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Starting Up Economic Engines:

Key Highlights from a Survey of Minnesota's Business Start-ups

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THE BIG PLAN

Introduction

New businesses are key to a strong economy. They create new ideas, take advantage of niche markets and implement innovative techniques and strategies. Studies have shown that highly successful fast-growing new businesses provide much of the fuel to drive economies forward, may generate 60 percent of net new jobs and may account for about 50 percent of the difference in economic growth rates among industrial nations.[1]

In Minnesota, more than 12,100 new businesses were started in 2000. Although only a small number of these business start-ups will develop into high-growth companies, this potential source of success is critical to the state's future economic health. The start-up businesses generated approximately 47,300 new jobs in Minnesota during this period.[2]

However, not all start-up businesses succeed. A recent study by the U.S. Census Bureau found that about half of the new start-ups with employees survived for at least four years. Factors that led to longer survival included ample capital resources, educational background and starting the business for personal reasons. Young owners, businesses with limited capital and retail trade businesses were some factors that raised the likelihood of closure.[3]

The Minnesota Department of Trade and Economic Development (DTED) conducted a survey of business start-ups in the spring of 2001 in an attempt to understand some of the factors that contribute to the success of start-up businesses in Minnesota. Rather than surveying companies that had failed and the reasons for their dissolutions, as is commonly done, DTED pursued surviving businesses to find out what obstacles they had faced or were facing, and how some of these problems were being overcome.

Industries were selected based on their relatively higher potential for selling goods and services outside of Minnesota. Businesses that have sales beyond the local economy have the capacity to bring new income into the local economy, thereby generating growth, rather than merely redistributing income among businesses.

The selected industries included manufacturing, transportation, communications, computer-related services, business services and engineering and research-related services. The surveyed businesses started operations in Minnesota between 1994 and 1998 and initially employed more than four people. Surveys were mailed to 1,699 companies in March and April 2001. There were 512 returned surveys. After accounting for usable[4] responses, the response rate was 23.3 percent. The analysis of survey results applies only to the usable surveys.

Profile of Respondents

Founders were often young. Entrepreneurs between 25 and 44 years old started about 65 percent of the businesses and those between 45 and 64 years old started 29 percent. The start-ups had mainly one or two founders: 33 percent had one founder and 45 percent had two founders.

About two-thirds of the respondents were located in the metro area. Many of the businesses included a female founder (122 businesses, or 34 percent), while only a few (13 businesses) included an ethnic or racial minority founder.

As expected, most of the start-ups were small businesses: 76 percent of respondents employed 25 people or fewer. Only 10 percent employed more than 50 people. While 39 percent of the start-ups generated between $1.0 and $4.9 million in annual revenue, almost half generated less than $1.0 million in annual revenue.

The respondents' main industry areas were manufacturing (29 percent), business services (16 percent) and computer-related services (12 percent). About 18 percent of the start-ups (65 respondents) operated in high-tech areas (computer and electronics, electrical equipment, medical equipment or computer-related services).

Most of the businesses were located in Minnesota for personal reasons (home state, family and friends), but local customers (50 percent) and quality of life (39 percent), as well as local services, local suppliers and local competitors, also motivated the location decision.

About 38 percent of businesses offered new-to-market products or services, or improvements to existing products or services. More than 58 percent reported that their product or service was already on the market.

Although 75 percent of businesses indicated no current (or future) international sales, businesses in the Twin Cities and businesses involved in high-tech were relatively more likely to be planning entry into international markets.

Business Knowledge and Experience
The educational background and previous business experience of the founders, as well as preliminary steps taken by the founders, greatly impact the success of the new business.

The educational background of the founders varied by location. Business entrepreneurs in the Twin Cities were more likely to have a bachelor's degree. In contrast, entrepreneurs located outside the Twin Cities were more likely to hold a trade or vocational degree or a high school diploma or less.

Most of the respondents (64 percent) stated that the founders had no previous experience starting a business. However, this absence of experience was more prevalent for businesses outside the Twin Cities (about two-thirds) than for Twin Cities businesses (just over half).

About 62 percent of the start-ups prepared a business plan before starting operations. Marketing-related preparations were also important to the 38 percent of the start-ups who performed market research and to the 30 percent who prepared a marketing plan. However, more than one quarter (27 percent) did not prepare a business or marketing plan, perform market research, assemble a team of experts or organize an advisory board.

Government Services and Programs
Government services and programs supplement or fill gaps not covered by the private sector. The most commonly consulted government service was access to loans (27 percent), followed by tax-related services (25 percent), business planning (23 percent), advice on how to operate a business (19 percent) and local economic incentives (14 percent). Although start-ups were not highly satisfied with many government services, users were most satisfied with pollution control assistance and such technical assistance as how to operate and manage a business and site location.

Businesses located outside the Twin Cities were somewhat more likely to have consulted state and local government services and programs, and found them slightly more valuable than their Twin Cities peers. Non-high-tech companies were slightly more likely than high-tech companies to have used government services and programs.

Capital Needs and Sources
Financial capital is needed to start the business and to cover operations. In the survey[5], start-up capital was defined as capital used to establish a company and to initiate marketing, manufacturing and sales activities and working capital was defined as capital used for activities such as marketing efforts, expanding sales or developing an improved product.

