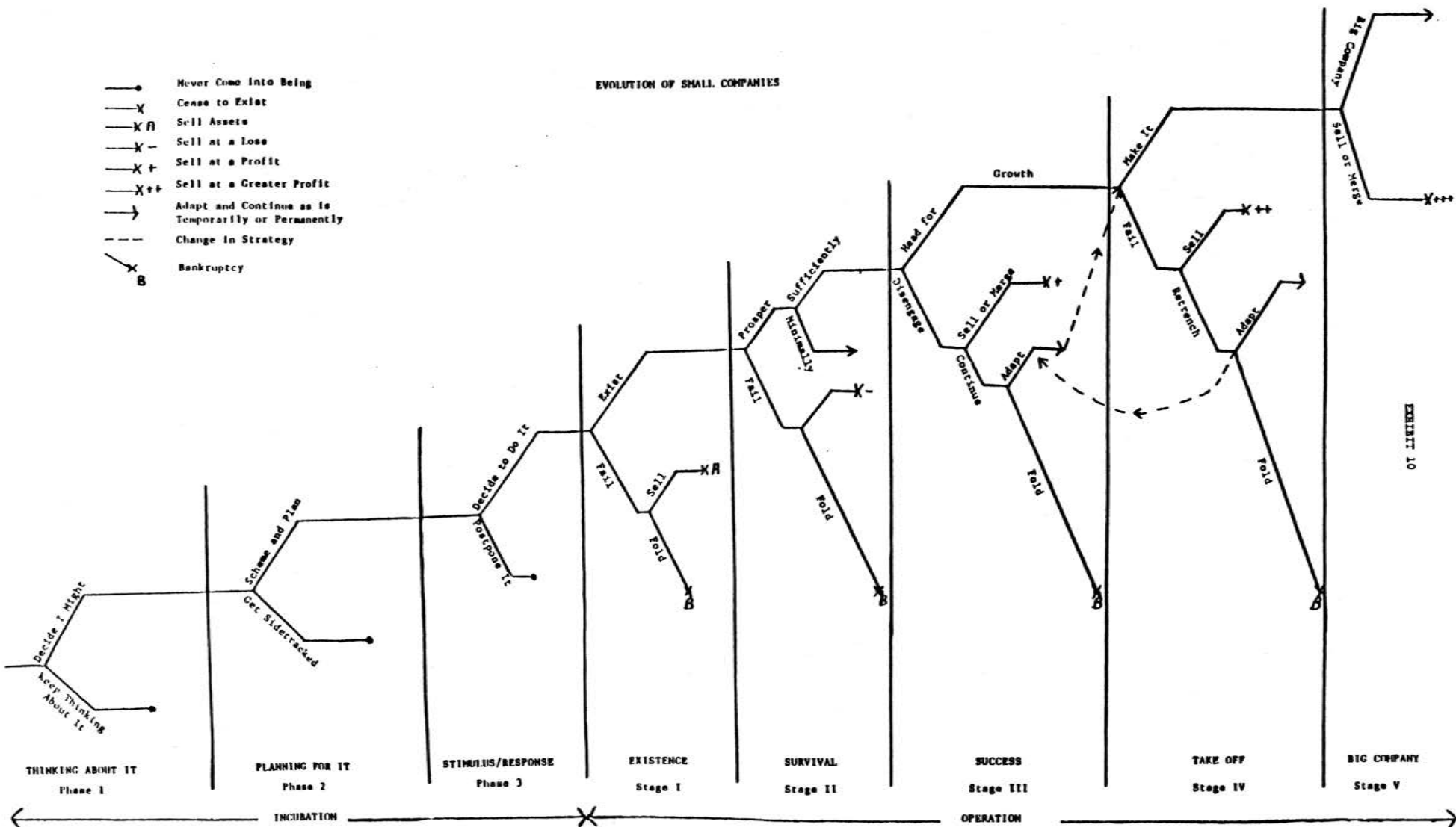
