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Why businesses fail

A look at why some businesses go no further

It has been widely recognised that business growth and survival depend on both internal and external factors. While most of the challenges which businesses face may be foreseeable, some are completely unpredictable. A number of reasons have been assigned to why some businesses, which at a point in time, were seen to be doing well suddenly crumble.

This article looks at some major internal and external factors that cause some businesses to fail and the need for organisation leaders to keep an eye on them.

Internal Factors

- **Lack of purpose and weak value proposition**

Businesses are driven by their purpose, underpinned by strong value propositions. These set the tone for the direction in which a business is headed. As is often said, succeeding without a plan is possible, but accidental success is dangerous. There are some businesses that have achieved successes without a plan. However, could these businesses have been more successful with proper strategic direction and purpose? That's very possible!

Lack of purpose and values could mean that the business is operating on weak or no footing at all. 'Touch-and-go' decisions and related resources committed by any organisation with such traits is likely not to achieve the desired business objectives. Values and purpose that employees can identify themselves with result in a great sense of belonging and greater employee commitment, without which productivity suffers.

Having a weak purpose and organisational values is risky; having none is as worse.

- **Weak corporate governance practices**

Much has been written about the loss of public trust in institutions and organisations of all types since the global financial crisis. In Ghana, corporate governance has been mentioned in all discussions around the recent banking crisis. Corporate governance involves all the methods a corporation uses to protect its investments and the interests of its stakeholders.

The way business leaders conduct themselves and communicate on a daily basis – and the ethics and values they exhibit in doing so – are instrumental in setting the 'tone from the top'. This tone shapes every action, decision and relationship across the organisation. As a result, the right leadership tone is the starting-point and bedrock not just for corporate governance, but also for the effective overall management of any business.

A company that does not adhere to best corporate governance practises runs the risk of weakening the confidence of its shareholders. Shareholders who feel threatened by the organisation's sacrifice of long-term sustainability for short term returns will sell off shares. A large share sell-off may lead to falling share prices which consequently devalue the company.

Organisations with a reputation of bad governance practices lose 'ethical' customers, key employees and attract increased regulatory oversight. Such organisations find it difficult raising finances. They also risk making bad investment decisions as a result of poor risk management which ultimately leads to the collapse of businesses.

- **Working capital challenges/ overtrading**

Every business aims to expand its product and service offerings through various product and market development strategies. Businesses make significant capital investment to expand production and operation capacities to achieve growth. Such growth, as much as it is desired, needs to be managed to avoid unintended consequences of overtrading being a victim of their own successes.
Overtrading occurs when a business expands too quickly without having the financial resources to support such a quick expansion. This results in liquidity challenges where businesses are not able to meet their liabilities as they fall due. Suppliers then resort to 'cash before delivery' terms further complicating working capital challenges when other financing options do not materialise.

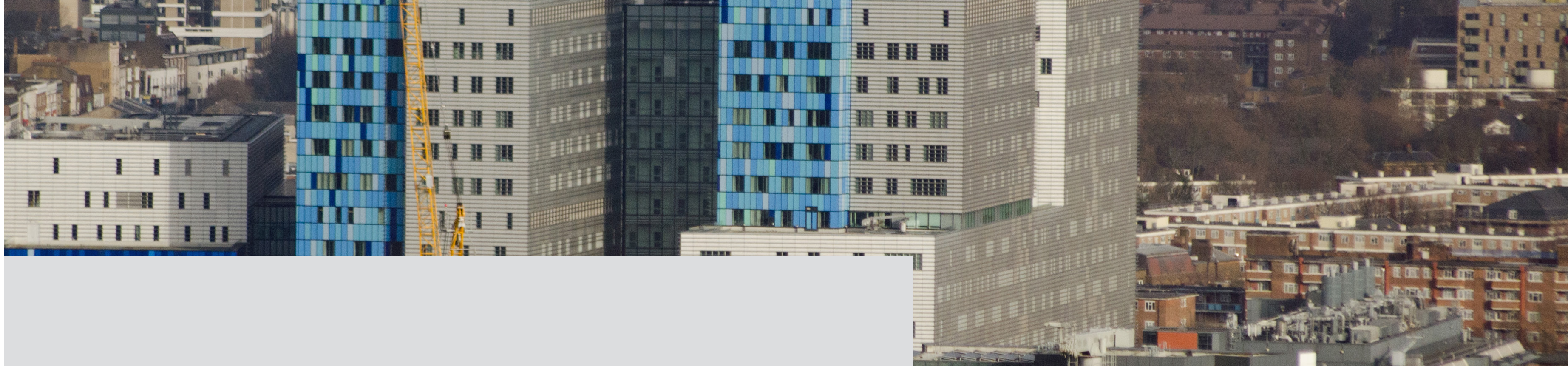
In fact, over-trading is very common - it probably kills a greater number of businesses than the more obvious problem of not having enough demand for product offerings. According to the PwC Global Crisis Survey 2019, liquidity issues are the most disruptive crises businesses face. It is also a hidden danger that can blind-side any company unless it is addressed head-on.

- **Poor crisis management**

A highly competitive, volatile global marketplace is a double-edged sword, providing great opportunities for growth while presenting abundant sources of risk. Unpredictable and unwelcome events, either internal or external, can negatively impact even the most stable businesses.

