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Planning Against A Business Failure

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Development of value-added enterprises, corporate downsizing, a generally favorable economy and ill-feelings toward corporate America are reasons that have been given for recent increases in the number of people starting small businesses. While small business growth represents a positive contribution to the nation's continued economic expansion, entrepreneurs need to be aware that it takes more than a good idea for a small business to succeed. Small business entrepreneurs must plan for success. This includes market research, identifying the primary audience/consumer and developing a five or ten year plan that includes cash flow, financing and expansion concerns[1].

According to Dun & Bradstreet reports, "Businesses with fewer than 20 employees have only a 37% chance of surviving four years (of business) and only a 9% chance of surviving 10 years." Restaurants only have a 20% chance of surviving 2 years. Of these failed business, only 10% of them close involuntarily due to bankruptcy and the remaining 90% close because the business was not successful, did not provide the level of income desired or was too much work for their efforts [2].

The old adage, "People don't plan to fail, they fail to plan" certainly holds true when it comes to small business success. The failure rate for new businesses seems to be around 70% to 80% in the first year and only about half of those who survive the first year will remain in business the next five years [3].

During the first half on 1997, over 43,000 U.S. businesses failed. This failure rate was up 13% from the first six months of 1996. Dollar liabilities from business failures totaled over $20 billion, 40% over the same time period of the previous year [4].

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[1] "Keys Two Long-Term Success in Business," Paul Stappas, Franchise Handbook: On-Line.

[2] "Some of the Reasons Why Business Fail and How to Avoid Them." Entrepreneur Weekly, Issue 36, 3-10-96.

[3] The Business Plan, Small Business Development Center, Bradley University, Peoria, IL.

[4] "Business Failures Rise in Nearly Every Industry Sector in First Half of 1997," Neil DiBernardo, Dun & Bradstreet - News, Views and Trends.

Nine out of ten business failures in the United States are caused by a lack of general business management skills and planning [5]. During the early 1990's, worldwide business failures occurred at rates higher than any time since the 1930's [6].

While no person should start a new venture preparing for failure, they should have a clear plan for success which involves actions if things do go wrong. Every business has a life span that is depicted by its business life cycle. A business life cycle is normally defined by four stages; Introduction, Growth, Maturity and Decline. Most business life cycles will experience a slow introduction and growth stage, a short maturity stage and a rather quick decline stage. Determining why most businesses fail can be a helpful identification of the eventual decline phase of a business.

In a broad perspective, business failures can be classified into two categories; catastrophic failure and general lack of success. Catastrophic failures are the primary result of economic factors. According to Dun and Bradstreet, over 75% of those businesses that cite economic factors as a reason for failure, indicate that a lack of profits is the primary reason. Catastrophic failures also result from the death of a partner, fire, fraud, burglary and acts of God.

According to Dun & Bradstreet statistics[7], 88.7% of all business failures are due to management mistakes. The following list summarize the 12 leading management mistakes that lead to business failures.

1) Going into business for the wrong reasons
2) Advice from family an friends
3) Being in the wrong place that the wrong time
4) Entrepreneur gets worn-out and/or underestimated the time requirements
5) Family pressure on time and money commitments
6) Pride
7) Lack of market awareness
8) The entrepreneur falls in love with the product/business
9) Lack of financial responsibility and awareness
10) Lack of a clear focus
11) Too much money
12) Optimistic/Realistic/Pessimistic

It should be understood that no magic solutions will guarantee a business success. However, the following items should assist in the improvement of chances for success.

1) Development of a business plan
2) Obtaining accurate financial information about the business in a timely manner
3) Profile of target customer

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[5] Small Business Development Center, Troy State University, Troy, Alabama.

[6] "The Usefulness of Cash Flows in The Prediction of Bankruptcy: An Empirical Investigation Using Artificial Neural Networks" Charalambous & Charitou, Paper presented at the 19th Annual Congress of the Europan Accounting Association, Bergen, Norway.

[7] "Small Business: Preventing Failure - Promoting Success," Lewis A Paul, Jr., the Wichita State University, Small Business Development Center.

4) Profile of competition
5) Go into business for the right reasons
6) Don’t borrow family money and don’t ask the family for advice
7) Network with other business owners in similar industries
8) Don’t forget, someone will always have a lower price than you
9) Realize that consumer tastes and preference change
10) Become better informed of the resources that are available

While a listing of reasons for small business failures would at first seem lengthy, according to Scott Clark of the Puget Sound Business Journal, the majority of the causes can be condensed into the three “Ms” of business failure; Money, Management and Marketing.

