

## 1.4: Evolution

### LEARNING OBJECTIVES

1. Define the five stages of small business growth.
2. Identify the stages of the organizational life cycle.
3. Characterize the industry life cycle and its impact on small business

Small businesses come in all shapes and sizes. One thing that they all share, however, is experience with common problems that arise at similar stages in their growth and organizational evolution. Predictable patterns can be seen. These patterns “tend to be sequential, occur as a hierarchical progression that is not easily reversed, and involve a broad range of organizational activities and structures.” “Organizational Life Cycle,” *Inc.*, 2010, accessed October 7, 2011, [www.inc.com/encyclopedia/organizational-life-cycle.html](http://www.inc.com/encyclopedia/organizational-life-cycle.html). The industry life cycle adds further complications. The success of any small business will depend on its ability to adapt to evolutionary changes, each of which will be characterized by different requirements, opportunities, challenges, risks, and internal and external threats. The decisions that need to be made and the priorities that are established will differ through this evolution.

### Stages of Growth

Understanding the **small business growth stages** can be invaluable as a framework for anticipating resource needs and problems, assessing risk, and formulating business strategies (e.g., evaluating and responding to the impact of a new tax). However, the growth stages will not be applicable to all small businesses because not all small businesses will be looking to grow. Business success is commonly associated with growth and financial performance, but these are not necessarily synonymous—especially for small businesses. People become business owners for different reasons, so judgments about the success of their businesses may be related to any of those reasons. B. Kotey and G. G. Meredith, “Relationships among Owner/Manager Personal Values, Business Strategies, and Enterprise Performance,” *Journal of Small Business Management* 35, no. 2 (1997): 37–65. A classic study by Churchill and Lewis identified five stages of small business growth: existence, survival, success, take-off, and resource maturity. Neil C. Churchill and Virginia L. Lewis, “The Five Stages of Small Business Growth,” *Harvard Business Review* 61, no. 3 (1983): 30–44, 48–50. Each stage has its own challenges.

- **Stage I: Existence.** Neil C. Churchill and Virginia L. Lewis, “The Five Stages of Small Business Growth,” *Harvard Business Review* 61, no. 3 (1983): 30–44, 48–50. This is the beginning. The business is up and running. The primary problems will be obtaining customers and establishing a customer base, producing products or services, and tracking and conserving cash flow. Darrell Zahorsky, “Find Your Business Life Cycle,” accessed October 7, 2011, [sbinformation.about.com/cs/marketing/a/a040603.htm](http://sbinformation.about.com/cs/marketing/a/a040603.htm). The organization is simple, with the owner doing everything, including directly supervising a small number of subordinates. Systems and formal planning do not exist. The company strategy? *Staying alive*. The companies that stay in business move to Stage II.
- **Stage II: Survival.** Neil C. Churchill and Virginia L. Lewis, “The Five Stages of Small Business Growth,” *Harvard Business Review* 61, no. 3 (1983): 30–44, 48–50. The business is now a viable operation. There are enough customers, and they are being satisfied well enough for them to stay with the business. The company’s focal point shifts to the relationship between revenues and expenses. Owners will be concerned with (1) whether they can generate enough cash in the short run to break even and cover the repair/replacement of basic assets and (2) whether they can get enough cash flow to stay in business and finance growth to earn an economic return on assets and labor. The organizational structure remains simple. Little systems development is evident, cash forecasting is the focus of formal planning, and the owner still runs everything.
- **Stage III: Success.** Neil C. Churchill and Virginia L. Lewis, “The Five Stages of Small Business Growth,” *Harvard Business Review* 61, no. 3 (1983): 30–44, 48–50. The business is now economically healthy, and the owners are considering whether to leverage the company for growth or consider the company as a means of support for them as they disengage from the company. Shivanne Byrne, “Empowering Small Business,” *Innuity*, June 25, 2007, accessed October 7, 2011, [innuity.typepad.com/innuity\\_empowers\\_small\\_bu/2007/06/five-stages-of-.html](http://innuity.typepad.com/innuity_empowers_small_bu/2007/06/five-stages-of-.html). There are two tracks within the success stage. The first track is the **success-growth substage**, where the small business owner pulls all the company resources together and risks them all in financing growth. Systems are installed with forthcoming needs in mind. Operational planning focuses on budgets. Strategic planning is extensive, and the owner is deeply involved. The management style is functional, but the owner is active in all phases of the company’s business. The second track is the **success-disengagement substage**, where managers take over the owner’s operational duties, and the strategy focuses on maintaining the status quo. Cash is plentiful, so the company

should be able to maintain itself indefinitely, barring external environmental changes. The owners benefit indefinitely from the positive cash flow or prepare for a sale or a merger. The first professional managers are hired, and basic financial, marketing, and production systems are in place.