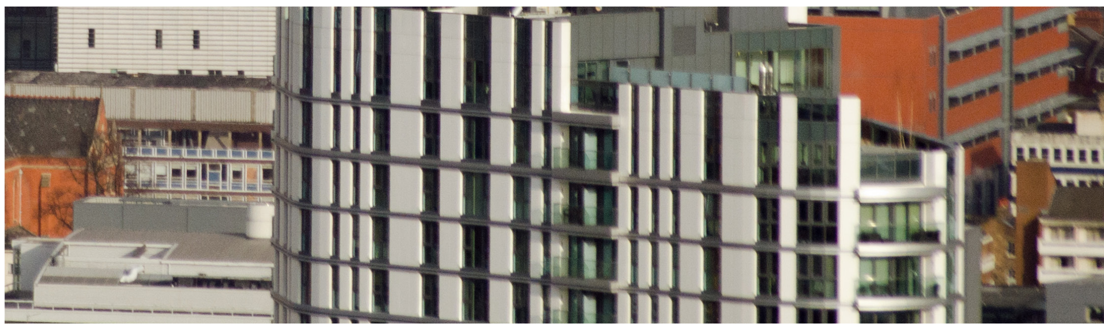
A crisis can trigger serious problems, including declining earnings, liquidity and cash-flow shortfalls. Lack of confidence and pressure from stakeholders, suppliers and customers, as well as regulatory scrutiny, demoralisation of staff and reputational damage are some of the major concerns. A delayed or limited response to these issues can be extremely damaging to businesses.

About 69% of business executives have experienced some form of crisis in the past 5 years (averaging 3 crises within the same period) with 95% expecting to be hit by one in the future (PwC Global Crisis Survey 2019).



Why businesses fail

A look at why some businesses go no further (continued)



Clearly, crises do not discriminate. Like businesses themselves, they come in all shapes, forms, and sizes – and no one or region, is immune.

Good crisis management is therefore a major part of running a successful business. Organisations therefore need to, among other things, allocate budget for crisis management, have a tested plan and adopt a fact-based approach. My experience has shown that, a lot of businesses are reactive to crises and are caught by surprise, a clear case of ‘planning to fail by failing to plan’.

By a margin of nearly 2-1 (54% vs 30%), organisations that had a crisis response plan in place fared better post-crisis than those who did not. Those that keep their crisis plan up to date and implement the lessons learned are four times more likely to come out on top (PwC Global Crisis Survey 2019).

The shock waves from a crisis can travel far and wide - and then back again - leading to business failure.

- **Ineffective marketing strategy**

Marketing strategy is the backbone of any business. It generates the required awareness about a business’s service offerings among customers and also drives demand. An effective marketing strategy should correlate well with the long-term marketing plans and business objectives.

Some businesses continually introduce to the market, value propositions that offer solutions to problems that are interesting to solve, as opposed to those that satisfy the needs of the market.

Businesses must strike the right balance between generating value for the customer and value for the business. To achieve this, businesses must evaluate their overall customer landscape, determine which segments they should focus on, and then consistently engage with those customers in every interaction across products, services, solutions, and brand messaging.

Marketing efforts must also incorporate excellent after sales service. In the era of digital marketing where customers’ online reviews are inevitable, a business may have a good product, but poor after sales service is all it takes to derail its gains.

External Factors

- **Economic challenges**

Every economy goes through a series of fluctuations associated with general booms and slumps in economic activity. Economic fluctuations generally take businesses along with it. No matter how well a business functions, it depends on the economic environment to be healthy and prosperous. Economic conditions such as unemployment, high exchange rates and interest rates can hold businesses back.

The rate of employment impacts the demand for goods and services of businesses. Exchange rates play an important role for businesses who import raw materials. Depreciation of the local currency causes an increase in the cost of raw materials and adversely affects the overall cost of production. Interest rates impact the businesses ability to raise funds.

- **Government intervention and regulation**

Every government strives to create an enabling business environment that makes businesses thrive. Governments also aim to protect the business environment and its people through regulations and international partnerships. However, actions of governments, though well intentioned, may end up crippling some businesses.

When governments or regulators introduce new rules and regulations, some businesses operating in a particular sector can be badly affected. For example, the Bank of Ghana announced an increase in capital requirements for banks operating in Ghana from GHS120 million to GHS400 million from 31 December 2018. Even though the banks that survived the reforms are now in a position to undertake big ticket transactions (according to the 2019 PwC Banking Survey), banks who could not meet the new capital requirement fell off.

Similarly, when a government enters into trade agreements and treaties which opens the country to cheaper imports, local businesses face strong competitions which may stifle their growth.
Any time government and regulators try to do much more than lay out the basic rules of the game, unintended consequences rear their ugly heads.

Concluding remarks

No entrepreneur sets up a business intending to fail. Some of the causes of business failure are within their reach. In most cases, a complex mixture of causes contributes to business failure.

However, if a business is to succeed, management must be mindful of all matters which are likely to have a material impact on its viability and demonstrate skills to exploit opportunities and mitigating threats.

Want to know more?

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