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The Top 10 Reasons New Businesses Fail

Entrepreneurs face many challenges, and common missteps can send a small company into a tailspin

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Everything seemed to be going right for Dan Moyer. During the pandemic, he decided to launch a business with a friend — creating frames for displaying comic collections. What began as a passion project turned into a thriving enterprise. His company, Crafti Comics, was shipping thousands of frames worldwide, and revenue was flowing.

But the good times didn't last. Even though sales were soaring, costs were growing too, as Moyer sank money into machinery to meet customer demand for different sizes and styles of frame. The business failed to turn a profit, and tensions mounted between Moyer and his business partner.

Things finally came to an end this March, as Moyer shipped his final orders and closed the business. "We expanded too quickly," he says. "Instead of doubling down on our core products and customer experience, we tried to appease too many people with too many variations."

Growing too fast is just one of many mistakes that can sink a small business. Entrepreneurs face many challenges and make a lot of common missteps that can send a company into a tailspin, experts say. And small operations don't have the same capital reserves as big companies to ride out rough times.

Small wonder that only half of new businesses survive two years, and only a third last five years, according to research by Robert Fairlie, distinguished professor of public policy and economics at UCLA.

With that in mind, we asked experts for the biggest reasons that small companies fail. Here is a subjective ranking of their top 10, from least to most important.

10. Going it alone

Many people picture a successful entrepreneur as a loner—a sole proprietor who comes up with an idea and works alone to make it a reality. But that isn't usually the path to success, experts say. Entrepreneurs need a team around them to bring different skills and perspectives to the table, and to support each other during tough times.

Note

Recent research shows that companies run by couples—"copreneurs"— have particularly high success rates, largely because they tend to share the same values and goals for the business. The research also found that it is easier for these couples to achieve worklife balance and avoid burnout. One study, by Jo-Ellen Pozner and Jennifer L. Woolley at Santa Clara University, found that craft businesses started by couples were half as likely to close as others.

9. Growing too quickly

As the story of Crafti Comics shows, expanding too fast can stretch a business beyond its means, whether that means buying too much equipment, opening too many locations or hiring too many employees.

The key, says Josh Baron, senior lecturer of business administration at Harvard Business School, lies in finding the right balance between long-term and short-term thinking. Reinvesting earnings into the business can lead to substantial growth over the long haul, but only when it is combined with a focus on moreimmediate issues like cash flow and working capital.

8. Lack of experience

Entrepreneurs with prior experience in their industry have a big advantage. They can learn details and tactics, and take away important lessons about success and failure.

The best experience of all? Working in a family business. Back in 2007, Fairlie found that "the children of family-business owners were more successful and less likely to exit," he says. "And when they'd worked in that family business, there was an additional bump to their survival rates."

For entrepreneurs, working for a self-employed family member was associated with a 17% lower likelihood of a business closure and roughly 40% higher sales, Fairlie says.

7. Too much passion

Anna Jenkins, associate professor in the School of Business at the University of Queensland in Australia, interviewed 120 entrepreneurs who had recently been forced to file for bankruptcy. She found that those whose identities and self-worth were most tightly coupled to the business had the hardest time coping with failure. Nope

"When the business is struggling, it becomes much more difficult to make a clear decision to close because it's not just losing the business—it's also sort of losing part of who you are," she says.

6. Internal conflict

When business partners start to butt heads, the company can suffer. They might be unable to agree on important strategic decisions, like whether to invest in opening a new location. A severe conflict may paralyze the business and destroy morale among employees.

But having no disagreements at all can be just as damaging, says Baron. "When you have too much fighting, it's hard to grow the company because you can't focus on things like what your competitors are doing and what you should do in response," he says. "But when you're avoiding issues, you end up in the same place. You can't grow because no one will raise difficult issues because they're worried it's going to set off a conflict."

The answer, he says, is to find what he calls the "Goldilocks zone" of healthy conflict, where people inside the business feel comfortable raising problems without triggering squabbles.

5. Getting capital

It can take time to build a customer base and bring in revenue, even as expenses are mounting.

Capital reserves can bridge the gap, but *getting* that cash isn't easy.

Challenges with access to credit and capital were among the top concerns raised by respondents to a Federal Reserve survey of small-business resource organizations earlier this year. The same finding came up in research conducted last year by the Morehouse Innovation and Entrepreneurship Center.

Some segments of the smallbusiness world face particularly tough challenges raising capital. Fairlie's 2020 research on access to funding among minority-owned startups shows that Black-owned startups face more difficulty in raising external capital, especially debt.

"Minority-owned businesses often just don't have the reserves or access to capital," he says. "Often they start off smaller scale than they should be, and so then they struggle. They're more likely to exit because of that."

4. Lack of a market

It is economics 101: If there is no market for your products, your business won't succeed. But it can take a lot of work —and resources— to study a potential market in depth, and many smallbusiness owners aren't prepared to make that kind of investment up front.

For instance, many people start small businesses because they have a passion for the core activity, says Robert Blackburn, professor of entrepreneurship at the University of Liverpool in the U.K. People who like to cook might want to open restaurants, for instance.

But making good food isn't enough. Blackburn says he has seen many restaurants fail when the owners chose the wrong location or decor, or were marketing to the wrong set of target customers.

3. External shocks

Small businesses are particularly vulnerable to recessions or other disruptive changes. They have less capital than big companies do to absorb shocks, less capacity to stockpile inventory and less leverage to renegotiate prices or change suppliers.

Look at what happened during the pandemic. In the second quarter of 2020, 8.5% of small businesses closed their doors, about double the prepandemic rate, and much higher than the closure rate of 2.7% for large businesses, according to an analysis by Fairlie and the National Bureau of Economic Research.

2. Inability to pivot

Of course, small-business owners can't do anything to prevent huge disruptions like pandemics and recessions, or big changes in consumer tastes. But the way entrepreneurs respond to those events makes a big difference.

"No parent wants to hear that their child isn't beautiful, and no entrepreneur wants to hear that the opportunity isn't perfect," says Danna Greenberg, Walter H. Carpenter professor of organizational behavior at Babson College.

For example, the Covid-19 lockdowns posed serious challenges to many businesses that relied on face-to-face sales. But some small companies boosted their odds of survival by turning to strategies like home delivery.

"The ones that weren't flexible or stuck by their current offerings even though they weren't the most convenient solution for the job that needed to get done, well, their customers went somewhere else," says Woolley.

1. Being too stubborn

Ultimately, many small-business failures are a matter of poor leadership. The problem can manifest in many different ways, but it comes down to an "inability to hear, to listen, to be open to other perspectives," Greenberg says. Many entrepreneurs want to be in complete control, so tied to their ideas that they refuse to correct course when necessary.

That mistake helped to sink Crafti Comics. "People were trying to tell me to look at things from a different perspective, to be patient, or to weigh decisions from a financial or operational standpoint before diving headfirst into the sales and marketing creativity," says Moyer, who now works at a corporate job. "I was stubborn. I didn't want anything to slow us down or stand in our way."

Moyer says the lessons have given him a new perspective on success. "You've got to focus on your strengths, grow at your own pace and don't lose sight of why you started in the first place," he says.

