Business Start-Up issues

"Seven Reasons Why Businesses Fail"

This paper explores the key reasons why businesses fail. If you want your business to succeed, then paying attention to these issues will help you develop effective plans to reduce your risk. All business is about risk, and no business exists without some levels of risk – there are no guarantees. Entrepreneurship is about taking calculated risks, and ensuring that the odds are working in your favour. Ensuring you succeed requires a rigorous approach to making sure you understand and cope with the issues that your business idea will raise.

CONTENTS

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1. Planning:

"Seat-of-the-pants" is often used as a term of abuse in the business world, for people who run their business "on instinct" and are therefore "chancers". Well, sometimes they are very successful, so why is that? The answer, I believe, is that their brains are able, or have learned how, to process and synthesise a lot of disparate data, so that they can focus on the few most important factors, and understand the significance of sometimes apparently minor indications. They are therefore able to be decisive and effective, without major analytical studies. (I once asked an American businessman whom I much respected how he could decide to take over the admittedly small business I ran based on only one visit. His answer: I ask myself three questions. Firstly is the business essentially the same as the one I run, i.e. do I understand it and can we run it; secondly, do the management team understand the business and know what they are doing? Thirdly, are they likely to stay with the business after take-over. If I can answer "yes" to all three, then there is no problem. That did not stop him demanding an extensive business plan, though). Are you that good? If you are not sure, then it pays to get the key information and issues down on paper or computer screen, to allow your mind to assimilate and order all that information. And if you are that good, then how much better could you be, if you did the same and undertook a formal planning process too?

At STANTA we are in favour of "fit-for-purpose" business planning – if the plan is just for you, it only needs to focus on what will help you, and if it is for an investor, then it needs to be more formal and detailed. But in either case, if properly used, it will help you identify the best path forward, give you a basis against which to evaluate your business, and ultimately help you to get better results. It is the roadmap for your business with the assumptions and milestones you have set. As you see what happens in reality, it enables you to go back and correct assumptions, change milestones, and detect errors or omissions in your planning – you should then be able to see the implications of the reality on the elements of your business plan, and in particular, on the finances of your business.

This is critical. Businesses go bankrupt not when they fail to make a profit, but when they run out of cash. If your business is one of those that requires cash to grow – for instance if you have to wait for some time for payment for your product or service, but have to incur some of the costs up front, then you are more likely to go bankrupt because you are exceeding your sales forecast than because you are not achieving it. And this is often a typical start-up business situation: suppliers are unwilling to give credit to an unproven business; unforeseen circumstances – for a new business it is difficult to foresee all the issues - delay project completion and delay the flow of funds from customers; expenses turn out higher than anticipated; the premises refurbishment uncovers a few problems that need attention etc. A sensible plan will build in some contingencies depending on the risks being taken in the business, and will ensure that adequate funds are available to both run the projected business and cope with the likely eventualities. Perhaps the most disheartening of experiences is when a business fails not because the idea or execution was wrong, but because it runs out of money just as it is starting to succeed. Business planning is often the difference between success and survival, or survival and failure. It is worth the effort.

So the most common reason why businesses fail can be summed up in the well-worn but true expression: "failing to plan is planning to fail". In particular, planning for adequate finance to deal with the twists and turns that beset any business is critical. There are many elements to a good business plan but these will lead ultimately to a profit and loss projection and a cash flow forecast based on robust information and justifiable assumptions. STANTA can help you develop a plan, but the first ingredient is always adequate research.

2. Research:

Probably the second most common reason that businesses fail is a failure to research adequately: whether it is failing to understand the market, the market trends and changes that are happening, the competitors, the needs of the buyers or attitudes to the product or service. So the first piece of planning is planning your research. What do you need to know?

Research can encompass anything from finding out what you need to do when starting a business, through desk research on published market information, looking at your competitors' offerings, at company accounts, talking to users and suppliers, using market research questionnaires to gauge attitude, sampling and testing products and ideas, through to complex studies carried out by professional agencies with sophisticated statistical analyses of data gathered. What questions you ask and the method you use all depend on what the crucial things are that you need to know for the success of your business, and how accurate the answer has to be.

