Why Start-up Businesses Fail

Goddmmaste Consulting, Investment Company Ltd
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Publisher

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Introduction:

The business community world over witness the emergence of new businesses year after year, but these businesses faces a myriad of challenges. Approximately, an average of 20 percent of these businesses disappear in their first year of operation, 50 percent of them fail within five years of operation, and only about 30 percent make it to ten years and further.

Most of the startups are in form of Micro, Small and Medium Sized Enterprises (MSMEs). MSMEs form about 90 percent of new businesses and are described as efficient and prolific job creators, the seeds of big businesses and the fuel of national economic engines.

In Nigeria, over 41.5 million MSMEs are registered and in operation according to Nigeria Bureau of Statistic (NBC) (16 May 2021), contributing over 48 percent GDP, accounting for 96 percent businesses and employing over 84 percent of the country's population.

However, the Association of Small Business Owners of Nigeria (ASBON) reported that, about 10 million (25 per cent) of these businesses were shut in 2023 due to economic hardship and other various reasons (Punch, December 30, 2023).

With the rising unemployment rate in Nigeria which is now estimated to reach 40.6%, the importance and need for entrepreneurial activities cannot be overemphasized. Therefore, issues regarding MSMEs are critical not only to the entrepreneur, but also the professionals, the regulators, the policy-makers, academics and the general public. A good understanding of the issues surrounding MSMEs will increase the chances of the businesses surviving.

Hence, in this E-book, Goddmmaste CIC Ltd will discuss clearly the 9 major reasons why businesses fail. The following are the most majors or main causes or reasons why several businesses fail:

1. Lack of Product Market Fit,
2. Marketing Problems,

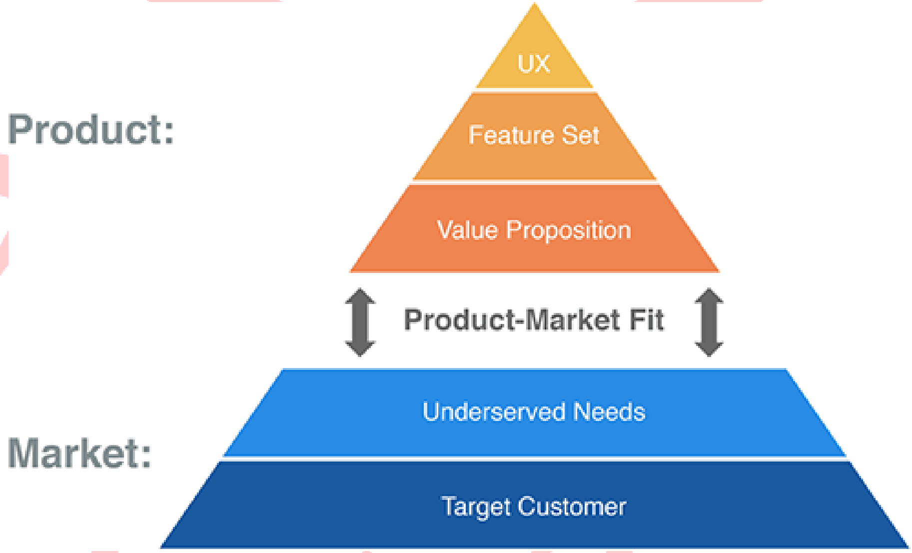
3. Team Problems,
4. Finance Problems,
5. Technology Problems,
6. Operational Problems,
7. Legal Problems,
8. Business packaging,
9. Policy direction or framework.

Lack of Product Market Fit (PMF)

Do you know that up to 42 percent of startups fail because no one wants to buy their products or services? For corporations, nearly 80 percent of new products and services fail each year for this same reason.

Product-market fit is the first step and key to building a successful business. It describes a scenario in which a company's target customers are buying, using, and telling others about the company's product in numbers large enough to sustain the product's growth and profitability.

According to Marc Andreesen, product-market fit means finding a good market with a product capable of satisfying that market.



Product-Market Fit Pyramid framework created by Dan Olsen

Why is Product-Market Fit Important? In our experience, the major problem facing mostly startups, MSMEs and even established businesses is that, they do not have product-market fit when they think they do. This is because, most of the start-ups venture in wrong businesses unknowingly thinking they will be successful and such businesses are a failure from conception.

Due to this major misconception, many venture capitalist demand evidence of product-market fit before investing their funds in a business. Therefore, it is necessary for every start-up to divide its life into two key stages: before product-market fit (BPMF) and after product-market fit (APMF). This will enable them to determine if their product(s) has enough of the market to sustain and generate profit.

Considered as one of the major challenges, some of the signals to identify lack of PMF may be evidence in low-average sales, low demand, or poor customer reviews.

Reasons that can lead to lack of PMF are:

a. Lack of large market enough for the product,
b. Lack of defined client buying process,
c. Trying to scale the business too soon,
d. The product fails to provide a solution that customers can easily buy,
e. The product does not solve a pain point that is urgent enough,
f. There are issues with the business sales cycle.

