What are the major factors hindering small business's success?

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Abstract:

There is no more puzzling or better studied issue in the field of small business than what causes them to fail. Given the critical role of small businesses in the economy, the economic consequences of failure can be significant. Yet there is no definitive answer to the question.

Success in business is never automatic. It isn't strictly based on luck. It depends primarily on the owner's foresight and organization. Even then, of course, there are no guarantees.

Starting a small business is always risky, and the chance of success is inadequate. According to the U.S. Small Business Administration, over 50% of small businesses fail in the first year and 95% fail within the first five years.

Introduction:

Business failure refers to a company ceasing operations following its inability to make a profit or to bring in enough revenueto cover its expenses. A profitable business can fail if it does not generate adequate cash flow to meet expenses. Business failure can also be defined as closure or cessation of business activity that results in a loss to its creditors.

Business failure is the last stage of an organization's life cycle. Organizational decline, leading to failure is characterized by management who has become reactionary. The result is inadequate or nonexistent planning and inefficient decision-making. The most common reasons for business to underperform (low productivity, low profits) or fail (bankrupt, cease being) are as follows:

- **Poor cash flow management.**
- **Absence of performance monitoring.**
- **Lack of understanding or use of performance monitoring information.**
- **Poor market research**
- **Lack of financial skills and planning.**
- **Failure to innovate.**

Therefore this study attempts to identify and analyze the major factors and reasons causing small business failure. This study will also identify which factors cause the firms to cease operations quicker.

Hypothesis:

Three broad categories of causes of failure have been identified: managerial inadequacy, financial inadequacy, and external factors.

The research's main hypothesis is that managerial inadequacy is the most significant factor or obstacle hindering the success of small businesses. The majority of new businesses fail within a few years mostly due simply to poor planning or no planning at all.

Another hypothesis of this study is that managerial inadequacy causes firms to fail quicker than any other reasons. It is considered the most significant cause of failure for firms and organizations.

Literature review:

Managerial inadequacy is generally perceived as the major cause of small business failure. Unfortunately, this term encompasses a very broad set of issues. It has been estimated that two thirds of small business failures are due to the incompetence of the owner-manager.

The identified problems cover behavioral issues, a lack of business skills, a lack of specific technical skills, and marketing myopia. Specifying every limitation of these owners would be prohibitive. However, some limitations are mentioned with remarkable consistency. Having poor communication skills, with employees and/or customers, appears to be a marker for failure. The inability to listen to criticism or divergent views is a marker for failure, as is the inability to be flexible in one's thinking.

There are several common causes of failure for small businesses including;

- **Failure to clearly define and understand your market, your customers, and your customers' buying habits.**
- **Failure to price the product or service correctly, and failure to clearly define the pricing strategy**
- **Failure to adequately anticipate cash flow**
- **Failure to anticipate or react to competition, technology, or other changes in the marketplace.**
- **Overdependence on a single customer.**

The author of the book "Small Business Management"; Michael Ames mentioned the following reasons for small business failure in his book:

- **Lack of experience**
- **Insufficient capital**
- **Poor location**
- **Poor inventory management**
- **Over-investment in fixed assets**
- **Poor credit arrangements**
- **Personal use of business funds**
- **Unexpected growth**

Methodology & data collection:

This research's data collection primarily relies on a survey & questionnaire that was conducted with 15 ex-owners of small businesses and firms who ceased operations due to different reasons and factors. They stated that their businesses failed and ceased operations and was eventually shut down due to the following reasons:

Inadequate Financing, lack of Planning, poor cash flow management, absence of performance monitoring, poor debtor management (A combination of not paying the debtor on time and not coordinating payments with incoming cash flows), Over borrowing (the company becomes over-leveraged).

In order to analyze the association between the three variables and their effects on small businesses, we will conduct the Pearson correlation coefficient test. The Pearson correlation coefficient is a measure of the strength of a linear association between two variables and is denoted by r.

The Pearson Correlation coefficient test will measure the strength of the association between the independent and dependent variables. The independent variables are managerial inadequacy, financial inadequacy, and external factors and the dependent variable is the duration of operations/how long the business operated before shutting down.

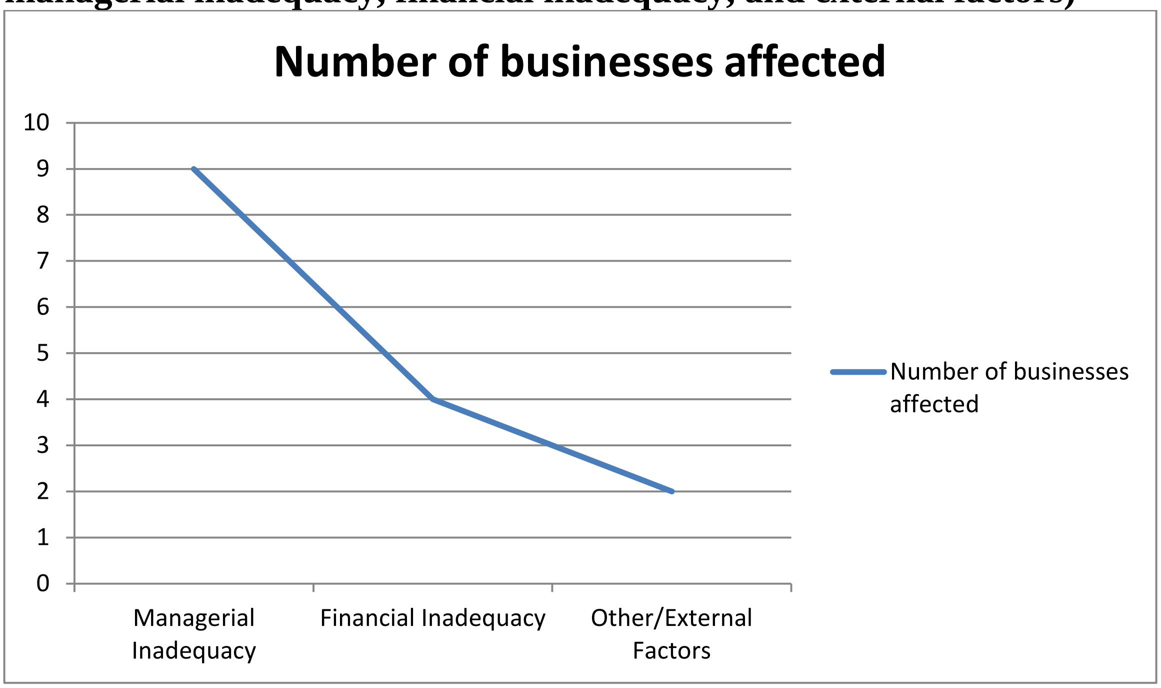
Data analysis:

