12 Reasons Why New Businesses Fail

by Mike Pendrith

According to Dun & Bradstreet and INC. magazine, 33% of all new businesses fail within the first six months. Fifty percent of new businesses fail within their first two years of operation and 75% fail within the first three years.

Here are the leading reasons of business failures.

1. No Business Plan

You‘ve heard the old saying “If you don’t know where you are going, how will you get there?”

Too many business owners start their business without a plan. They simply “open their doors” for business and then expect to succeed.

Before starting your business, take the time to develop a Business Plan.

Your plan will identify what you want your business to accomplish (where you want to go) and the strategies that you will utilize (how you will get there).

(For tips on how to how to write a Business Plan, see the article entitled “How to Write an Effective Business Plan”).

2. Under Funded

Many businesses fail within the first few months, because the owner runs out of money.

When starting any business, you will need money for all of your start up costs as well as money to sustain the business for the first few months of operation (until cash flow from operations is positive).

Running out of money is a result of poor planning. A properly developed Business Plan will tell you exactly how much money you require for start up expenditures and to operate the business until cash flow is positive.

A business owner should develop Income Statements and Cash Flow Statements for the first two years of operations. That will tell you whether or not you have sufficient funds to sustain the business until it is profitable.

3. Lack of Operating Goals and Objectives

Many business owners create a Business Plan to obtain a loan. Once they receive their funding, they put their plan "on the shelf" and do nothing further with it.

While it is important to have a Business Plan, it is also very important to have specific goals and objectives for the first twelve months of operations.

In your planning process, create goals and objectives for your business. Break down goals and objectives by quarter – in other words, identify all of the things that must be done during the first quarter, the second quarter, the third quarter and the fourth.

Examples of specific goals could be for each month; revenue objectives, profit objectives, numbers of new customers, specific marketing and operational activities, etc.

4. Failure to Measure Goals and Objectives

All too often, once a business starts operating, the owner becomes too immersed in the ongoing daily activities to take the necessary time to assess the progress of the business.

It is fine to establish operational goals and objectives, but you also have to measure how well your business is performing against those goals and objectives.

Measuring against the identified goals and objectives will tell the owner whether or not modifications and alternate strategies are required.

5. Failure to Pay Attention to Cash Flow

There is an old saying in business "Cash is King". In the early months of your new business, monitoring cash flow is extremely important.

It is really as simple as this: if you continue to spend more money than you bring in, you will soon be out of business.

Cash flow is all of the money that you take in each month minus all of your expenditures.

Cash inflow is cash sales and accounts receivables collected.

Cash outflow is all monies paid for inventory purchases and operating expenses (rent, heat, hydro, salaries, marketing expenditures, etc.).

It is not uncommon for most businesses to have a negative cash flow for the first several months of operation (in some businesses this may be for more than a year).

However, at a point in time, the cash from revenues will exceed expenditures and the business will be in a positive cash flow position. Every new business owner has to ensure that he / she has preserved enough cash to reach this point.

6. Failure to Understand the Industry and the Target Customer

Some business owners start their businesses before fully investigating the industry.

What are the trends in your industry – is it growing or declining? What are the opportunities and what are the threats? Where can you position your business in this industry in order that your business will succeed? Will new technologies have an impact on your industry?

If you have not taken the time to understand your industry, you could be entering a "sunset industry".

I have worked with two companies that had to reinvent themselves because they were both in "sunset industries" due to changes in technology. One was a manufacturer of computer printer ribbons for dot matrix printers. This was a very good industry until the introduction of laser and ink jet printers. People stopped buying dot matrix printers and the demand for printer ribbons declined significantly. The other company was a cheque printing company. Due to electronic payments, the usage of cheques declined significantly.

Some business owners open their doors for business without taking the time to understand their target customers (buyer demographics and psychographics, how they buy, what they buy, when they buy, what motivates them to buy and where they buy).

Do not expect that just because you are now in business, that customers will flock to your door. If you do not understand your target customer, how do expect to effectively reach them?

7. No Means of Differentiation – Just Another "Me Too" Business

Many businesses have failed because they are just another "me too" business.

Customers need a reason to come to, or to want to do business with your company.

If your products or services are the same quality and prices as your competitor(s), why will people buy from you? They already have an existing supplier.

If however, you can offer a different or better product / service (better quality, lower prices, broader selection, faster delivery, better location, extended warranty, etc.), prospective customers will want to do business with your company.

Every business owner must objectively ask this question "If I were a customer, why would I want to do business with this (my) company?" If you cannot identify two good reasons, then rethink your positioning and your strategies.

8. Poor or No Marketing Programs in Which to Attract New Customers

Just because you have opened your doors for business, that does not mean that customers will beat a path to it.

You have to announce to prospective customers that (a) you are open for business and (b) why they should want to deal with you.

By understanding the demographics and psychographics of your target customers, you can identify how to best reach them.

There are numerous ways in which you can market your business. Some of the more common are:

Advertisements (newspapers, magazines, radio, television, yellow pages, value packs); billboards; brochures (electronic and printed); cross marketing / cross promotions; direct mail; fax (broadcast or personalized); networking; newsletters; postcards; posters; promotional items; public speaking; referrals; sales calls (cold calls, scheduled calls); sales letters; seminars & workshops; signs (interior and exterior); targeted e-mail; telemarketing; telephone on hold messages; trade shows; website.

In order to ensure that your business succeeds, in the first few months you will have to implement marketing programs that get the attention of, and appeal to the needs of your target customers.

9. Underestimating the Competition

Some business owners underestimate the reaction of the competition when they start their businesses.

Any owner of an existing business that perceives that a new entrant to the industry will be taking away some of their customers, will aggressively take steps to defend their customer base.

They could do this by lowering prices, offering package / bundle pricing, extending terms, introducing new products, improving product quality, extending warranties, increasing marketing activities, etc.

Do no underestimate the competitive reactions to the start of your business. You may find yourself in an extended competitive “war”.

10. Not Cost Competitive

Before starting your business, attempt to obtain information about and to understand the cost structure(s) and selling prices of your competitors.

You may find that your competitors have lower operating costs than you. Your overhead may be too high. Your manufacturing processes may not be as efficient.

If your selling prices are the same as your competitors and their operating costs are lower, their margins will be higher. If that is the case and you get into a protracted price war with a competitor, you will not survive.

You will have to find ways to reduce the cost disparity if you plan to last in this industry. The lowest cost producer will always win a price war.

11. Lack of Attention to Accounts Receivables and Inventory

Some businesses owners do not pay attention to their receivables and their inventories. Accounts receivable and inventory can suck cash from a business.

If customers are not paying you, or are not paying you on time, they are using <u>your money.</u>

If you have excess inventory or slow moving or obsolete inventory, you have your money tied up in products that are of little or no use to your business.

Just as you should be monitoring the cash in the bank, you should also be carefully watching accounts receivables and inventory levels.

12. Poor People Management Skills

Many companies state that their employees are their most important asset.

Frequently customers do business with an organization because they like the people that they deal with in that company.

If you do not treat your people fairly and with respect, you may have a constant turnover of employees.

After a while, due to the constant turnover, customers may become wary about dealing with your company.

If your business requires employees with unique skill sets, it may become difficult to find acceptable replacements. If that is the case, quality and output may suffer leading to customer dissatisfaction and a decline in your business.

Treat your employees well and they will enthusiastically help to grow your business.

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