- **Stage IV: Take-off.** Neil C. Churchill and Virginia L. Lewis, “The Five Stages of Small Business Growth,” *Harvard Business Review* 61, no. 3 (1983): 30–44, 48–50. This is a critical time in a company’s life. The business is becoming increasingly complex. The owners must decide how to grow rapidly and how to finance that growth. There are two key questions: (1) Can the owner delegate responsibility to others to improve managerial effectiveness? (2) Will there be enough cash to satisfy the demands of growth? The organization is decentralized and may have some divisions in place. Both operational planning and strategic planning are being conducted and involve specific managers. If the owner rises to the challenges of growth, it can become a very successful big business. If not, it can usually be sold at a profit.
- **Stage V: Resource Maturity.** Neil C. Churchill and Virginia L. Lewis, “The Five Stages of Small Business Growth,” *Harvard Business Review* 61, no. 3 (1983): 30–44, 48–50. The company has arrived. It has the staff and financial resources to engage in detailed operational and strategic planning. The management structure is decentralized, with experienced senior staff, and all necessary systems are in place. The owner and the business have separated both financially and operationally. The concerns at this stage are to (1) consolidate and control the financial gains that have been brought on by the rapid growth and (2) retain the advantage of a small size (e.g., response flexibility and the entrepreneurial spirit). If the entrepreneurial spirit can be maintained, there is a strong probability of continued growth and success. If not, the company may find itself in a state of **ossification**. This occurs when there is a lack of innovation and risk aversion that, in turn, will contribute to stalled or halted growth. These are common traits in large corporations.

## Organizational Life Cycle

Superimposed on the stages of small business growth is the **organizational life cycle (OLC)**, a concept that specifically acknowledges that organizations go through different life cycles, just like people do. Carter McNamara, “Basic Overview of Organizational Life Cycles,” accessed October 7, 2011, <http://managementhelp.org/organizations/life-cycles.htm>. “They are born (established or formed), they grow and develop, they reach maturity, they begin to decline and age, and finally, in many cases, they die.” “Organizational Life Cycle,” *Inc.*, 2010, accessed October 7, 2011, [www.inc.com/encyclopedia/organizational-life-cycle.html](http://www.inc.com/encyclopedia/organizational-life-cycle.html). The changes that occur in organizations have a predictable pattern, Robert E. Quinn and Kim Cameron, “Organizational Life Cycles and Shifting Criteria of Effectiveness: Some Preliminary Evidence,” *Management Science* 29, no. 1 (1983): 33–51, and this predictability will be very helpful in formulating the objectives and strategies of a small business, altering managerial processes, identifying the sources of risk, and managing organizational change. “Organizational Life Cycle,” *Inc.*, 2010, accessed October 7, 2011, [www.inc.com/encyclopedia/organizational-life-cycle.html](http://www.inc.com/encyclopedia/organizational-life-cycle.html). Yash P. Gupta and David C. W. Chin, “Organizational Life Cycle: A Review and Proposed Directions for Research,” *The Mid-Atlantic Journal of Business* 30, no. 3 (December 1994): 269–94. Because not all small businesses are looking to grow, however, it is likely that many small companies will retain simple organizational structures.

For those small businesses that are looking to grow, the move from one OLC stage to another occurs because the fit between the organization and its environment is so inadequate that either the organization’s efficiency and/or effectiveness is seriously impaired or the organization’s very survival is threatened. Pressure will come from changes in the nature and number of requirements, opportunities, and threats. “Organizational Life Cycle,” *Inc.*, 2010, accessed October 7, 2011, [www.inc.com/encyclopedia/organizational-life-cycle.html](http://www.inc.com/encyclopedia/organizational-life-cycle.html).

Four OLC stages can be observed: birth, youth, midlife, and maturity. Carter McNamara, “Basic Overview of Organizational Life Cycles,” accessed October 7, 2011, <http://managementhelp.org/organizations/life-cycles.htm>. In the **birth** stage, a small business will have a very simple organizational structure, one in which the owner does everything. There are few, if any, subordinates. As the business moves through **youth** and **midlife**, more sophisticated structures will be adopted, and authority will be decentralized to middle- and lower-level managers. At maturity, firms will demonstrate significantly more concern for internal efficiency, install more control mechanisms and processes, and become very bureaucratic. There are other features as well that characterize the movement of an organization from birth to maturity, which are summarized in Table 1.6.

Table 1.4.1: Organizational Life Cycle Features

Feature	Birth Cycle	Youth Cycle	Midlife Cycle	Maturity Cycle
Size	Small	Medium	Large	Very large
Bureaucratic	Nonbureaucratic	Prebureaucratic	Bureaucratic	Very bureaucratic

Feature	Birth Cycle	Youth Cycle	Midlife Cycle	Maturity Cycle
Division of labor	Overlapping tasks	Some departments	Many departments	Extensive, with small jobs and many descriptions
Centralization	One-person rule	Two leaders rule	Two department heads	Top-management heavy
Formalization	No written rules	Few rules	Policy and procedure manuals	Extensive
Administrative intensity	Secretary, no professional staff	Increasing clerical and maintenance	Increasing professional and staff support	Large-multiple departments
Internal systems	Nonexistent	Crude budget and information	Control systems in place: budget, performance, reports, etc.	Extensive planning, financial, and personnel added
Lateral teams, task forces for coordination	None	Top leaders only	Some use of integrators and task	Frequent at lower levels to break down bureaucracy

Source: Richard L. Daft, *Organizational Theory and Design* (St. Paul, MN: West Publishing, 1992), as cited in Carter McNamara, "Basic Overview of Organizational Life Cycles," accessed October 7, 2011, <http://managementhelp.org/organizations/life-cycles.htm>.

