“Why businesses fail”

According to the Small Business Administration, nearly 45,000 businesses close each month. Declining consumer confidence, massive layoffs, credit constraints and foreclosures are only part of the increasing pressure that will likely lead to record numbers of business failures, closures and bankruptcy in the coming years. Is there any light at the end of this tunnel?

Yes! Proactive positioning can make all the difference between survival and demise. Since my area of expertise is facilitating turnarounds, I will focus on five common reasons (even in a food economy) why small businesses fail. Many of these causes are preventable with proper planning, advice and education. Therefore, accounting professionals and trusted advisors are going to play a critical role in becoming the “first response” to aid in managing the crisis on behalf of your business clients.

FIVE REASONS BUSINESS FAIL

1. **Loss of revenue.** Lost income and declining customer base may be due to circumstances beyond your client’s control, such as the current economic climate. This also may be attributable to other factors, such as pricing, location, declining market share, or even slow-or non-paying customers.
2. **Poor business models.** While losing revenue is problematic, it is most often because the original or existing business model is no longer viable. Business planning (and measuring) is essential to ensure that opportunity and competitiveness are optimized. A business model must also be executed property for the entity to realize revenue.

3. **Management/operational issues.** Entrepreneurs by nature may not possess (or employ) the proper balance between ownership and management skills. If internal management is insufficient, the effects are usually strongly reflected on the bottom line.
4. **Lack of capital.** All businesses must have sufficient working capital. A business should strive to maintain a balance sheet that can support three to six months of payroll and operational expenses, to maintain a cushion for unforeseen loss or crisis.
5. **Credit/debt issues.** Many businesses have relied on access to easy credit in the form of lines of credit, credit cards, loans and home equity lines of credit to finance their businesses. Small businesses are now struggling as a result of tighter lending, high-rate credit card, reduced lines and maturing loans, leaving many heavily burdened with mounting and high-cost debt.

Any of these elements can wreak havoc on a business. Most would agree that the loss or revenue can damage a business the most. In addressing the loss of revenue, businesses and trusted advisors can begin by examining key factors such as operating expenses, receivables, pricing, service or product offering, and inventory to assess areas where cash flow can be improved.

Craig Szabo, CPA, of Szabo Accountancy Calabasas, Calif., notes that, in his experience, loss of revenue is the key reason that businesses fail: “We have seen many more business failures, and everyone seems affected by the economy. We all used to have a cushion (savings, available credit lines and home equity); now, with credit so impacted, clients don’t have the resources to salvage a business if it is distressed.”

Revenue loss coupled with being over-extended is a deadly combination. Improving upon these conditions is predicated on how prepared a business is to handle loss, utilize available resources and manage cash flow. Owners who suffer revenue loss often begin to manage their businesses from a cash-at-hand position. Remember that banks balances and cash balances are two different forms of cash. Rarely will they ever resemble each other. Be clear on cash projections so they can be utilized for improvement. Accountants can play a vital role in providing this sort of cash management and measuring the results of changes needed to help in stabilization.

In concert with this, the business model and plan need to be carefully evaluated to determine if the present business model is still viable.

Michael Stoddard, CPA, of the CPA Network, in Provo, Utah, has always advised his clients to review their business model periodically to ensure viability. Now more than ever businesses must be encouraged to proactively plan to enable survival and ensure sustainability. This should include careful and realistic assessments of, and improvements to business models, management skills and financial stability.

In evaluating business models, Stoddard asks, "Can the model generate revenue? If not there is little hope. If it can, you can always fix it." Doing so has its price, and may call for tough choices such as downsizing, repricing and reducing debt.

Timing is essential in making changes during a crisis, first to identify the key issues, and then to implement measurable actions. Unfortunately, as advisors, we are sometimes called in too late. If a business is exhibiting signs of failure, one should not forget that even the best entrepreneurs don't wear a big red "S" on their chest. If things have gone from bad to worse, that would be an opportunity for the advisor to begin forming (or executing) a dissolution plan that can wind down a business cost-effectively and properly.

Yet another factor in deterioration of business models in managerial weaknesses. The Dun & Bradstreet Business Failure Record states that “incompetence, unbalanced experience and lack of managerial experience create issues in areas such as operating expenses, receivables and inventory.”

Other key issues include overstretched and overstressed owners and personnel. Brad Marks, chief executive and founder of Brad Marks Enterprises, a Los Angeles based executive search firm, feels that owners need to seek means to strengthen cash positions so that key personnel can be retained, rather than discarded and later replaced at significant cost. He suggested examining both fixed and unfixed operational expenses prior to considering layoffs.

Even now, growth opportunities are plentiful, but not without working capital, and lack thereof can halt even a strong business model. In tougher climates and without good cash management, a normally well-capitalized business can rapidly turn undercapitalizes.

Compensating for that deficiency is where problems can arise. Once again, enabling reserves and building up balance sheets can determine survival in lean times. When it comes to utilizing credit, many owners lack understanding of appropriate options and the costs associated with borrowing. Without credit or collateral, lending options are too few; some report that even venture capital activity is at a 12-year low.

DEALING WITH DEBT

Then there is the matter of debt. In my experience, this can be a silent killer, and one that can be truly devastating to the finances and morale of a business.

When squeezed with higher rates, or diminished cash to afford payments, many businesses adopt a knee-jerk reaction to fixing the problem. One typical response is to appeal to creditors in hoes of lowering interest rates, or reducing payments. Most will find that creditors are unsympathetic, and some of the few relief programs offered can take up to five years to complete and are null if defaulted upon. A worse response is to become non-compliant with tax filings or payments. We have seen a significant rise in clients with large amounts owed in back taxes. Debt is so stressful when not managed that it can take focus off making money and use valuable resources in dealing with demanding creditors.

However, there is a viable option to strengthen cash flow and reduce liability exposure called business debt negotiation that can provide significant financial relied to the business debtor.