10 Reasons Why Small Businesses Fail (and How to Avoid them)

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Why do small businesses fail? That's the million-dollar question. Starting a business is not easy, and there are countless statistics out there about the survival rate of startup companies.

Here are a few popular ones:

- Only about 20% of new businesses survive their first year of operation
- The U.S Census data shows that new business creation is nearly at a 40-year low
- Half of small businesses fail within their first five years

Whether you're a seasoned small business owner or an entrepreneur just starting out, these statistics can be a little scary. What you probably don't realize is the sample of small companies cited in these studies. Fit Small Business does an excellent job of debunking some of these numbers and defining the types of companies taken into consideration.

The point is that while there may be some truth to these numbers, you shouldn't let it kill your entrepreneurial spirit. Instead, try to understand the major reasons why small businesses fail. If you understand the mistakes of others, you can avoid following in their footsteps.

Here are 10 reasons why small businesses fail.

10. No business plan or poor planning

This reason is especially true for brand new small business owners. What you think sounds like a good business idea on paper may not fare so well in reality. (For some hard truths, see the fastest-growing occupations as measured by the Bureau of Labor.)

This doesn't mean you should ignore your passions. Instead, it means you need to do a little research and business planning.

A business plan forces you to define your Unique Value Proposition (UVP) — what differentiates your project from its competitors. In a sea of food trucks gathered in a parking lot, how will yours stand out? Is it the food? The service? Is it the neon hues and festively decorated truck? Is it the daily social media promotion? Likely, it's all of the above. Maintaining a sustainable business model requires setting yourself apart from competitors.

Other important considerations include: Who comprises your customer base? How will they buy your product or service—in-store, online, or both? What's your marketing plan? How will customers find out about your business? What are your cash flow projections? Your startup capital? How far will your cash reserves take you? Remember to factor in both business and living expenses, as most businesses are not profitable during their first year.

Answering these kinds of questions while your business idea is still in the planning stage will help you boost the probability of your product or service becoming a success.

9. Failure to understand customer behavior today

In our connected age, 'the customer is always right' rings more true than ever. For example, today's consumers expect small brick-and-mortar companies to accept credit cards and "currencies" like Apple Pay, even if the shop is a tiny mom-and-pop operation. And they demand quality customer service. If you don't deliver it, expect your customers to complain loudly on social media and with other communication tools.

For better or worse, review sites and platforms amplify word-of-mouth marking.

In our digitally obsessed society, it's easier than ever for customers to share their thoughts and opinions about the businesses they interact with—which means it's easier than ever for business owners to monitor and solicit customer feedback.

Not sure where to start? Here is a list of channels to help you monitor feedback and engage in conversations with customers.

Social media

All social media platforms (Facebook, Twitter, Instagram, Pinterest, TikTok, etc…) are great social listening tools that make it easier than ever to listen to your customers. In fact, in today's world, using a social media platform to contact a business is often preferred by customers as a faster alternative than traditional phone calls. Thanks to push notifications that alert you when your business has been mentioned, re-tweeted, liked, pinged or poked, knowing when to engage with customers is easier than ever.

Yelp reviews

Yelp is one of the go-to destinations for people who want to find local businesses. With over 148 million cumulative reviews, it's also a great place to find out what customers are saying about their experience with your business. If a company receives a poor review, Yelp encourages the business owner to jump into the conversation, so you have an opportunity to apologize or explain.

Google reviews

Just like Yelp, this a more passive channel than social media, but nonetheless, very important. Google is dominating the review market with 6 in 10 consumers now looking to Google for reviews. Since literally everything is Googled these days, your business' Google reviews are likely one of the first things a user will notice about your business.

Dedicated customer advocacy website

One of the most trusted websites for consumer reviews is Trustpilot. With over 45,000 new reviewers each day, they've built an entire online review community dedicated to helping customers share their genuine experiences.

Customer surveys

Surveys are still one of the best ways to ask customers specific and direct questions. If you collect customer email information at the point of sale, you can quickly identify your top customers and previous customers who are less engaged. Using this data, you can create a survey for free using SurveyMonkey to find out how you can improve your business. It doesn't hurt to offer an incentive for completion, like a discount on their next purchase.

With 85% of consumers saying they trust online reviews as much as personal recommendations, it's imperative that your online reputation is intact so that potential customers aren't turned off by poor reviews. At the very least you should try to make sure your positive reviews outnumber the negative ones. While poor reviews may not bring down a startup on their own, they play a large role in the success of brick and mortar businesses.