The path to finding a product-market fit is full of potential risks but a most do step. If your team is not careful, it could make any of the mistakes highlighted above and this can delay your company's efforts to attain PMF.

Marketing Problems

Failure is so common because MSMEs that want to market and position themselves, in other words, cost effectively increase their leads and sales, face some fundamental challenges which are:

a. Creating a Clear Marketing Strategy,

b. Time and Resources are not in their side,
c. Difficulties Aligning with Buyer Personas,
d. Difficulties Adapting to New and Current Trends
e. Above all difficulties improving Return on Investment (ROI)

The need for a defined process is necessary. Some key questions to start with can be, where do clients come from? How do you get new clients? How do you nurture the clients you already have? How do you maximize profit per clients?

These are key question every MSMEs and even established businesses should be asking regularly, getting answers to these questions and implementing them may create a path to a defined process. Unfortunately, most businesses do not put a lot of effort into these issues.

Team Problems

When managing a team of employees, the ability to keep staff working optimally together can significantly improve production in any operation. In order to solve any disagreements or problems, it's beneficial to understand the most common workplace teamwork challenges and effect solutions for any upraising. Although there are some challenges that are unique to each industry or field, some common teamwork challenges which can affect the operation of many organizations include:

a. Lack of role clarity
b. Trust issues
c. Personality conflicts
d. Withholding information
e. Lack of adequate communication
f. Staff numbers (Excessive or Shortage)
g. Interior unhealthy competition
h. Habitual clashes
i. Opposing goals
j. Working in isolation

k. Lack of self-awareness
l. Skill overlap

One toxic team to work with is family members. There are a lot of perks associated with hiring family members. For the most part, you know what you are getting into: it's likely you know a bit about the dependability, loyalty, and skill set of the potential hire. Additionally, family members, particularly those closest to you, have a vested interest in the success of your business, whether it be a desire to see you succeed or to benefit from the financial comfort that a successful business may yield.

Many business owners, especially MSMEs grapple with the pro and cons of hiring family members. For some, the personal relationship may result in a strong and productive professional relationship. For others, hiring a family member can be a risky situation that compromises both personal and professional relationships, leading to a total breakdown of both family tiles and work relationship.

Our experience in business using family members saw a situation where a family member was among the first management team in a particular startup. This particular staff uses his position and influence to enrich his pocket at the expense of the business. Shortly, this staff registered his business and commences operation why still in this company's payroll. Due to underperformance of the business, an investigation was carried out on all staff unknowingly to them and this ill activity was discovered.

Another instance was a situation where a company engaged a member in the family out of some consideration. The family staff brought in a business which was executed at a total price of Naira 750,000.00. After the execution of the business, the staff collected the money in the name of paying into the company's account. An alert of Naira 250,000.00 was later received for that contract below the cost of executing the business. When question were raised, the customer confirm full price was paid to the family staff.

With this experience and many more which other businesses may experience, if you are considering hiring a family member, be sure to acknowledge the risks that comes with their actions.

Finance Problems

Experience shows that, limited access to finance is one of the inhibiting factors to growth and development of businesses (especially in developing countries), given that formal financial institutions mostly shy away from financing start-up businesses. Therefore, these business owners are compelled to depend on personal savings, family and friends at the initial stages to finance their business. Moving through the business cycle and as the business grow organically, most of the businesses may want to access the financial market to tap funds to finance working capital and other financing needs like working capital.

However, these start-up businesses may still find out that, the formal financial institutions are not willing to lend to them, and where such funds are provided:

- ✓ The fund may not meet the full needs of the start-ups or MSMEs,
- ✓ The maturity, term or condition of the loans provided may also differ from what the entrepreneurs require, and
- ✓ The interest rates may be high making it difficult to sustain the funds.

In addition, experience shows that, the inability of MSMEs to acquire funds is due to the fact that they do not have adequate operational and financial track record.

Due to information asymmetry, lenders shy away from funding startups and MSMEs. Information asymmetry occurs because the potential lender and entrepreneurs possess different quantities and quality of information.

Information asymmetry may lead to adverse selection and moral hazards. Adverse selection may occur because the limited nature of information available to the lender will lead to his acceptance of a bad credit risk or the rejection of an otherwise good applicant.

Moral hazards occur because the applicant, for example, may use a loan for a purpose other than the intended or agreed purpose. The borrower may use the loan for buying of his personal car, building his house, wedding or a funeral instead of the expansion of the business, as agreed with the creditor.

Asymmetric information can lead to failures in the market for loans, where lenders may not even be willing to lend at any interest rate.

Technology Problems

To compete effectively on the national or global stage, a minimum required state of the art equipment and technology is needed so that businesses can stand up to the competition.

However, one of the challenges to this is the rate at which technology changes are happening. It is tough or difficult for MSMEs or even established business to change as per the environment.

In addition to this, it may be too expensive to acquire some of these technologies. The cost of acquisition may also include monthly or yearly subscription which some of the MSMEs or startups may find it difficult to meet. For instance, for an MSME to own a webpage, they need to pay a yearly fee for the domain name. This may be considered expensive where the business is having difficulties with revenue. Also, the knowledge and proficiency to operate the technology may be scarce domestically.