A small business will always be somewhere on the OLC continuum. Business success will often be based on recognizing where the business is situated along that continuum and adopting strategies best suited to that place in the cycle.

## Industry Life Cycle

The industry life cycle (ILC) is another dimension of small business evolution, which needs to be understood and assessed in concert with the stages of small business growth and the OLC. All small businesses compete in an industry, and that industry will experience a life cycle just as products and organizations do. Although there may be overlap in the names of the ILC stages, the meaning and implications of each stage are different.

The **industry life cycle** refers to the continuum along which an industry is born, grows, matures, and eventually experiences decline and then dies. Although the pattern is predictable, the duration of each stage in the cycle is not. The stages are the same for all industries, but every industry will experience the stages differently. The stages will last longer for some and pass quickly for others; even within the same industry various small businesses may find themselves at different life cycle stages. "Industry Life Cycle," *Inc.*, 2010, accessed June 1, 2012, [www.inc.com/encyclopedia/industry-life-cycle.html](http://www.inc.com/encyclopedia/industry-life-cycle.html). However, no matter where a small business finds itself along the ILC continuum, the strategic planning of that business will be influenced in important ways.

According to one study, the ILC, charted on the basis of the growth of an industry's sales over time, can be observed as having four stages: introduction, growth, maturity, and decline. "Industry Life Cycle," *Inc.*, 2010, accessed June 1, 2012, [www.inc.com/encyclopedia/industry-life-cycle.html](http://www.inc.com/encyclopedia/industry-life-cycle.html). The **introduction** stage "Organizational Life Cycle," *Inc.*, 2010, accessed October 7, 2011, [www.inc.com/encyclopedia/organizational-life-cycle.html](http://www.inc.com/encyclopedia/organizational-life-cycle.html). finds the industry in its infancy. Although it is possible for a small business to be alone in the industry as a result of having developed and introduced something new to the marketplace, this is not the usual situation. The business strategy will focus on stressing the uniqueness of the product or the service to a small group of customers, commonly referred to as innovators or early adopters. A significant amount of capital is required. Profits are usually negative for both the firm and the industry.

The **growth** stage "Organizational Life Cycle," *Inc.*, 2010, accessed October 7, 2011, [www.inc.com/encyclopedia/organizational-life-cycle.html](http://www.inc.com/encyclopedia/organizational-life-cycle.html). is the second ILC stage. This stage also requires a significant amount of capital, but increasing product standardization may lead to economies of scale that will, in turn, increase profitability. The strategic focus is product differentiation, with an increased focus on responding to customer needs and interests. Intense competition will result as more new competitors join the industry, but many firms will be profitable. The duration of the growth stage will be industry dependent.

The **maturity** stage“Organizational Life Cycle,” *Inc.*, 2010, accessed October 7, 2011, [www.inc.com/encyclopedia/organizational-life-cycle.html](http://www.inc.com/encyclopedia/organizational-life-cycle.html). will see some competition from late entrants that will try to take market share away from existing companies. This means that the marketing effort must continue to focus on product or service differentiation. There will be fewer firms in mature industries, so those that survive will be larger and more dominant. Many small businesses may move into the ranks of midsize or big businesses.

The **decline** stage“Organizational Life Cycle,” *Inc.*, 2010, accessed October 7, 2011, [www.inc.com/encyclopedia/organizational-life-cycle.html](http://www.inc.com/encyclopedia/organizational-life-cycle.html). occurs in most industries. It is typically triggered by a product or service innovation that renders the industry obsolete. Sales will suffer, and the business goes into decline. Some companies will leave the industry, but others will remain to compete in the smaller market. The smaller businesses may be more agile for competing in a declining industry, but they will need to carefully formulate their business strategies to remain viable.

#### KEY TAKEAWAYS

- Small-business management should consider the growth stages, the OLC, and the ILC in its planning.
- There are five stages of small business growth: existence, survival, success, take-off, and resource maturity. The success stage includes two substages, growth and disengagement. Ossification may result if a mature small business loses its entrepreneurial spirit and becomes more risk averse.
- Some small businesses may not be looking to grow, so they may remain in the survival stage.
- The OLC refers to the four stages of development that organizations go through: birth, youth, midlife, and maturity.
- Some small businesses may stick with the very simple organizational structures because they are not interested in growing to the point where more complicated structures are required.
- The ILC is the time continuum along which an industry is born, grows, matures, declines, and dies.
- There are four stages in the ILC: introduction, growth, maturity, and decline.

#### EXERCISE

1. Interview the owners of three small businesses in your community, each a different type and size. Where would you put each business with respect to the five stages of small business growth? Justify your answer.

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