At the very least, you need to keep your business information current across as many channels as possible.

8. Inventory mismanagement

Your business startup cannot be successful if your inventory is poorly managed. According to the Small Business Administration (SBA), problems with inventory ranks among the major reasons new businesses fail. Poor management can often lead to inventory shortages and overages—silent cash flow killers.

It's a rookie mistake that easily happens to new businesses that don't understand their sales patterns. The best way to combat this is to use inventory management software or a point of sale (POS) system that can track inventory and provide reports detailing your best and worst selling products to help you identify sales patterns.

If you're not keeping track of your top-selling items or when they're in high demand, you're going to experience inventory shortages that will shrink your profits.

As a merchant, you take on risk when you buy large amounts of inventory with the goal of selling it for a profit. If you don't sell those products as quickly as you forecasted, they can lose value or become obsolete. This forces you to sell them at a deep discount, or not at all. Until you can recoup your money by selling the inventory you have on hand, your capital will be tied up in a lot of unsold inventory.

Picture this. Instead of thinking of stock items as inventory lining your shelves, think of it as piles of cold hard cash. Each product in storage or your local warehouse is cold hard cash you'll never see since it's not contributing a return on investment (ROI).

The harsh reality is that U.S. retailers are sitting on $1.43 of inventory for every $1.00 in sales they make. Proper inventory management using modern tools will ensure you're not one of them.

7. Unsustainable growth

In business, slow and steady wins the race most of the time. Expanding too quickly, which usually entails financing on credit like a small business loan, can backfire if the market changes or you hit a rough patch.

Trying to take on more business than you can handle drains your working capital and usually results in a quality decline. You are overwhelmed and your product or service suffers.

Instead, be smart about which customers you court, and how you will pay back each business loan. Saying no is part of running a business.

6. Lack of sales

On the other end of the spectrum, nothing hurts a new business faster than not reaching its sales goals.

This can happen when you rely too much on one large customer. If your cafe depends on student traffic during the school year, you will need to diversify come summer to stay afloat.

The only way to make sure you'll hit your sales targets is to gain analytic insights from existing data and use those insights to inform your sales strategy. A quality point of sale system is a good place to start.

5. Trying to do it all

Small business owners are a scrappy bunch, and tend to view themselves as Jacks (or Jills) of all trades. But entrepreneurs, like all people, have strengths and weaknesses, not to mention a finite number of hours in each day.

Delegation is your friend. Whether that means hiring your first employees or investing in software that cuts down on busywork, your business will only start making money once you offload some of your responsibilities onto other qualified shoulders.

4. Underestimating administrative tasks

When you were planning your company, maybe you imagined happy customers, smart marketing and of course, plenty of cash. You probably didn't imagine spreadsheet after spreadsheet. But large chunks of running a business revolve around administrative tasks.

From inventory management to managing employees to all the bookkeeping and accounting involved in the endless quest to meet your financing goals and turn a profit, administrative responsibilities can easily eat up your entire day.

According to a poll conducted by SCORE, 47% of small business owners dislike the financial costs associated with bookkeeping, and 13% dislike the administrative headaches and the amount of time it sucks out of their workday.

So be prepared. Hire accordingly or outsource many of your rote tasks to technology. As an example, Lightspeed Accounting seamlessly integrates with QuickBooks, so you never have to manually input your accounting data. Shortcuts like this save you time, and time is money.

3. Refusal to pivot

That's right, old-fashioned stubbornness comes in at #3 of the top reasons small businesses fail. It's easy for entrepreneurs to become obsessed with their business idea or product, even when all evidence points to it not being a success.

Maybe by the time your brick-and-mortar store is celebrating its second anniversary, all the excitement and shininess of your new store has worn off, and fewer locals are walking through your doors. Now what? Do you become a statistic and resign to failure, or do you take the time to figure out where you need to adapt? Maybe you pivot to appeal to tourists, or stock a different type of merchandise that appeals to your customer base, or use your space to host weddings and parties on the weekends.

Sometimes an effort to pivot to eCommerce can backfire, if not done properly. Typically, physical stores and digital stores will share inventory. And while you may keep them in separate storage areas, if you sell out of an item online faster than in-store, you'll have to fulfill some of your online orders from your store inventory. Unless of course, you'd rather ship to your warehouse first and then ship to the customer—causing unnecessary delays and a poor customer experience. To avoid this, invest in a POS system that offers a truly omnichannel eCommerce experience that automates the exchange between online and physical inventory.