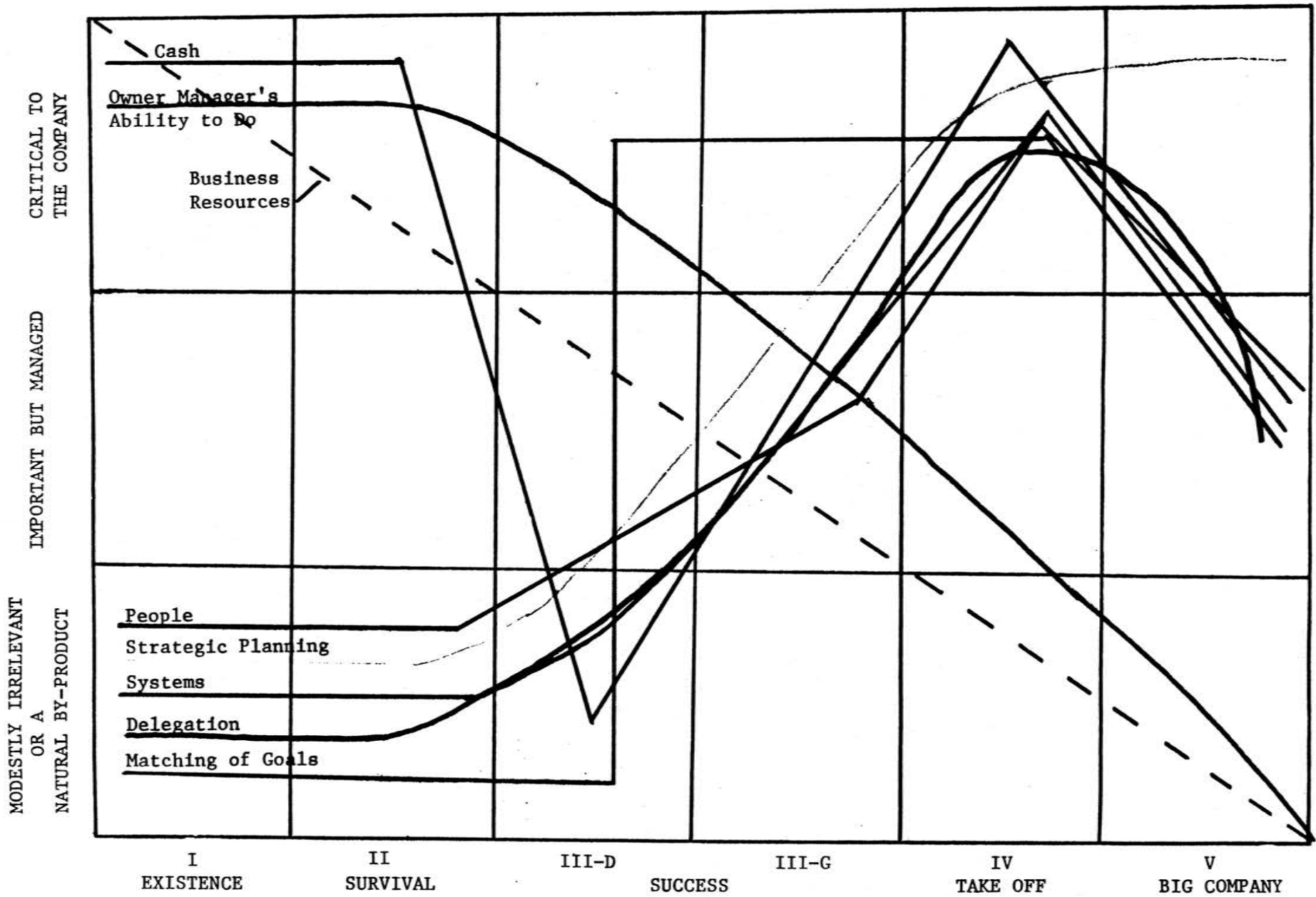


