

Why is it that start-ups tend to have high failure rates?

Burgeoning entrepreneurs usually think about three main functional areas when planning their start-up business. All three areas are certainly important, but the order of execution should be reversed. **Don't be the next entrepreneur to make The Big Start-up Mistake!**

The **BIG** Mistake

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You've probably heard the alarming statistics saying that start-ups have failure rates of 80 percent and higher. While this statistic may be inflated, the truth is that many start-up companies do indeed fail. After working with hundreds of start-ups as a business consultant, I have identified the number one mistake causing most start-ups to founder is in the way they order the execution of the start-up process. Allow me to explain. When planning a start-up, burgeoning entrepreneurs usually think about the three main functional areas of a business in the following order: operations, finance and marketing. While all three are certainly important, they need to be executed in the correct order. Let's explore this further.



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Operations

My experience has been that almost all start-ups begin their journey focused on the operational aspects of the business idea. An enormous amount of effort is placed on acquiring the information to make management and operational decisions. The typical start-up entrepreneur will do a tremendous amount of research on licenses needed, taxes to pay, and whether to launch the new business as a sole proprietorship, LLC, or corporation. They search for equipment needed and lowest cost per-square-foot for leased storefront or office space. These items are necessary, but starting and stopping research right here will result in a premature launch of the business, which will likely result in failure. Operations should be the last item of focus, after all other foundations are set.

Finance

Only a fraction of start-ups spend any real time on the second area of business— their financial projections. Here is where the aspiring entrepreneur gets the opportunity to research and forecast the financial health of the proposed business. If done correctly, this is where the four most important pro-forma financial reports are created and thoroughly evaluated. Those four “must have” financial projections are:

- »» Break-even analysis
- »» Cash flow analysis
- »» Income statement (also known as the P&L)
- »» Balance sheet

The breakeven analysis will help the potential business owner determine a minimum level of sales/revenue required to sustain the business. The cash flow projection is crucial for a start-up, especially if the business will require fixed assets such as equipment, buildings and real-estate. Cash flow is also imperative when the business intends on leasing commercial property, an office or a store front.

Since many businesses do not generate enough cash to sustain operations during the first months of their existence, a cash reserve is crucial in order to meet the financial requirements of the firm. By completing a cash flow projection prior to the launch, the entrepreneur can estimate how much additional funding the company will need until sales finally approach the breakeven point. In short, the cash flow projection will help to keep the business from starving for cash. If there is not enough cash to cover expenses while the business is ramping up its sales, the company will quickly fail. Many do.

Marketing

The last area of consideration for potential business owners tends to be the market/marketing. Frankly, very few start-ups spend enough time understanding or researching their market. They often completely omit the functions necessary to attract customers, assuming they can address this after opening for business. The “build it and they will come” strategy seems to be the common thread. Unfortunately, this is NOT a good strategy. Surveying your family and friends about your business idea is NOT valid market research.

It’s my opinion that the lack of market and marketing knowledge is the real reason for most start-up failures. They fail because they could not attract enough customers! No customers, no revenue, no cash to sustain the business. Knowing who is most likely to buy from you and why they will buy from you is critical in developing an effective marketing plan.

Even if you have a huge cash reserve, you will eventually exhaust the fund if you have not generated enough customers to overcome the monthly overhead. I once saw a readerboard in front of a poorly performing six-month-old restaurant which read “Low on Cash, Need Partner.” Because the business had so few customers, a new partner’s injection of cash would eventually dwindle to zero, simply prolonging the inevitable. Sadly, many start-ups don’t market until it is too late.

Revise the order of execution of the start-up process:



Start with creating your marketing plan. This consists of evaluating the size of your market, researching your competitors, identifying your target market (who is most likely to buy from you), and determining how you will successfully reach them.

Once you have done your market research and have reasonably demonstrated market feasibility (meaning that there are sufficient customers interested enough in your product/service to buy from you rather than your competitors), then you should perform the financial projections based on the market research. If the financial proformas satisfy financial feasibility (that you can make an acceptable profit and pay back your banker), THEN and only then, are you ready to form your entity, sign that lease and launch your business.

DON'T form your entity, build a website or launch your business until you have done REAL market research and have created a complete set of realistic financial projections. **Don't be the next entrepreneur to make The Big Mistake!**

Want more information on marketing and market research or starting a business? join the SBDC's Starting Your Business Series. The SBDC also provides market research and business consulting services at no cost to current and prospective business owners.
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Since joining the SBDC in 2007, Bill McKown has assisted hundreds of entrepreneurs throughout the Tampa Bay region through consulting and training programs. He specializes in marketing and assisting second-stage clients with sustainable growth strategies under the Florida SBDC Network's Growth Acceleration services.

Bill has owned and operated businesses in the transportation, wholesale distribution, and vending industries. As retail vice president for a petroleum marketing company, Bill directed the chain's marketing, co-op advertising, signage, location selection, retail construction, human resources, franchise acquisition, purchasing and vendor relations. He also has experience in training, facilitating, sales, organizational management, and entrepreneurship.



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