Money *It takes a long time for a start-up company to break even because unforeseen contingencies always develop. In the interim, you still need to support your family. Before you launch your business, set aside a nest egg that will allow your family to survive for at least three times longer than the time period you are projecting to achieve break even with the business. Use this same multiplier to project the operating capital your company will need; determine your maximum negative cash flow from your projections and multiply this amount by three to determine the operating capital you should raise. As tough as it is to raise small-business capital, it is always easiest the first time around. If you raise insufficient capital and only achieve small successes by the time your money runs out, investors probably won't be interested in throwing good money after bad.*

Management *The vast majority of aspiring entrepreneurs fill their management ranks with friends. This is not only the surest way to break up a friendship, it is also the most predictable way to enhance failure. Never hire acquaintances to join your management team unless they have management experience appropriate to the field of your business and they are willing to openly disagree with you. Otherwise, you are destined to have mediocre business success at best.*

Marketing *This involves far more than just knowing your market and what motivates it. Most businesses focus on the marketing "push," but few ever focus on the "pull," which is one of the secrets to success. To appreciate the difference, envision a pipeline flowing from your business through your distribution network all the way to your end users. You have a sales force that closes orders with your next level. If you manufacture hardware, this next level could be your dealers. If you bottle soft drinks, it could be grocery stores. This activity puts product in their inventory or on their shelves, and is known as the push because you are pushing products through your pipeline and realizing sales at your end. If this is all you do, you are destined for failure, because if customers don't ask for your product at the other end, the pipeline will become clogged. This is the cause of failure for many businesses that achieve early profits from those orders that initially fill the pipeline and then flounder. The key is to focus on the pull; it is your responsibility, not that of your dealer, to make potential customers aware of what your product will do for them. In this manner they will pull your product out of the other end of the pipeline, and orders will continue to flow smoothly. Even more than your product or service, these three Ms are critical to the success of your business. Take care of them and they will take care of you. Ignore any one of them and you could be courting disaster*[8]*.*

[8] “Reasons for business failure come in three broad groups,” Scott Clark, Puget Sound Business Journal, July 21, 1997.

Table #1 shows four of the most common causes for business failure according to Dun & Bradstreet reports.

TABLE #1 - - COMMON CAUSES FOR BUSINESS FAILURE

MAJOR CAUSE	PERCENTAGE OF FAILURES	SPECIFIC PITFALLS
1) Incompetence	46%	Emotional pricing Living too high for the business Nonpayment of taxes No knowledge of pricing Lack of planning No knowledge of financing No experience in record-keeping or lack of understanding
2) Unbalanced Experience or Lack of Managerial Experience	30%	Poor credit granting practices Excessive bad debts Expansion too rapid Inadequate borrowing practices
4) Lack of Experience in line of goods or services	11%	Carry inadequate inventory No knowledge of suppliers Wasted advertising budget
5) Neglect, fraud, disaster	01%	- - - - - - - - - - - - - - - -

Table #2 shows the types of businesses with the best and worst rates of success in New York after the first and fifth years of operation.

Table #3 provides a list of fourteen common reasons for business failures. The table is presented in a worksheet format so the new business owner/manager can better prepare for business success. For each common reason for failure, planned methods to avoid it can be listed. Then, each method of avoiding can be "rated" in terms of the likelihood of avoiding. Certainly, the total listing of methods to avoid should become a part of the overall business plan. However, those items with a low rating, or a low chance of being avoided should receive special attention during the life and growth of the business.

CONCLUSION

Proper planning is critical to the success of a new business. While some of the best prepared and best planned businesses still fail, an understanding of the above reasons for failure can help assess the overall success potential of a business. In planning against failure, be honest and objective, know yourself and your limitations and be prepared to really manage the business. There are many ways to achieve business success. Study the success of others, identify business role models and network with other business professionals.

TABLE #2- - NEW YORK BUSINESSES WITH THE BEST AND WORST SUCCESS RATES [9]

BUSINESSES WITH BEST RATE OF SUCCESS AFTER FIRST YEAR

1) Religious organizations
2) Vegetable crop production
3) Offices & clinics of medical doctors
4) Apartment building operators
5) Legal services
6) Child day care services

BUSINESSES WITH BEST RATE OF SUCCESS AFTER FIFTH YEAR

1) Religious organizations
2) Apartment building operators
3) Vegetable crop production
4) Offices & clinics of medical doctors
5) Child day care services

BUSINESSES WITH WORST RATE OF SUCCESS AFTER FIFTH YEAR

1) Plumbing, heating, air conditioning
2) Single-family housing construction
3) Grocery Stores
4) Eating places
5) Security Brokers & Dealers
6) Local Trucking

[9] From New York State Department of Labor "Guide to Starting Your Own Business,"
Source: NYS Department of Labor Unemployment Insurance System Employer Accounts.

TABLE #3 - - PLANNING FOR BUSINESS SUCCESS		
REASONS BUSINESSES FAIL	**HOW TO AVOID** (List ways to avoid)	**LIKELIHOOD OF AVOIDING** (Rate 1-10 with a 1 being a small chance of avoiding and 10 being a large chance for avoiding)
Mistaking A Business for a Hobby		
Asking Friends & Relatives for Advice		
Asking Friends & Relatives for Money		
Mismanaging Money		
Poor Marketing		
No Business Plan		
No Understanding of Pricing		
Inability to Manage Growth		
Inability to Plan for Transitional Periods		
Lack of Commitment		
Failure to Set and Revise Goals		
Inability to Develop and Monitor Financial Statements		
Inability to Balance Business & Family		
Underestimation of the Time Requirements		

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