EXHIBIT 10

COMPONENT FACTORS



APPENDIX A

SUMMARY OF QUESTIONNAIRE DATA

Number of responses: 83; number of questionnaires: 110

Size of companies:

Range: \$1 million to \$35 million in sales; 4-400 employees

Under \$5 million	30%
\$6-10 million	33%
\$11-20 million	34%
Over \$20 million	3%

Age of organizations: Median 37.4 years; range 3 to 182 years
44% 21-50 years

Composition of companies:

Manufacturers	55%
Wholesalers	5%
Retailers	16%
Service	24%

The following papers are currently available in the Edwin L. Cox School of Business Working Paper Series.

- 79-100 "Microdata File Merging Through Large-Scale Network Technology," by Richard S. Barr and J. Scott Turner
- 79-101 "Perceived Environmental Uncertainty: An Individual or Environmental Attribute," by Peter Lorenzi, Henry P. Sims, Jr., and John W. Slocum, Jr.
- 79-103 "A Typology for Integrating Technology, Organization and Job Design," by John W. Slocum, Jr., and Henry P. Sims, Jr.
- 80-100 "Implementing the Portfolio (SBU) Concept," by Richard A. Bettis and William K. Hall
- 80-101 "Assessing Organizational Change Approaches: Towards a Comparative Typology," by Don Hellriegel and John W. Slocum, Jr.
- 80-102 "Constructing a Theory of Accounting--An Axiomatic Approach," by Marvin L. Carlson and James W. Lamb
- 80-103 "Mentors & Managers," by Michael E. McGill
- 80-104 "Budgeting Capital for R&D: An Application of Option Pricing," by John W. Kensinger
- 80-200 "Financial Terms of Sale and Control of Marketing Channel Conflict," by Michael Levy and Dwight Grant
- 80-300 "Toward An Optimal Customer Service Package," by Michael Levy
- 80-301 "Controlling the Performance of People in Organizations," by Steven Kerr and John W. Slocum, Jr.
- 80-400 "The Effects of Racial Composition on Neighborhood Succession," by Kerry D. Vandell
- 80-500 "Strategies of Growth: Forms, Characteristics and Returns," by Richard D. Miller
- 80-600 "Organization Roles, Cognitive Roles, and Problem-Solving Styles," by Richard Lee Steckroth, John W. Slocum, Jr., and Henry P. Sims, Jr.
- 80-601 "New Efficient Equations to Compute the Present Value of Mortgage Interest Payments and Accelerated Depreciation Tax Benefits," by Elbert B. Greynolds, Jr.
- 80-800 "Mortgage Quality and the Two-Earner Family: Issues and Estimates," by Kerry D. Vandell
- 80-801 "Comparison of the EEOCC Four-Fifths Rule and A One, Two or Three σ Binomial Criterion," by Marion Gross Sobol and Paul Ellard
- 80-900 "Bank Portfolio Management: The Role of Financial Futures," by Dwight M. Grant and George Hempel
- 80-902 "Hedging Uncertain Foreign Exchange Positions," by Mark R. Eaker and Dwight M. Grant