2. Lack of data

Your small business is competing with cash-rich behemoths like Wal-Mart and Starbucks. What do those giants have at their disposal? Data. Tons of data.

Though your market is much smaller, you should still gather as much information as you can. If you don't have insight into the performance of your business in real-time, it will drastically limit your ability to make smart, data-driven decisions.

For example, you need complete visibility into the revenue you collect and the expenses you pay. Without this knowledge, you are literally flying blind.

On the expense side of the equation, if you want to buy a new line of inventory or make some updates to your storefront, you need to know how it's going to impact your bottom line. And it's not just these expenses you need to keep an eye on, but all of your costs.

As a business owner, you need to know what percentage of revenue you can allocate to employee wages, utility bills or rent so you can set proper targets for cost savings. On the revenue side, you want your business to grow month over month or year over year.

If you don't achieve your goals, you may want to examine areas of your business where you're overspending—i.e., the expense side. To ensure your expenses don't exceed your revenue and turn your business into a failure rate statistic, it's helpful to know your net income.

Calculating your net income

First, you need to define your Gross Profit (GP) by taking the Cost of Goods Sold (COGS) and subtract the number from the total net sales. If you're using a POS system like Lightspeed, you can find reports like these, and more.

The second factor you'll need in this calculation is your Operating Profit (OP). To find the OP, you need to subtract your operating expenses (i.e., payroll, rent, utilities) from your gross profit. If you're using accounting software, you'll easily be able to retrieve this information.

Lastly, you have non-operating expenses. These are expenses that are not related to core business operations like your operating profits, but rather taxes or interest you may have on loans or cash advances. Non-operating expenses are subtracted from your operating profit to yield your net income.

The secret to running a lean business is a long-term, ongoing strategy that strives to eliminate waste to improve efficiency, agility and quality of business operations—all while maximizing value to customers.

While this seems like a contradiction, doing more with fewer resources, it's much easier than you think once you break it down into small steps. The ideology of a lean business is built on the methodology of build-measure-learn.

Build

The main idea behind build is that Rome wasn't built in one day. Nor was Google's Gmail, Apple's iPhone or mega-retailer, Amazon. Businesses don't start out doing all the cool and fancy things they're known for today. For instance, Amazon started as an online bookstore, and now they deliver groceries to your home and provide streaming music services. The point is these companies started with a basic idea, or in the business world, a Minimum Viable Product (MVP) that they can introduce to the market.

Measure

Next, these companies measured. They measured the results of the MVP during the experimental stage. How did the market respond to your product or business? Did they react the way you expected them to, or was the reaction the complete opposite of your hypothesis?

Learn

Once you have some reliable data measurements, you can then determine which direction to move based on the results of that data. Have you been right all along and now you have the data to back it up? Or did the measurements provide you with some insight into areas you can improve?

Applying build-measure-learn

To apply this to your small business, you need to go back and look at your business plan. What are you trying to build? What are your goals? Finally, what is the bare minimum you need to get started?

Whatever the outcome, know that it is backed by reliable data that you can trust to help pivot your business in the direction that will help it be most successful.

Real-time data dramatically reduces lag time between data collection to data analysis, thus making your business more agile and responsive to changing trends. And if there's one thing every small and medium-sized business has over big-box retailers is the innate ability to be agile because they don't have to cut through the corporate red tape to make changes. They can see the data trends in real-time and respond accordingly.

1. Poor management

We've finally reached the #1 reason why a new business might fail. Entrepreneurs have power over their businesses, and with great power comes great responsibility.

Management is partly about attitude and mindset—and it does have an effect on your bottom line.

Sometimes small business owners become set in their ways when it comes to doing certain things. This is especially true for veteran business owners. For new entrepreneurs, make sure you don't fall into this trap. And to be fair, it's not just business owners. It's everybody. It's human nature, and we are all guilty of it at some point in our lives.

Assumption and complacency typically happen when a business is doing well and fall into a false sense of security that your business is operating in the best possible and most productive way. That's precisely when fallacy swoops in and wreaks havoc if you're not careful.

Planning your road to business success

Operating a successful business is not something you can leave up to chance or luck. It takes a clearly defined business plan, strategic operations and sound financial management from startup and throughout the life of your business.

These ten reasons should give you a solid understanding of how to turn around a failing small business so your company doesn't become a failure rate statistic. While you might not be able to avoid every single reason listed above, it's important to be aware and think preemptively about what you can do to tackle each of them, and come out winning. If you want to get started on proper inventory management, analytics, and ecommerce, let's chat!