Almost 40 percent of the businesses were started for less than $50,000, and 25 percent had start-up costs between $50,000 and $100,000. In the entire group, 62 percent said that their actual start-up costs were as expected. About two-thirds (63 percent) of the founders who had prepared a business plan reported that actual start-up costs were as expected.

The most common source of capital was personal funds (85 percent). Less than 10 percent of those who used personal funds, credit cards or family reported high difficulty in obtaining this financing for start-up capital. Metro area respondents were more likely to use personal funds, credit cards and friends as sources of capital, while non-metro businesses had a greater tendency to seek commercial bank loans and government sources.

Just over half of all respondents (52 percent) sought outside debt or equity financing. A greater share of non-high-tech companies (53 percent) than high-tech companies (45 percent) sought outside financing. Of those who sought outside financing, the most significant challenge in obtaining debt financing was the collateral or deposit requirement (35 percent).

Most companies sought outside financing from traditional sources such as commercial banks. About 40 percent of start-ups succeeded in raising start-up capital from commercial bank loans, and of these, less than 30 percent had high difficulty in obtaining start-up capital from this source.

Less traditional sources of financing seem to present a higher degree of challenge. Fewer than 30 respondents sought start-up funds from either private placements, venture capital investors or initial public offerings, and most reported high difficulty in obtaining this financing. Forty respondents succeeded in receiving government loans or incentives for start-up capital, and 60 percent of these had high difficulty in obtaining this financing.

Business Operations and Technology
In order to better operate the business, owners have various ways to fill the gaps in their experience and knowledge. About two-thirds of the start-ups hired personnel with the needed expertise and sought advice from a mentor or advisor, which was regarded as the most useful actions to improve business operations. Switching to full-time work on the new business was also rated as one of the most effective means of improving business operations.

Outside experts and professionals (fee-for-service or non-fee) were consulted by less than half of the start-ups and were highly useful to only about half of those who used such services.

Not surprisingly, 88 percent of high-tech businesses used high-speed Internet access, compared to two-thirds of non-high-tech businesses using this technology. Start-ups located in the Twin Cities (76 percent) were more likely to be users of high-speed Internet access than non-metro area businesses (56 percent). The next most-used technology was computer-based training, for both non-high-tech and high-tech start-ups, and for both metro and non-metro area start-ups.

Taxes and other Regulated Costs
Respondents repeatedly pointed to health benefits costs, payroll taxes, corporate income tax, compensation costs and unemployment insurance costs as having the most adverse effects on their businesses, particularly in the first few years. Although the state has reduced state-controlled costs significantly, most respondents cited these areas as some reasons for the state's lower-than-expected start-up rate.

While a larger share of metro area businesses felt that corporate income tax had a high impact than did their non-metro counterparts, a larger share of non-metro area businesses felt that the other payroll taxes, compensation, unemployment costs and health benefits had a high impact on their business.

Workforce-Related Issues
Despite the ongoing skilled labor shortage, staffing issues were not of great concern to most respondents, perhaps an indication of reduced staffing needs due to the 2001 economic slowdown. Few respondents indicated that lack of basic skills or lack of advanced training had a high impact on labor operations. About one third of the start-ups reported too few qualified applicants for job openings, with the greatest difficulty being recruiting workers in production and technical operations, professional occupations, sales and management. Many more respondents were concerned about the high impact of labor-related taxes and costs than about staffing issues (e.g. hiring, training, staff turnover).

Future Plans
Many start-up businesses plan to diversify their products and services (38 percent), make capital improvements (35 percent), expand or relocate operations in Minnesota (32 percent) and expand sales to other U.S. markets (29 percent). Other plans include investment in research, technology or worker training (23 percent) and expansions or relocations outside Minnesota (16 percent).

A larger share of non-metro area businesses plan to make capital improvements, while a larger share of metro area businesses plan to expand sales to other U.S. markets, and merge or acquire a business in a similar or related industry.

High-tech companies were more likely to be planning on expanding sales to other U.S. and international markets, investing in R&D and advanced technology, diversifying products and services, and expanding over the next two years. In contrast, non-high-tech companies had a greater tendency to be planning capital improvements.

The Next Step
The final report of the survey responses will more fully examine the results and highlight significant differences in responses between populations characterized by factors such as location and industry (for example, metro and non-metro start-ups, high-tech and non-high tech start-ups). These differences may point to ways of improving or revising current programs to help populations of start-ups with different characteristics.

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[1] National Commission on Entrepreneurship, "Five Myths About Entrepreneurs", March 2001 (http://www.ncoe.org, Aug. 2001).
[2] Business Tracking System Report: 2001, Minnesota Department of Trade and Economic Development.
[3] Headd, Brian. "Business Success: Factors Leading to Surviving and Closing Successfully." Center for Economic Studies, U.S. Bureau of the Census, November 2000.
[4] Returned surveys that were not usable involved businesses which were not start-ups or were not established between 1994 and 1998. There were 151 surveys that were not usable.
[5] These definitions are based on the usage of the capital and differ from the traditional accounting definitions.