- 80-110 "Strategic Portfolio Management in the Multibusiness Firm: An Implementation Status Report," by Richard A. Bettis and William K. Hall
- 80-111 "Sources of Performance Differences in Related and Unrelated Diversified Firms," by Richard A. Bettis
- 80-112 "The Information Needs of Business With Special Application to Managerial Decision Making," by Paul Gray
- 80-113 "Diversification Strategy, Accounting Determined Risk, and Accounting Determined Return," by Richard A. Bettis and William K. Hall
- 80-114 "Toward Analytically Precise Definitions of Market Value and Highest and Best Use," by Kerry D. Vandell
- 80-115 "Person-Situation Interaction: An Exploration of Competing Models of Fit," by William F. Joyce, John W. Slocum, Jr., and Mary Ann Von Glinow
- 80-116 "Correlates of Climate Discrepancy," by William F. Joyce and John Slocum
- 80-117 "Alternative Perspectives on Neighborhood Decline," by Arthur P. Solomon and Kerry D. Vandell
- 80-121 "Project Abandonment as a Put Option: Dealing with the Capital Investment Decision and Operating Risk Using Option Pricing Theory," by John W. Kensinger
- 80-122 "The Interrelationships Between Banking Returns and Risks," by George H. Hempel
- 80-123 "The Environment For Funds Management Decisions In Coming Years," by George H. Hempel
- 81-100 "A Test of Gouldner's Norm of Reciprocity In A Commercial Marketing Research Setting," by Roger Kerin, Thomas Barry, and Alan Dubinsky
- 81-200 "Solution Strategies and Algorithm Behavior in Large-Scale Network Codes," by Richard S. Barr
- 81-201 "The SMU Decision Room Project," by Paul Gray, Julius Aronofsky, Nancy W. Berry, Olaf Helmer, Gerald R. Kane, and Thomas E. Perkins
- 81-300 "Cash Discounts To Retail Customers: An Alternative To Credit Card Performance," by Michael Levy and Charles Ingene
- 81-400 "Merchandising Decisions: A New View of Planning and Measuring Performance," by Michael Levy and Charles A. Ingene
- 81-500 "A Methodology For The Formulation and Evaluation of Energy Goals And Policy Alternatives For Israel," by Julius Aronofsky, Reuven Karni, and Harry Tankin

- 81-501 "Job Redesign: Improving The Quality of Working Life," by John W. Slocum, Jr.
- 81-600 "Managerial Uncertainty and Performance," by H. Kirk Downey and John W. Slocum, Jr.
- 81-601 "Compensating Balance, Rationality, and Optimality," by Chun H. Lam and Kenneth J. Boudreaux
- 81-700 "Federal Income Taxes, Inflation and Holding Periods For Income-Producing Property," by William B. Brueggeman, Jeffrey D. Fisher, and Jerrold J. Stern
- 81-800 "The Chinese-U.S. Symposium On Systems Analysis," by Paul Gray and Burton V. Dean
- 81-801 "The Sensitivity of Policy Elasticities to the Time Period Examined in the St. Louis Equation and Other Tests," by Frank J. Bonello and William R. Reichenstein
- 81-900 "Forecasting Industrial Bond Rating Changes: A Multivariate Model," by John W. Peavy, III
- 81-110 "Improving Gap Management As A Technique For Reducing Interest Rate Risk," by Donald G. Simonson and George H. Hempel
- 81-111 "The Visible and Invisible Hand: Source Allocation in the Industrial Sector," by Richard A. Bettis and C. K. Prahalad
- 81-112 "The Significance of Price-Earnings Ratios on Portfolio Returns," by John W. Peavy, III and David A. Goodman
- 81-113 "Further Evaluation of Financing Costs for Multinational Subsidiaries," by Catherine J. Bruno and Mark R. Eaker
- 81-114 "Seven Key Rules For Successful Stock Market Speculation," by David Goodman
- 81-115 "The Price-Earnings Relative As An Indicator of Investment Returns," by David Goodman
- 81-116 "Strategic Management for Wholesalers: An Environmental Management Perspective," by William L. Cron and Valarie A. Zeithaml
- 81-117 "Sequential Information Dissemination and Relative Market Efficiency," by Christopher B. Barry and Robert H. Jennings
- 81-118 "Modeling Earnings Behavior," by Michael F. van Breda
- 81-119 "The Dimensions of Self-Management," by David Goodman and Leland M. Wooton
- 81-120 "The Price-Earnings Relatives - A New Twist To The Low-Multiple Strategy," by David A. Goodman and John W. Peavy, III.

- 82-100 "Risk Considerations in Modeling Corporate Strategy," by Richard A. Bettis
- 82-101 "Modern Financial Theory, Corporate Strategy, and Public Policy: Three Conundrums," by Richard A. Bettis
- 82-102 "Children's Advertising: The Differential Impact of Appeal Strategy," by Thomas E. Barry and Richard F. Gunst
- 82-103 "A Typology of Small Businesses: Hypothesis and Preliminary Study," by Neil C. Churchill and Virginia L. Lewis