At the root of any successful business is a customer with a problem or need for which your product or service can be perceived to be the best, or most practical or most affordable solution. It is **market research** in its broadest sense which identifies the problem, the customer and the features of the product which will provide the solution. Market research is the cornerstone of business planning, and good planning is one of the biggest predicators of business success. Some people think of research as fat theoretical reports but it encompasses many things, a lot of them very direct and practical.

Desk Research can reveal a lot – reading market and company reports and articles can clarify trends and identify opportunities. Hertfordshire has an excellent business library in Hatfield www.hertsdirect.org/libraries.

Observational Research gives more immediate results – for instance counting "footfall" in shopping areas and restaurants, or "mystery shopping" of established suppliers to check how current services work.

Direct Research usually involves some form of questionnaire or structured conversation, whether it is gauging a reaction to a product sample, or asking about attitudes to a product or discussing market developments with a potential customer. This might be implemented via post, on-line, telephone or face-to-face – at its most basic it may seem to be just a chat with a potential client, but if planned and structured this can give real information. All research can be **qualitative** or **quantitative**.

Let's see how this might work in practice: **desk research** on price shows an average price of £100; **observational research** suggests that most people get 10-20% discount; **direct qualitative research** suggests that a small sample of people like your version and consider £95 good value, but **direct quantitative research** shows that 30% of target customers claim they would buy at £95. You can do a lot yourself – research is not cheap – but there are companies offering communal (omnibus) research nationally and for a local version consider: www.adroit-e.co.uk

One area of research which is crucial for any business is **buyer behaviour research**: how, what, why, when, where do your customers buy, and who is the buyer – the decision-maker.

a) How do your customers buy? Do they do research and make an informed decision, or do they buy on impulse? Do they decide what they want, but then have to persuade the purchasing department or their boss to let them buy it? Is there a committee decision? Do they like lots of choice, or does this confuse and put them off making a decision? Understanding this will enable you to target your effort in a way that will get results and save wasting money on unimportant factors (for instance, if consumers research and make informed decisions on a logical basis about factual attributes for your product, there is not much point in putting the cost up with the most glamorous packaging; whereas, if they buy on impulse, this is likely to be a critical factor). It will also help you avoid underestimating the importance of part of your business process: for instance, the internet is widely used to research products even though the final sale may be made on the telephone, or the query answered on the telephone may generate the sale on the internet. Failing to see this could lead to part of the process being ignored and not managed.
b) What do your customers buy? Do they buy prestigious brands or the cheapest they can find? Do they buy in bulk or in small quantity? Do they prefer certain flavours? Do they really buy a product or service, or do they buy reassurance and peace of mind? Offering the right product is critical, but it is also important that it is at the right price in the right place at the right time.
c) Why do your customers buy? What problem does your product solve for them? Does it improve their image and sense of self worth, or take away the pain of a headache? Does it help then succeed in their job, or take away the irritation of an unpleasant chore, or make their life easier by reducing complaints from their clients? You cannot get the right message to encourage your customers to buy from you unless you understand what their motivation is.
d) When do your clients buy? There is usually no point in advertising your product in January if people make the buying decision in June, and if you do it in July it is almost totally wasted. Do your clients have to be in the right mood to buy your product and if so, when is this likely to be? Have you ever had someone try to sell you something when your mind is on other things? Understanding the right time can increase effectiveness and reduce waste.
e) Where do your customers buy? Is it a high street store, or from the internet? By mail order, or on the telephone? In closed boardroom discussion or in an open meeting where you are able to present your product or service? In consumer and commercial markets there are increasing numbers of channels to choose for a purchase, and they are increasingly inter-related. So where do your customers prefer to buy? When the internet first became a sales channel, of course, research would not have suggested that they bought from the internet; but understanding how they currently bought, why they bought and doing more research on their attitudes might have indicated the opportunity.
f) Who are your customers, or who are they likely to be? One of the key areas for new businesses is to be clearly targeted. In business there are ultimately no

second places – you either get the order or you do not. It is impossible to be all things to all people, and by trying to do this, you are likely to be not very special to anybody, so you risk never getting the order. Far better to focus where you have something special to offer, and by carefully selecting your target customers make sure you are special to them. This maybe means that you have fewer opportunities to sell, but your chances of making a sale go up enormously. Even in mundane product areas, product advertising, packaging and presentation is often very specifically targeted. Some soap powders for instance major on their technological attributes whilst others focus on being warm and family friendly: the makers have defined different target markets and are carefully building a package that specifically appeals to that group. Even though others may buy, they know where their strength is, because they know exactly who their main customers are. Whether the product defines the customer, or the customer the product, they need to coincide.

