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EVALUATING THE RISK OF RUIN:
A CRITICAL EXAMINATION OF NEW
VENTURE RISK AND RETURN

by

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ABSTRACT

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New ventures play an important role in any economy, yet the dynamics of the process are poorly researched and badly understood. This study provides a detailed analysis of start-up businesses in New Zealand, exploring the risks and returns of new ventures as well as the motivations behind the start-up decision. It analyses new business formations from 1987 to 1993 and determines their success rates and growth. This leads to the conclusion that the high failure rates, when combined with the low growth rates of survivors, results in returns that are on average insufficient to justify the high risks involved. Despite insufficient returns, far more new ventures are started than the economy can absorb. It is this oversupply of new firms which is identified as the underlying cause of the high business failure rates.

A survey is used to investigate the motivations of people in the process of founding a business. New venture founders, as a group, are shown to have unrealistic expectations as to the financial returns that can be achieved. While their estimates of the risk of starting a business are reasonably accurate, they tend to believe that this risk only apply to others. When viewed through the eyes of their founders, a new business is an extremely attractive proposition providing high rewards, in both financial and non-financial terms, with only a modest risk of failure.

The phenomena observed are at odds with neo-classical economics, but are consistent with emerging theories, particularly evolutionary economics. The role of new ventures in economic development is explored. The views presented provide a fresh perspective on the nature and role of business start-ups, which is in marked contrast to commonly held views upon which many public policy initiatives are based.

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