TOPIC: BUSINESS FAILURE

Business is about risk and reward. The ultimate risk of running a business is that it fails and goes out of existence. Many businesses do fail. Why?

High Failure Rate of New Businesses

The highest rate of business failure is amongst new businesses (start-ups). It should be pretty obvious why this is the case:

Difficult to test a business model without trading
Easy to be over-optimistic in the business plan
Competitor response is often aggressive
Management may lack experience
Among the most common reasons why new businesses fail so frequently are:

No demand for the business idea
Poor market research & unrealistic plan
Competitor response
Just a bad idea – was doomed to fail!
Good idea, but poorly executed
Wrong people; poor management
Growth is too quick (overtrading) or too slow
Failure to manage cash flow
A competitor grabs the good idea and does it better
External shocks
Economic change
Legal & social change

Why Do Established Businesses Fail?

The main reasons why established businesses fail can be grouped into:
FINANCIAL REASONS

- poor management of cash flow
- Inadequate or inappropriate financing.
  NON-FINANCIAL REASONS

- Lack of management control
- Significant external shocks

The key points to remember about each of the four reasons above are:

<u>Evidence of poor management of cash flow:</u>

Significant increases in stock levels

Inadequate credit control
Bad debts incurred
Poor accounting practices including late invoicing
Inaccurate forecasting by management
Failure to plan for significant capital and/or exceptional expenditure

Evidence of inadequate or inappropriate financing:

Use of short term overdrafts for long term investment or capital spending
Failure to use debt factoring when sales are substantially increasing
Inadequate shareholder capital all contribute to cash flow problems
These problems will become more pronounced when a substantial difficulty such as a major bad debt, loss of a major customer or business interruption occurs

Evidence of lack of management control:

Failure to develop a credible business plan
Failure to understand costs, markets and key customers
Failure to administer the business properly
Caught be surprise by significant illegality or unethical behaviour leading to substantial business costs
Excessive marketing expenditure

Evidence of significant external shocks

Loss of important / major customer (particularly if costs cannot be reduced)
Sudden decline in market demand
Change in legislation /government regulations impacting demand or increasing costs
Exchange rate fluctuation
Changes in interest rates
Natural phenomena.