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A RE-CONCEPTUALIZATION AND TEST OF EXIT, EXIT RATES, EXIT ROUTES, AND THE TENUOUS LINK TO FIRM PERFORMANCE (INTERACTIVE PAPER)

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INTERACTIVE PAPER

A RE-CONCEPTUALIZATION AND TEST OF EXIT, EXIT RATES, EXIT ROUTES, AND THE TENUOUS LINK TO FIRM PERFORMANCE

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Principal Topic

Previous research examining firm exit rates has focused upon failure rates and the consensus has been that new firms fail at an alarming rate. Several perspectives including theories of efficiency, utility maximization, and natural selection explain that firms will exit the market if they fall below a certain level of output and well-performing firms survive while those with poor performance do not. However, new research exists which suggests that exits should not be equated with failure (Headd, 2003). Threshold theory and prospect theory, with its recent application in behavioral finance, have been used more recently to explain these discrepancies.

In order to begin to reconcile the differences between these findings and theoretical perspectives this research completes a follow-up study of 5 year old firms to examine exit/failure rates and the reasons for exit.

Method

This study is a follow-up to a 2005 exit strategy study of 113 firm founders. The 2009 follow-up study uses secondary data (internet searches, Census data, bankruptcy records) and telephone interviews to determine firm status (continuance, exit) and reason for exit.

Results and Implications

Analyses indicate that 59% of the firms were continuing firms and 37% had exited. Exited firms were recoded into five categories (failure, success, liquidation with poor and strong performance, and liquidation for personal reasons). While nearly 2/3 of these firms were ongoing, the rest had exited through various means. Sixteen percent had completed successful harvesting strategies, 8% were outright failures or distress liquidations, 10 percent liquidated with high performance, and 3% liquidated due to personal reasons (death, disability).

This research examines firms that have survived the first five years of the start-up process and are thereby considered to be stable economic entities; however this analysis indicates a continual churning among these firms as well. Our research supports previous research which indicates that entrepreneurs liquidate both high and low performing firms, but adds to this literature by indicating that personal reasons also account for firm exit. This research adds to the growing literature which indicates that exit should not be equated with failure, that firm performance is only one of many explanations for exit, and that true failure rates are overstated.

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