Two words of warning on research surveys of all sorts: it is very easy to bias answers with loaded questions and most people will tend to give you the answer they think you want, so this is not an easy area. Talk to STANTA if you want to get an objective view.

But we often ignore the obvious when looking for help. The Central Resources Library at Travellers Lane, Hatfield, is a mine of business information. Have you had a look at what is there? If you sign up for STANTA's newsletter at www.localbusinessadviser.co.uk/subscribe, when you receive it, **browse the tabs above** under the headings: **Planning, Marketing, Selling, Finance, Purchasing, HR, Legal and Workplace**. Under each heading you will find some sub-headings: Checklists; Frequently Asked Questions; Factsheets, and Features. This information will not answer your specific questions, but it may help you think through many of the issues in your business. The factsheets in particular are quite extensive explorations of issues: you will find Research under the Marketing heading. It will take you through many of the issues relating to researching your business in more detail, including prompting you to think about what it is that you need to know to be confident your business will be successful.

3. Objectivity:

"Mission impossible" - how can people be objective about themselves? Yes, you cannot be completely objective, but there are two ways you can become more objective: i) you can develop measures and a mode of thinking which builds in reality checks, and ii) you can ask opinions of others, especially those who are a) impartial and b) have some relevant experience. Many businesses fail because they see what they want to see, rather than the reality. And this does not just apply to small companies or individuals.

For example, early in my career I worked for a large manufacturer. Marketing reports suggested the market would fragment, with more product varieties required to compete as the lifecycle reached maturity. Despite these reports, the board took the decision to build an ultra-modern high-volume factory at the expense of existing smaller, more flexible units. If a major company board can delude itself so readily, and ignore its own and independent market research, how much easier is it for a lone individual?

So do a SWOT analysis on yourself and your business (Strengths, Weaknesses, Opportunities and Threats) and become more self-aware. Strengths and weaknesses are internal to you and your organisation, and you can do something about them; opportunities and threats are external, and usually, unless you have enormous resources, these are things that you have to understand and adapt to, so that you take advantage of them or negate any ill effects.

A SWOT analysis is not easy to do well – often they can be bland and meaningless. But if done well, this is where the clues as to what is special about you and your business and why people will buy from you can be found. (And remember that amongst your strengths might be not just what you know, and what resources you have, but also who you know). Ask yourself some questions: if no one else is succeeding in doing what I want to do, why will it work for me? If lots are, why will customers come to me? Is there any research and what does it indicate? If not, can I do some? Are people telling me what they think, or what I want to hear? Do my numbers reflect any justifiable experience, or am I forecasting what I hope to see? Are there relevant comparisons? What do people who understand the market say? What do impartial third parties say? Can I test the concept before committing too much of my resources? Most importantly, am I listening to what people are saying to me?

Two more reasons why businesses fail: lack of commitment and of effort. Aren't they the same thing? Well, no. By commitment, I mean the willingness to go the extra mile, the passion for what you are doing and how you go about doing it that marks you out from the rest; by effort I mean having the tenacity to do those jobs that you do not like doing and not putting off what needs to be done. You can have lots of commitment but still not be able to bring yourself to pick up that telephone to make that cold call or chase that outstanding debt, or to write that speech or make that presentation, or whatever it is that you find difficult or uncomfortable.