We were able to categorize the previously mentioned factors under the following three categories:

Managerial inadequacy	Financial inadequacy	Other/external factors
Lack of Planning	Inadequate Financing	Unexpected growth
Poor cash flow management	Over borrowing	Poor location
Absence of performance	Insufficient capital	Failure to innovate

monitoring		
Poor debtor management	**Personal use of business funds**	**Lack of human resources/employees**

The graph below illustrates the factors stated by the ex-small business owners that led to their businesses' failure, and the number businesses affected by the following factors: (the factors were categorized as managerial inadequacy, financial inadequacy, and external factors)



The following tables represent a breakdown for the information represented previously:

Managerial Inadequacy	Number of businesses/owners affected (total:9)
Lack of Planning	**3**
Absence of performance monitoring	**2**
Lack of experience	**1**

Poor cash flow management	**3**

Financial Inadequacy	**Number of businesses/owners affected (total:4)**
Insufficient capital	**1**
Over borrowing	**2**
Personal use of business funds	**1**

Other/external factors	**Number of businesses/owners affected (total: 2)**
Poor location	**1**
Failure to innovate	**1**

The table below illustrates the average number of months the businesses took to cease operations and shut down:

Managerial Inadequacy	**Number of businesses/owners affected**	**Average number of months for businesses ceasing operations**
Lack of Planning	**3**	**20**
Absence of performance monitoring	**2**	**18**
Lack of experience	**1**	**15**
Poor cash flow management	**3**	**22**

Financial Inadequacy	Number of businesses/owners affected	Average number of months for businesses ceasing operations
Insufficient capital	1	13
Over borrowing	2	24
Personal use of business funds	1	21

Other/external factors	Number of businesses/owners affected	Average number of months for businesses ceasing operations
Poor location	1	38
Failure to innovate	1	46

Research Findings:

After the Pearson Correlation Coefficient test was conducted, we were able to observe the following:

Pearson Correlation Formula:

$$r = \frac{\sum XY - \frac{(\sum X)(\sum Y)}{n}}{\sqrt{\left(\sum X^2 - \frac{(\sum X)^2}{n}\right)\left(\sum Y^2 - \frac{(\sum Y)^2}{n}\right)}}$$

The following are the results obtained after conducting the Pearson Correlation Coefficient test on one of our samples:

Linear Regression

y= ax+b

a= 3

b= 12

r^2= 0.9252336449

r= 0.9618906616

The results above indicates a very strong correlation/ assosciation between the two variables, in other words, there is a very strong relationship between managerial inadequacy and the average number of months it takes for a firm to cease operations.
In order to support the research's hypothesis, the coefficent of determination $r^2$was also calculated.

Coefficent of Determination value interpretation (r^2):

Value	Strength of association
$r^2= 0$	No correlation
$0<r^2< 0.25$	Very weak correlation
$0.25\leq r^2< 0.50$	Weak correlation
$0.50\leq r^2< 0.75$	Moderate correlation
$0.75\leq r^2< 0.90$	Strong correlation
$0.90\leq r^2< 1$	Very strong correlation
$r^2= 1$	Perfect correlation

According to the previous table, the coefficient of determination indicates a very strong correlation between managerial inadequacy and the time it takes for a small business to fail.
The results also indicate that managerial inadequacy affects the businesses significantly and causes it to fail quicker than the two other variable; financial inadequacy and other aspects.
Therefore business owners and upper management should take into consideration the fact that managerial inadequacy must be avoided in order for the business to succeed and live longer, they should also ensure that they invest a decent amount of the company's capital in developing and training the human resources as it is the most significant aspect for business success.

Conclusion:

According to our research and study, there are several avoidable events and aspects that will eventually lead to the failure of a business.
The short answer is, regardless of the industry, failure is the result of either the lack of management skills, decisions, and expertise or lack of proper capitalization or both.

A common problem faced by Successful companies is growing beyond management resources or skills. As the company grows, it might surpass certain individuals' ability to manage and plan. If a change becomes necessary, companies shouldn’t lower their standards just to fill vacant positions or to accommodate someone within the organization. Organizations must decide on the skills necessary for the position and insist the individual has them.

References

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