Therefore, start-ups may take a relatively much longer time to produce and then also produce at less cost than their competitors.

It stands to reason those higher levels of efficiency can be achieved once the resources are available to acquire and operate the equipment and its technology.

Operational Problems

Another key challenge for start-ups is the inability of the owners to effectively manage the business. Usually, entrepreneurship and management do not coincide. Entrepreneurs are thrilled by forming a business.

During the early stage of the business, top challenges or difficulties may include:

a. Leadership
b. Culture
c. Strategy fit and execution
d. Building an "A" team
e. Making the business stand out
f. Putting employees first
g. Systems and Processes
h. Measuring performance

As the business grows and expands, it may be better for these entrepreneurs to hire professional managers or gain managerial training. The lack of managerial know-how tends to hinder the development of these enterprises.

MSMEs mostly have difficulty attracting highly motivated managers because of the fierce competition with large companies in the labour market for such skilled and talented personnel. This has to do with the quality of management.

Legal Problems

The level and quality of regulation mostly in developing countries is weak and usually inadequate. Regulatory and institutional failures are considered to be more widespread and pervasive in developing countries and these may hamper the development of MSMEs.

For instance, having considered as the engine of job creation in Nigeria, the decline and continues decrease in the value of Naira triggering an economic downturn, many excellent, profitable and established firms are unable to get finance they need to continue and to prosper. Now, more than ever, Nigeria needs its small businesses to succeed.

Proactive regulations, for example, can create differential reporting and regulatory systems for MSMEs. This however assumes that the regulator is well resourced financially and in terms of staff to do this. Regulators in developing countries are usually constrained both in financial and in human resource terms. Tax laws and regulations pertaining to large firms may not be suitable for small firms. For example, start-ups may have difficulties in complying with the requirements of being Value Added Tax registered. ***However, Nigeria in the current Finance Act 2021 provided some leverage for small businesses which is very encouraging. This will be discussed in details in our next E-book (Solutions to Why Start-up Business Fail)***.

It's is very disconcerting the quality of institutions mostly in the developing nations which leaves much to be desired. It may take ages for commercial disputes to be settled in law courts. A typical example is seen in Nigeria where commercial disputes take years (3 – 5 years or more) to be settled in courts. These challenges lead to developing nations achieving low ratings in the World Bank's Yearly Ease Doing Business Report.

Business Packing

A common sign of poor packing is damage a to the product. Whether it is the primary or secondary packaging, if it is not durable enough to withstand the conditions it faces along the business line, it is not likely that the product will reach the customer or the final consumer in good condition. This can be costly to businesses, especially the MSMEs, who could end up refunding to the customer or the consumer or discounting the product(s) to sell it. Damaging packaging also deters customers from buying again, leading to a loss of sales.

In addition to the potential financial costs of the product's packaging being damaged, brand reputation can also be affected or completely destroyed. Quality made attractive packaging are expected, particularly for luxury products, as consumers have high expectations for the packaging and products due to the price they are paying. If flimsy or impractical packaging are used, consumers may or will be deterred from making a repeat purchase or even recommending the brand to others.

Policy Direction or Framework

From the technical perspective, the following policies of a government can impact businesses directly or indirectly:

a. Taxation,
b. Subsidies,
c. Interest rates,
d. Exchange rates, and
e. Public-private partnerships.

Policy direction of a country depends upon the political culture of that country. It can also vary depending on the form, style or type of the government. Policy in a communist country will be different from that in a democracy or monarchy. Policy in a politically stable country will also be different from an unstable country. In a stable political system, a government can take sustained business-friendly decisions to strengthen local businesses. But in an unstable political system in which the opposition boycotts parliament and takes to street agitations, businesses and investment would suffer and those mostly affected are the MSMEs.

In such a negative political culture, a country cannot have a sustained business-friendly policy or environment. In an unstable system, a government finds it difficult to maintain law and order which affects the business environment. Example of this situation is what is happening in Nigeria currently.

Summary and Conclusion

With our years of experience, the major problems affecting startups, MSMEs and even some established businesses are bundle into above 9 listed points.

If you succeed in positioning your product, you need a great marketing strategy to grow revenue quickly. If you succeed in having a great marketing strategy, you need people skill to manage your team. If your team members are great at their roles, you may need to raise fund to finance the business operations.

Technology cannot be left behind because, it is the new way of doing business. Failure to adopt new technologies put your business at risk of obsolete. If you have proper fit technology and equipment, operations are easily managed by your team and effectively supervised by management.

Above all, you need to stay within the boundaries of the laws and regulations governing your operations.

In our next E-book "**Solution to Why Startups Businesses Fail**", we shall try to suggest possible solution to these 9 problems. We can also offer entrepreneurship training and development to complement this E-book.

For further discussion, training, development, coaching or mentoring, connect us below.

Connect with us

We will like to hear from you, kindly reach out to us on any of your favorite platforms.

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