To Be or Not to Be

Factors to Consider When Contemplating Whether to Start a New Business

By DENNIS G. EGAN JR., Esq.

While we've all heard that most small businesses fail within the first five years, statistics from the U.S. Small Business Administration put the number closer to 50%. While this number paints a somewhat rosier picture than previously thought, there are still a great number of small businesses that fail.

Knowing the factors that most often lead to failure can be the first step toward deciding whether or not the conditions are favorable to start a new company. In fact, understanding why most small businesses fail can be the best road map to launching a successful venture.

One of the most important components of any successful company is its business plan. A successful business plan is firmly rooted in fact, based on the most accurate and timely information available, and it should address the following issues:

- The goals of the business and a roadmap for achieving them;
- Financial considerations, such as capital requirements, expense forecasts, and cash-flow analysis;
- A marketing and advertising plan;
- Knowledge of direct competitors; and
- An accurate budget.

Too often new businesses are launched without any clear-cut plan to succeed. As a result, there are no benchmarks against which to judge progress. Often these business owners spend non-existent capital on unnecessary equipment or technology. While some entrepreneurs may have the knowledge and expertise to formulate a business plan on their own, most individuals should start by seeking the services of a competent, well-respected business consulting firm, accountant, and/or attorney.

When deciding whether the time is right to launch a small business, it's a good idea to realistically assess your level of experience relative to the business you wish to launch. While experience alone does not ensure success, lack of it may likely spell disaster.

Experience helps to provide the level of understanding necessary to organize a business properly and offer quality products and services that match the needs of your potential customers. After all, if you don't understand what your potential customers want and/or need, they will not purchase your product, and your business won't make any money. If, after careful consideration, you decide that you don't possess the necessary level of expertise to ensure the success of the new venture, you are left with two choices: hire an experienced team, or move on to something else.

Another common characteristic shared by many businesses that fail is insufficient capital, or not accurately calculating how much money the business will require. Undercapitalization may also be the result of unrealistic expectations regarding the amount of income the new business will generate. It is vitally important to determine the amount of capital needed to start and sustain a new company over its first few years of operation because it may require several years before the business becomes profitable.

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You must also identify appropriate financing sources. Robust personal savings are often the best option. If you're like the vast majority of Americans, most of your personal savings is likely held in some type of qualified retirement plan, such as a 401(k), 403(b), IRA, etc.

You may choose to finance your new business, at least in part, by accessing these retirement funds, but be forewarned that this approach can be potentially devastating. Withdrawals and/or loans taken from one of these plans can have significant tax consequences. In addition, tapping the funds in your retirement plan may jeopardize your future financial situation. So it is a good idea to first contact a financial and/or tax professional.

If personal savings are not an option, you may rely heavily on credit cards to finance your new business. While they offer readily available credit, the interest rates and fees associated with them can easily erase any profit your company may begin to realize, and you may find yourself in business simply to make monthly credit-card payments.

There are other finance sources, so it is a good idea to identify all potential resources (banks, equity funds, etc.) and engage the various players. The key factors when determining the best financing for a small business are interest rates and repayment terms.

Sometimes small-business owners dismiss bank financing without even exploring this option. While it is true that many new businesses may not be in a position to receive institutional financing, it is key to engage banks before you begin to raise your capital.

Banks often have programs designed specifically for small business owners, and if your business has been in existence for two or three years and has shown the ability to turn a profit, you may be in a better position to receive institutional financing.

If bank financing is not an option, equity financing may be viable. While you may not care for the prospect of a diminished ownership interest in your company, you may agree that it is far superior to no interest at all.

Another unappealing downside to equity financing is the usual source of it — family and friends. While it is often a good idea not to mix business with your personal and family life, family and friends are often good sources of financing. Like any other source, though, the key is to have thorough and reasonable expectations regarding your relationships once money becomes involved.

Another significant factor when deciding to start a new business is the time commitment that you're willing to make. Many people underestimate how much time a new business actually requires. If you're not prepared mentally and physically to handle the demands of the new business, you will likely experience burnout and give up, and your business will fail. On the other hand, if you have realistic expectations of the time involved, subsequently invest that time, and learn from your mistakes, your business will be positioned for success.

You should also consider the impact your new business will have on your family. It's a good idea to discuss these demands with your spouse and/or family and secure their respective support before you launch the new venture. You are far more likely to succeed with the support and understanding of your family.

On the other hand, if time invested in your new business is perceived as taking time away from family, resentment and stress can grow, and your business will probably suffer.

Finally, you must understand the state of your local, regional, and national economy. Does the business you're trying to start have a readily available customer base that is willing to buy the goods and services that your business sells?

With the expansion of the Internet and other technology, local economies are becoming far less important. Businesses are more easily operating on a national and global level, which makes it easier to weather difficult local and regional economic conditions. Nonetheless, a thorough understanding of the local economy and its potential impact on a new business is a must before you launch your new business venture.

While this is not an exhaustive list of the factors that influence whether a new business succeeds or fails, it does outline some of the most common issues that affect startup success. Taking the time to address these and other issues may make the difference in whether or not your new company makes it to its sixth anniversary.❖

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