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Towards a theory on corporate reputation and survival of young firms

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Abstract

A high percentage of companies cease to exist in the first years of life because of their typical fragility. There is a widespread view that these companies are very fallible. New businesses do not have a history that demonstrates, indirectly, their ability to meet the expectations of customers and stakeholders (investors, lenders, strategic partners, suppliers, dealers). Therefore, the main cause of the fragility of the new businesses is the lack of a reputation. This is the weakness that unites the newly established firms, distinguishing them from those who have already passed the first stage of life. This lack of reputation hinders the acquisition of human resources, financial and technical they need to survive. Therefore, these young firms must quickly gain customers and stakeholders confidence. This study highlights this logical relationship between corporate reputation and survival of young companies, focusing some levers that can contribute to the building of corporate reputation.

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Introduction

A high percentage of companies ceases to exist in the first years of life. The high vulnerability is a general characteristic of young companies (Bensman, 2014), since a high rate of fallibility of these firms is relatively

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constant in the "time", i.e. in enterprises established in different years, and in the "space", i.e. in companies operating in different countries and sectors.

The dynamics that occur in the micro-environment in which businesses operate, especially the structure of the industry, can affect the survival of all businesses, both the young and mature (Porter 1985). However, the newly established firms are more vulnerable to other companies (Boubacar and Foster, 2014), although exposed to the same external phenomena and events. The logical consequence is that the cause (or causes) of their fragility must be sought in what is common to all the young business, distinguishing them from other companies that have already passed the first stage of life.

Based on this assumption, with a deductive method, this paper aims to demonstrate that the lack of corporate reputation is the distinctive trait of young companies that makes them very fragile. If it is true that companies can fail even with a positive reputation, it is equally true that the lack of corporate reputation makes it difficult for young companies to overcome the difficulties they face in the competitive arena.

These young companies have a high risk of extinction in the early years of life and do not have a history that can demonstrate their ability to meet the expectations of customers and stakeholders. These two weaknesses make it difficult for them to gain the trust of customers and stakeholders (investors, lenders, strategic partners, suppliers, retailers). As a result, the first difficulty these weak bonds of trust are broken and the company collapse on itself.

This paper aims to provide a theoretical framework that: 1) highlights the logical relation between the lack of corporate reputation and the early termination of business; 2) focuses on some determinants of corporate reputation on which young businesses can leverage to create solid and lasting relationships of trust with stakeholders and, in this way, to reduce the risk of failure in the early stage of life.

The proposed framework is the starting point for subsequent empirical investigations by which to verify the proposed principles and logic relations.

The second section shows that the high fallibility is a distinctive feature of young companies. The third examines the relation between corporate reputation, the strength of the bonds of trust with customers and stakeholders, the vulnerability of the businesses in the early years of life, and focuses on some determinants of reputation on which companies must leverage to reduce their typical high vulnerability.

2. The high fallibility as distinctive character of firms in the first stage of life

Several studies have highlighted the high fallibility of business during the first stage of life (Reynolds and Miller 1992, Van de Ven 1992, Venkataraman et al. 1990, Knaup 2005, Knaup and Piazza 2005)

Our analysis of the data on the five-year survival rates of firms from 21 countries in Europe, operating in 9 sectors, of 3 cohorts (2004-2009, 2005-2010, 2006-2011) and 3 different size classes, shows that the high fallibility is a relatively constant trend over "time" (i.e. in companies started in different years); as well as, but with some exceptions, in "space" (i.e. in different industries and countries) (Nicolò and Ferrara in Press).

Data from the US Department of Labor shows that is 52.10% the five-year survival rate of USA firms of the same three cohorts (2004-2009, 2005-2010, 2006-2011) analyzed in our study (US Department of Labor).

In Canada, the five year survival rate, for the 2001-2006 cohort, is 51% (Fisher and Reuber 2010).

In Australia, an analysis of the cohort 2009-2013, revealed that the survival rate of businesses from birth to 4 years is 62.9%. (Australian Bureau of Statistics Business Register).