4. Commitment:

Your business demands a lot from you – you have to be prepared to put in whatever it takes in terms of effort, time, and resources to make it happen. Even if your main objective is to make money rather than to change the market in which you operate, you are more likely to do this if you change your customers' world for the better. You will do this by understanding their problems (research) and providing the solution (by enhancing the product or service, or saving them money or time, for instance). If you know you can solve a client's problem or make their life easier – and that might be as simple as being a friendlier supplier – then that is something that you can be passionate about. Commitment, passion and vision are not the same thing, but they often go together. The drive to "go the extra mile" for the customer reflects commitment, but it is far easier to make that commitment if you really believe in what you are doing for the customer, and that is often expressed in some sort of vision or “mission statement” for the business and its role in its market. And it is clearly easier for the client to believe in an organisation that has a purpose to improve their lot in some way.

If you believe you have a benefit to offer, it is more likely that your staff, your customers and your suppliers will believe it. Commitment is what clients expect from a one-person business (although you do not always get it!) but it becomes more difficult as more people get involved. It’s then that commitment ceases just to be a personal characteristic and becomes part of the business plan. For instance, Avis in the car rental market started as very much the “outsider” to Hertz. So they made a virtue of it, and focused on the punch-line: “We try harder”. That is now part of the business philosophy – if staff do not implement it with clients, their whole marketing position is meaningless, so they make sure they do - trying harder is now ingrained in the culture. Are you clear what your business stands for? Have you that commitment?

As the Avis example shows, commitment can be both a personal quality and a reflection of your business’s strategic positioning in relation to its clients – and its competitors. It does not <u>have</u> to be a real difference (although this usually helps), but it does have to be a perceived difference. This is sometimes reflected in a business mission statement and it similarly verges on the marketing concept of developing a USP (unique selling proposition). This concept may be summed up in the answer to the question: what differentiates your product or service, and your business, from others in the market? In the Avis case it is about attitude to customers; in the case of Marks & Spencer in relation to food “it is not just food, it is M & S food” – quality, luxury and imagination are built into this phrase. The commitment is here passed from a corporate mission/strategy into something that is built into all aspects of the business, including product development and selection and marketing and advertising. Commitment to increasing the size and profitability of the business is probably there in the corporate plan, but this will be an outcome of the commitment to providing some defined benefits to customers and potential customers.

Lack of commitment may be about being not willing personally to put in that bit of extra effort, to take the risk with that savings nest-egg, but it may also be about not finding an imaginative idea that gives meaning to why your business is needed, and how its existence will make life better for someone, so it also has a lot to do with business strategy and hence again with business planning.

<u>5. Effort:</u>
By lack of effort I do not mean being lazy – rather it is being unwilling to drive yourself to do those things you do not like or find difficult – the cold sales call, chasing the debt, making that presentation are typical ones. You know what it is, even if you do not admit it! We have a natural instinct to put these things off – to make sure we are **so** busy doing other things.

But if you are planning in detail and prioritising, then you will know that these **cannot** be put off without imperilling your business. If you do not make the cold calls you will not get enough customers to hit your sales targets; if you do not chase the debt, you may run out of cash and become bankrupt. So what are your options? You can grit your teeth and get on with; you can seek training to become more comfortable and able at whatever it is; or you can find someone who is good at it to do it for you – either by delegating or outsourcing. But do not just hope the issue will resolve itself, because mostly it will not.

Although the subject is effort, you can see we are also back to planning – if you plan and know your clients, then you will also be planning and prioritising your activities and how these will be realised, including all those things you dislike! Then you will make sure you do something about it!

6. Controlling Costs:

From the "helicopter view" of having a clear strategy and detailed plan, through the psychological issues of drive and motivation, we get back to basics with failure to control costs: attention to detail is important to all businesses, not just retail. This goes back to planning though. If you have a clear plan, you will have a view of what your sales and expenses should be. If you are using your plan properly, you will be reviewing actual against plan every month. If you are not achieving your planned sales or gross profit margin, you may need to think of ways of cutting costs – you might want to do this anyway! If your gross margin is down, is that because you have been discounting or just not achieving your planned sales price, or are you paying more than expected for what you buy in to provide your product or service? And if other costs are higher than expected, why? What have you missed or under-estimated in your plan? Which costs can you do anything about? Which costs are significant to the total?

