ACE Research Vignette: The new venture mortality myth

This series of research vignettes is aimed at sharing current and interesting research findings from our team of international Entrepreneurship researchers. In this vignette, Dr Jonathan Levie of the University of Strathclyde notes wide and persistent gaps between perceptions and measures of new business mortality, and discusses possible implications.

Background and Research Question

Studies show that in the world’s advanced economies, new businesses do not suffer a high failure rate. Probably the most comprehensive cross-national set of new business survival rates (or more correctly, one year persistence rates) has been collected by the OECD Entrepreneurship Indicators Programme. For example, in 2005, over 80% of enterprises that entered an OECD country’s official records in one year were still recorded as persisting to the next year. Five-year persistence rates are just over 50%, on average. Is this a high or a low failure rate? Let’s compare this to job tenure.

Studies show that the median life of a typical new enterprise in an annual cohort, at around five years, is longer than the median tenure of a new job in Canada or the UK, and around the same as the median spell in self-employment in the US. Seen in this light, an enterprise discontinuance rate of 50% after five years is around what one would expect, and is neither high nor low. Furthermore, a significant proportion of these discontinuances are not failures. For example, the Global Entrepreneurship Monitor found in 2008 that in developed countries, about one third of the businesses that were discontinued by an owner in the previous 12 months continued in another form or with different ownership. Financial problems were cited by just over 40% of the owners as the most important reason for discontinuing the business.

Oddly, there is still a widespread perception in the media and in the public mind that new firms have a high mortality rate. A Google search on 26 and 27 July 2009 of the exact phrases “of businesses fail in their first year”, “of new businesses fail in their first year” and “of small businesses fail in their first year” revealed 301 percentage failure rate estimates on identifiably different websites. The average % failure rate quoted was 57%, while half of all estimates were at least 50%. Only 67 of the 301 estimates were attributed. 63% of the estimates were exactly 50%, and almost all of these also quoted an estimate of 95% in five years. Other surveys come up with similar new business failure rate estimates.

This leaves us with a question: why do most people think that new ventures have a high failure rate and does it matter?

How we investigated this

We tracked back phrases and sentences used to give new business failure rate estimates on the world wide web to their sources, almost all of which were false. We categorised the estimates by type of error and the profession of the person quoting the statistic. Then we used data from a range of surveys on entrepreneurial attitudes and activity in the United Kingdom to estimate what the actual rate of business start-up might be in the UK, if people knew the “true” failure rate.
**What we found**

We found that the myth of high failure rates was perpetuated by poor quality referencing of empirical evidence; misinterpretation of empirical evidence, and stating of assumptions without any referencing. These practices are used by promoters of books on how to achieve success and avoid failure in business, journalists in search of sensational stories, successful entrepreneurs who believe they are ‘special’, business advisors and trainers who wish to justify their work, suppliers of business equipment and services such as IT, business rescue, insurance and credit rating who wish to advertise their services, and, yes, academics who wish to justify their business research.

Data from a survey of perceived failure rates among individuals at different levels of engagement in new business activity in the United Kingdom suggested that the new firm failure rate myth has a significant and detrimental effect on over half of those thinking about starting a business, by reducing the perceived feasibility and the perceived desirability of this activity. Global Entrepreneurship Monitor data on skills and opportunity perception among individuals at different stages of engagement in new business activity who did and did not fear failure in business enabled us to estimate how nascent entrepreneurship rates in the UK might differ if people knew what the true failure rate was. Combining the potential yield from “thinkers” and “avoiders” for whom the principal barrier to starting a business appears to be fear of failure, we concluded that widespread knowledge of the true failure rate of new firms could lift the UK nascent entrepreneurship rate by around a third.

**Business and Policy Advice**

The true failure rate is much lower than the inverse of the survival rate, and also much lower than most people think. Interpreting “not survived” as “failed” and “not successful” as the inverse of “successful” is mistaken at best, disingenuous at worst. By making these terms equivalent, some academics and others with vested interests in heightening fear of failure have exaggerated the failure statistics, creating a very real fear of failing among a significant segment of the population and reducing nascent entrepreneurship rates.

The perception of high new firm failure rates causes misallocation of resources by government agencies, banks, entrepreneurs, and investors. Governments around the world encourage people to think about starting a business. At least some of this effort is unproductive because it results in people discovering and dwelling on the (false) high new business failure rate. A campaign to appraise people of the facts of the matter could produce a significant lift to nascent entrepreneurship rates.

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