Our previous research, referred to Italian companies failed in 2010, revealed that 343 out of 542 companies (63.28%) were established between 1 to 10 years prior to failure (Nicolò 2011).

These statistics cannot be compared at least to the following two reasons: 1) were collected using different criteria; 2) were calculated with reference to companies born in different years and belonging to cohorts of different extension. They, nevertheless, demonstrate that the early years of the companies are very critical in countries very different from each other, regardless of the year in which they were born, the geographical areas and sectors in which they operate. Consequently, the high vulnerability should be considered a general distinctive trait of the new enterprises (Williams, 2014).

The doctrine highlighted that the survival of companies in the first stage of life depends on various conditions (or variables) and, among these, in particular the following:

- Environmental conditions (Mintzberg 1973, Dubini and Schillaci 1988, Buttà 1995, 2003, Moore 2006, Adner and Kapoor 2010, Moss Kanter 2012);
- industry structure (Biggadike 1976, Miller and Camp 1985, Cooper et al. 1986, Sandberg 1986; McDougall et al. 1992);
- the personal characteristics of the founder (Child 1972, Kirzner 1979, Carland et al. 1984, Gartner 1985, Katz and Gartner 1988, Storer 1988, Miles et al. 1988, Shaver and Scott 1991), such as: persistence (Brockhaus and Horwitz 1986, Gatewood et al. 1995); education, competence and experience (Weick 1972, Sandberg 1986, Birley 1989, Brush 1992, Bird 1993, Chandler and Hanks 1994); the tolerance of risk (Brockhaus 1980);
- the activities performed before starting the enterprise and the duration for each of them (Gartner 1988, Bygrave 1989, Timmons 1990, Vesper 1990, Longsworth 1991); the sequence in which these activities take place (Gartner 1985, Van de Ven 1992, Van de Ven and Poole 1995, Van de Ven and Engleman 2004, Carter et al. 1996, Aldrich 1999, Delmar and Shane 2002, Liao et al. 2005).

The outcome of the genetic process (success / failure) depends on many variables, both internal and external, also subjective and qualitative in nature, which influence the costs, revenues, income and, therefore, the survival of enterprises (Gander, 2014). These variables continuously interact and influence each other, exercising unpredictable effects on companies. Even a slight modification of a variable, or set of variables, will make the effects propagate on many others. Each of these influential variables on the performance of companies presents a peculiar reaction time (Coda 1983, Mouritsen and Bekke 1999, Anderson-Gough et al. 2001, Nandhakumar and Jones 2001) and sensitivity to stress (Nicolò 2009, 2013). Therefore, the survival or extinction of the companies in the first stage of life cannot be predicted, nor is it possible to isolate one or a few variables and consider them the only causes of their success or failure (Poole et al. 2000, Aldrich 2001, Van de Ven and Engleman 2004, Nicolò 2013).

This is even more evident considering that each company is a singularity, as it has own distinctive features, both structural and operational (Koplyay et al., 2014), its own “genome”, which makes it unique, different from all other companies (Buttà 2003), also with regard to its ability to overcome difficulties and to adopt effective solutions to problems that may affect their survival.

For these reasons, it is to be avoided, because naively reductionist, any attempt to identify correlations between one or more variables and the success / failure of young companies (Poole et al. 2000). Such an approach, it is appropriate to interpret the operation of simple systems, static and closed, but can not be applied to companies, which are complex and dynamic systems (Morin 1993), that evolve along non-linear paths and operating in a turbulent environment and in constant evolution.

Since the high fallibility is a feature common to the newly established companies (Gatzia and Woods, 2014), because relatively invariant in the "time" (i.e. companies that are born in different years) and in "space" (i.e. companies operating in different countries and industries), it follows that the causes of this general trend should be identified in some feature that is common to the young companies, distinguishing them from those who have already passed the first stage of life.

The lack of reputation is this general characteristic, common to the young companies, regardless of countries in which they are located, the industry in which they operate, and the year in which they were born. This lack of reputation is the cause of the difficulties they face in gain the confidence of the customers and stakeholders.