For example, Rachel Bridge in her Sunday Times column identified one of the Seven Deadly Sins of start-up as spending too much on advertising. Many start-up businesses place too much reliance on advertising and not enough on networking and personal selling. Of course, this will depend on what type of business you have, and how fast you need to grow. But advertising is a very difficult area to judge what you will get in return for your money, and many small businesses assume that input in advertising automatically means output in orders, and this is often far from the case. Ensuring what you do is very carefully targeted and testing before committing significant amounts is sensible - "I know 50% of my advertising works but unfortunately I do not know which 50%!"

In the same way, you need to bring attention to detail to all significant areas of costs. Am I paying a fair price? Can I get comparators from other businesses, find alternative suppliers, renegotiate with existing suppliers? Am I using resources efficiently or buying unnecessary services? Can I change the way I operate? – some businesses are now closing retail outlets and operating entirely on-line, for instance.

7. Adapting to Change:

The last part of this sequence focuses on failure to adapt to change. We have looked at the need for attention to detail; but any business must keep an eye on the bigger picture, and particularly on the customer and the market place. It is easy to miss changes that make your product out-dated, change your channel to market, or change your customers' attitude to your product or service – the changes can be driven by many factors including competition, cultural and demographic changes, technology and legislation. But unless you are aware, it is easy to miss them. They say, if you drop a frog into hot water it will jump out, but if you slowly heat the water up it will not notice until too late. Please do not put this to the test, but you get the idea!

Let's think of examples:

- **Competition -** there was a thriving British motor-cycle industry until the Japanese arrived with small disregarded low-power machines – and attacked each segment until the UK industry was practically annihilated;
- **Cultural** - green issues are becoming a significant factor in people's attitudes, so will the phenomenal growth of the Sports Utility Vehicle continue?
- **Demographics -** across Western Europe the populations are rapidly aging with low birth-rates and longer life-expectancy, changing levels of demand for many products;
- **Technology** - the internet is changing the high street with electrical and entertainment retailers finding it increasingly difficult to survive: the internet has created a different channel to market and a new product - the download. Are the big players in this the traditional providers?
- **Legislation and taxation -** will the introduction of a smoking ban in public places effect the way many businesses market themselves? How has the increasing taxation on company cars affected the car market?
- **Market Changes and product life cycle** – if we consider the car market again, 30 years ago the vast majority of cars were 4/5 seat saloons, with the mainstream Ford and Vauxhall brands dominating. A number of interesting changes in the market have taken place, driven in part by many of the factors above, but also the natural process of markets to segment into more specialised sub-groups. And so we have seen develop significant separate markets for touring/estate vehicles, coupes and now alternatively powered vehicles; the sports car market has grown much bigger as has the luxury vehicle market, 4x4s and SUVs have emerged onto the scene, and the luxury brands have become increasingly core brands. The market is no longer dominated by the standard saloon car, nor by the traditional brands. These changes have had a very damaging effect on some businesses and opened up new opportunities for others. Back in the heyday of the saloon car, who would have imagined that Jeep and Land Rover would become significant consumer brands? These were traditionally brands bought by farmers and explorers, for special purposes only; now the majority of sales of these brands go to suburban dwellers.

You can probably think of better examples, but make sure you are not the frog ignoring a gradual warming. Top businesses are aware of their changing environment and of customers and their thinking; and are flexible and adaptable, evolving to cope with an ever-changing world. This is again something which should ultimately be reflected in your planning.

8. Summary

So there are many reasons that contribute to business failure, but most of them can be addressed by attention to research and planning. In some ways almost all failures come about because businesses run out of cash, but this can be viewed as a failure to plan. Good research and planning can resolve most of the issues during the whole of a business lifecycle, whether it is whether my business idea is viable in the first place and how can I expand it, through to what happens when I want to retire or how do I sell the business. Research itself should be carefully planned if it is going to be fully effective. So in some ways any failure will be a failure to plan – and that is why business support organisations generally give planning the highest priority in working with their clients.

If you want to discuss any business issues with a STANTA adviser, contact Mel or Ginny on 01727 837760 or advice@stanta.co.uk