

# What Causes Small Businesses to Fail?

The short answer is, regardless of the industry, failure is the result of either the lack of management skills or lack of proper capitalization or both.

## Eleven Common Causes of Failure

1. **Choosing a business that isn't very profitable.** Even though you generate lots of activity, the profits never materialize to the extent necessary to sustain an on-going company.
2. **Inadequate cash reserves.** If you don't have enough cash to carry you through the first six months or so before the business starts making money, your prospects for Success are not good. Consider both business and personal living expenses when determining how much cash you will need.
3. **Failure to clearly define and understand your market, your customers, and your customers' buying habits.** Who are your customers? You should be able to clearly identify them in one or two sentences. How are you going to reach them? Is your product or service seasonal? What will you do in the off-season? How loyal are your potential customers to their current supplier? Do customers keep coming back or do they just purchase from you one time? Does it take a long time to close a sale or are your customers more driven by impulse buying?
4. **Failure to price your product or service correctly.** You must clearly define your pricing strategy. You can be the cheapest or you can be the best, but if you try to do both, you'll fail.
5. **Failure to adequately anticipate cash flow.** When you are just starting out, suppliers require quick payment for inventory (sometimes even COD). If you sell your products on credit, the time between making the sale and getting paid can be months. This two-way tug at your cash can pull you down if you fail to plan for it.
6. **Failure to anticipate or react to competition, technology, or other changes in the marketplace.** It is dangerous to assume that what you have done in the past will always work. Challenge the factors that led to your Success. Do you still do things the same way despite new market demands and changing times? What is your competition doing differently? What new technology is available? Be open to new ideas. Experiment. Those who fail to do this end up becoming pawns to those who do.
7. **Overgeneralization.** Trying to do everything for everyone is a sure road to ruin. Spreading yourself too thin diminishes quality. The market pays excellent rewards for

excellent results, average rewards for average results, and below average rewards for below average results.

8. **Overdependence on a single customer.** At first, it looks great. But then you realize you are at their mercy. Whenever you have one customer so big that losing them would mean closing up shop, watch out. Having a large base of small customers is much preferred.
9. **Uncontrolled growth.** Slow and steady wins every time. Dependable, predictable growth is vastly superior to spurts and jumps in volume. It's hard to believe that too much business can destroy you, but the textbooks are full of case studies. Going after all the business you can get drains your cash and actually reduces overall profitability. You may incur significant up-front costs to finance large inventories to meet new customer demand. Don't leverage yourself so far that if the economy stumbles, you'll be unable to pay back your loans. When you go after it all, you usually become less selective about customers and products, both of which drain profits from your company.
10. **Believing you can do everything yourself.** One of the biggest challenges for entrepreneurs is to let go. Let go of the attitude that you must have hands-on control of all aspects of your business. Let go of the belief that only you can make decisions. Concentrate on the most important problems or issues facing your company. Let others help you out. Give your people responsibility and authority.
11. **Putting up with inadequate management.** A common problem faced by Successful companies is growing beyond management resources or skills. As the company grows, you may surpass certain individuals' ability to manage and plan. If a change becomes necessary, don't lower your standards just to fill vacant positions or to accommodate someone within your organization. Decide on the skills necessary for the position and insist the individual has them.

**So, the founder's attitude, ability to be objective, willingness to bring in needed help, and share power are all crucial to success.** "Most startups make the mistake of falling in love with their product or service," says Shukla. "Ultimately, it is this lack of self-criticism that causes many companies, startups and their more mature counterparts, to fail. Startups suffer this fate more often because there are more dreamers than doers." I think that fact speaks for itself," says Jonathan Goldhill, a small-business consultant and former director of an economic development center in California's San Fernando Valley. **"I would say that the primary reason for failure of startups within three years is usually...management's failure to act, or management's failure to react, or management's failure to plan."**

Other reasons why businesses fail in their early years include: poor business location, poor customer service, unqualified/untrained employees, fraud, lack of a proper business plan, and failure to seek outside professional advice.

**While poor management is cited most frequently as the reason businesses fail, inadequate or ill-timed financing is a close second.** Whether you're starting a business or expanding one, sufficient ready capital is essential. It is not, however, enough to simply have sufficient financing; knowledge and planning are required to manage it well. These qualities ensure that entrepreneurs avoid common mistakes like securing the wrong type of financing, miscalculating the amount required, or underestimating the cost of borrowing money.