Even when these young companies attract the resources they need, often fail to create strong bonds with stakeholders that bring resources. The first difficulty, these weak ties often break and the company collapses on itself.

3. Corporate reputation and new ventures survival

Building a positive business reputation requires the ability of the firm to satisfy the expectations of customers and stakeholders (Thompson 1967, Pfeffer and Salancik 1978). If this condition is not fulfilled, businesses cease to exist. This is due to the breaking of the bonds of trust with customers and stakeholders. If it is true that even companies with good reputation can fail, it is also true that the lack of business reputation, a fortiori a bad reputation, definitely affect the survival of businesses.

Referring to the period after the birth and the development of the necessary testing to tune the business model with the market, the company is exposed to the risk of operating for a long time in a *far-from-equilibrium* state

(Prigogine 1955). Since startup, companies begin to deplete financial resources. The companies often run out of funds before building strong bonds of trust with customers and stakeholders.

In such a situation there are also the small family businesses after the succession to the top. The identification with their founder is so strong that his withdrawal very often causes the sudden extinction of these firms. For this reason, when the founder leaves the reins of the company to his / her successor, often break the bonds of trust with customers and stakeholders. This makes it very difficult role of his successor, who must prove that he deserves the trust of customers and stakeholders (Nicolò 2001).

The company's reputation building process should begin before its birth in order to reduce this risk, minimize costs, and time to start-up.

The decision to establish the company must be preceded by clear signals of customers satisfaction and stakeholders confidence. To this purpose it is useful to undertake pilot experiments, participate in business plan competitions (Cannice 2004, Wen and Chen 2007, Russell et al. 2008, Bell 2010, Ross and Byrd 2011), to create strategic partnerships, participate in programs developed by incubators, etc. In this initial phase, the mistake of overestimating ephemeral signals of customer satisfaction (Porter 2001) must be avoided. Some examples: visits to the website, "Like" obtained in the fan page, free downloads, answers to interviews, etc.

Customer satisfaction is the necessary precondition for creating and distributes value and, thus, meet expectations of stakeholders. If the firm satisfies the customer, the reputation will grow with those stakeholders in multiple ways.

The corporate reputation has a positive effect on costs, revenues, and income. A positive reputation allows the company to gain the trust of stakeholders and, being equal all other conditions, to acquire resources paying lower costs. In the same way, a good corporate reputation is the essential for attracting customers and thus, maximize sales revenues.

For this reason, even in the subsequent stages the first, companies must continually improve their reputation. This is to minimize the risk to weak and to break the bonds of trust with customers and stakeholders.

How can young businesses to quickly create corporate reputation?

Young companies can build their reputation through a credible business plan; the only formal model through which they can demonstrate, in an analytical way, to able to achieve sustainability and to meet the interests and expectations of investors, lenders, suppliers, strategic partners, and dealers. This is because they do not have a history that can prove this ability. Evidence shows that many young companies have been able to attract relevant investments and loans, due to the credibility of their project.

Young companies can reduce the time needed to build a positive reputation by taking advantage of the brand of their founder (or co-founders), strategic partners, investors, lenders, and also from ecosystem in which they operate (Hoen, 2014). In newly established family businesses, even the "good name" of the family constitutes a valuable intangible resource for the company.

The companies takes advantage of the reputation that founder has gained in previous entrepreneurial experiences (Child, 1972, Chandler and Hanks 1994, Buttà 2003). If he has a negative reputation, this has a negative effect on the reputation of the company. Similar consequences are produced if the founder has no entrepreneurial experience. This is because inexperience is perceived by stakeholders as a source of risk in itself.

The reputation is also built even creating strong relationships with strategic partners. These partnerships have negative effects when strategic partners have a bad reputation.

