Why Businesses Fail

(and How You Can Avoid the Pitfalls)

Community Futures is not strictly in the business of loaning money to entrepreneurs – we really want to help build successful businesses that will have a positive and lasting impact on the economies of rural communities. So, anything we can do to help reduce the risks is a good thing – including sharing our wisdom about why some businesses fail while others succeed.

There are two main reasons that small businesses fail: poor management, and economic conditions. The first you can control. The second you can't – but you can be informed and strategic in your response.

1. **Managerial Shortcomings.** The good news about managerial shortcomings is that these are issues that you have control over. Good preparation can increase your chances of success. Key reasons for business failure related to business management include:

    a. Poor cash flow management or poor understanding of cash flow

    b. Poor capital structure – that is, errors in determining how much start-up capital is needed, inadequate financing, or, conversely, too much debt

    c. Over-expansion

    d. Lack of a well-developed business plan

    e. Poor pricing

    f. Being overly optimistic (about sales, time and energy required to be successful, etc.)

    g. Managerial inexperience: ineffective time management, not recognizing your weaknesses, not following your business plan after it is developed, poor delegation skills, hiring the wrong people, poor people management skills, poor execution or weak internal controls

    h. Lack of experience in the industry you are doing business in

    i. Poor marketing and promotion

    j. Bad business location

    k. Too much focus on one client/customer

2. **Economic conditions.** Research indicates that the most common causes of business failure are due to economic conditions outside of your control. So a big part of your job as an entrepreneur is surveillance, environmental scanning, and being strategic in your decisions. You must be able to respond to the opportunities and challenges posed by the environment in which your business is operating. These are some of the economic factors connected to business failure rates that you should keep an eye on:

    a. The unemployment rate of experienced wage and salary workers – when this unemployment rate is high, business failures increase

    b. Interest rates – when interest rates go up, business failures also go up after 2 to 3 years

    c. Gross domestic product – when the GDP goes up, business failures decrease. A good GDP means healthy businesses

    d. Profit ratios after tax for manufacturing corporations – when profits go up for manufacturers, business failures go down. Keep an eye on what's happening in this sector

    e. There are many other issues outside of the entrepreneur's control that can increase business failure rates: changes to government regulations, changes to international trade, and weather, to name a few

Solid management will allow many small businesses to survive during difficult economic periods, but entrepreneurs must always be aware of the strategic risks posed by economic conditions.

Community Futures

Growing communities one idea at a time.