Why Do Small Businesses Fail, and How Can I Prevent This?

Many people dream of starting a small business. This is a dream that can become a reality, or—as happens to about 33% of prospective business owners, according to the Small Business Administration – it can result in dismal failure within two years. There's no magic-bullet solution to ensure a successful business, but if you don't want to be in that 33%, you should be aware of the common reasons that small businesses fail.

1. Poor cash flow.

Uneven, unstable, or nonexistent cash flow is the #1 killer of small businesses. New business owners are liable to run into this problem because they have few or no paying customers and because they must overcome an onslaught of new expenses to keep their doors open. Depending on the type of business, the impact can be severe (particularly for brick-and-mortar businesses that must pay rent).

Heavily project-based businesses are also apt to run into cash-flow problems if getting paid takes too long, as the bills don't stop coming due. Before trying to predict income, sit down with an accountant to forecast your expenses so that you know how much savings you should have on hand and how much capital to seek.

2. Lack of managerial experience.

Say that you have decided to open a specialty bake shop because you're an incredibly talented pastry chef. You may know how to pipe a macaron better than the old French masters, but that doesn't mean you know how to *run* a bake shop. Many talented individuals are fantastic at the chief service or product that their business offers but lack the business insight they need to make it succeed.

An MBA is not needed to run a business, but it certainly helps to take business courses dedicated to the appropriate industry and to enlist a small-business consultant to help draft a business plan and put it into action. Talk to other business owners of all types and learn from them; ask them what they would and wouldn't do again when running their businesses.

3. Not providing what the market wants.

There's a reason that small-business ownership is just a dream for some people; often, a person's dream career just is not realistic because it does not have a market. If you live in a small town and want to open a formal dress shop, you should ask, "Do the people in this town have the income and tastes to present sufficient demand, or would a big city have a better market?"

Whether businesses target local or general markets, the inability to find a customer base is often what causes them to fail, despite their owners' love. Do some market research first before deciding to invest in a business or start a new product line. Such research takes time and money, but it can prevent a major loss—or reveal a major opportunity in a different place or another line of work.

4. Not keeping up with the pace of growth.

Have you ever heard of "the law of diminishing returns"? It refers to the inability to keep up with growth—both forecasted and unexpected. This problem causes a lot of business owners to crash and burn. When a business has been in famine mode for years because of cash-flow issues but suddenly begins to take off, it can be difficult for its owner to change his or her attitudes about money.

When a business grows, it eventually needs to hire help to keep up with the number of customers, as the owner can't do it all; if this doesn't happen, the business will start to lose money. Is that slow, old computer taking up too much time on high-value gigs and preventing work from getting done faster? Invest in both people and equipment when the time comes. Don't fall victim to the law of diminishing returns.

5. Not Learning From Failure

Even the wealthiest business owners in the world have had failures, whether they are projects or entire companies. They got to where they are by learning from their failures.

Based on the common causes of business failure outlined above, if the market doesn't want your product, you must adapt. If a lack of time or poor-quality equipment are holding you back, you must hire help or invest in faster computers and more efficient machinery.

It's only truly a failure if you do not learn from your mistakes.

By getting a proper handle on your finances and properly managing of all of your resources (including labor), you can drastically increase the chances that your business will succeed. Sometimes, the market is just fickle, requiring you to adapt to changing demands and technologies. By being prepared for all the intricacies of running a business and by having the wisdom to learn from failure, your business won't be among the 33% that fail in the first 2 years.