Companies can accelerate their ability to acquire resources, also taking advantage of the attractive force within the entrepreneurial ecosystem (Naert, 2014). This effect is very strong in those entrepreneurial ecosystems in which there are business clusters. Therefore they attract customers, qualified workers, suppliers, investors, lenders, retailers. Consider, for example, the tourist towns; the industrial, technological, and agro-food business clusters; urban areas, which are prestigious universities, research centers, incubators and accelerators. These places attract specialized and high skilled human resources and other resources that can be acquired easily by businesses.

The reputation of the ecosystem generates benefits to the brand building of businesses operating in it. This is accomplished if these companies operate in a industry consistent with the specialization of their ecosystem. For example, technology companies benefit from localize in ecosystems such as Silicon Valley or Israel.

Therefore, the choice of where to locate the new venture must aim to benefit from the attractiveness of the environment. For this purpose, this choice must be consistent with the specific resources that the company needs.

The corporate reputation can be considered as a "magnet" that attracts human, financial and technical resources (Nica, 2014). The attractive force of this magnet is constantly changing due to the interaction with the attractive force of the other firms. The entry into the competitive arena of a company with a stronger reputation will reduce the attractiveness of other companies. These, therefore, will suffer additional costs to hold the human, technical and financial resources they need.

A young company will suffer the negative consequences of greater attractive force of more established companies with which competes for the acquisition of resources. However, localizing near these companies with a high corporate reputation, the young company can acquire resources, attracted to the area by the strongest competitors, that they have not acquired (free resources).

The reputation also derives as a result of processes of imitation. If some customers allow or deny their trust to a company, it is likely that other will imitate their choice. Also the confidence assigned or denied from other stakeholders (lenders, venture capitalists, business angels, suppliers, retailers, strategic partners) spreads rapidly as a consequence of imitation. For example, if a company obtains a loan from a bank, it likely increases the inclination of other lenders to grant trust to the company. This effect is also evident in the field of recruitment of human resources: hiring an employee or a manager with an excellent professional reputation, will enhance the company's ability to attract other highly skilled workers (Herr and Ruoff, 2014).

Conclusions

A high percentage of companies is extinguished in the early years of life.

Fragility should be considered as a general characteristic of the young companies that distinguishes them from those who have already passed the first stage. This is because the low rates of business survival are relatively invariant in the "time" (i.e. in different cohorts of firms) and in "space" (i.e. in companies operating in different industries and nations).

This weakness common to young companies is the lack of reputation. Young companies have no history. A credible business plan is the only formal model through which they can demonstrate to stakeholders to be able to survive and achieve sustainability.

From the moment of birth, companies begin to deplete financial resources. Thus, they can exhaust all financial resources, before to achieve sustainability (Glac, 2014). The activities aimed at the construction of corporate reputation, therefore, must begin before starting the company. This is to minimize the time, cost and risk of the startups and, in this way, the vulnerability of young companies.

The corporate reputation facilitates the survival of enterprises, not only because is a prerequisite for the creation of solid and lasting bonds of trust with stakeholders and customers, but also because it increases its ability to create value.

The corporate reputation can be considered as a "magnet" that attracts human, financial and technical resources. If corporate reputation is positive, all other conditions being equal, the level of business risk is perceived as lower (Goyal and Yadav, 2014), and stakeholders will provide the human, financial and technical at lower prices. Even customer confidence will grow and this will enhance the firm's ability to create value.

The level of reputation of a company also varies as a result of processes of imitation. If an investor (or lender) lends confidence to a company, its reputation improves, and with it, the ability to gain the confidence of other investors and lenders.

The good reputation gained by the founder (or by the team of co-founders) in previous entrepreneurial experience, creates benefits of new businesses that he start. Young companies can reduce the time needed to build a positive reputation by taking advantage of the brand of their strategic partners, investors, lenders,

Even the brand of the ecosystem creates benefits for companies operating in it. If the ecosystem has a high attractiveness, the companies will encounter less difficulty in attracting the resources it needs.

The attractive force of the corporate reputation is relative. It changes as a result of the interaction with the attractive forces that arises from the reputation of the other companies with which it competes for the resources.

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