Why Companies Fail – Part 2

Businesses can come unstuck easier and faster than most people think.

While factors like emerging technologies and greater customer access have introduced many new opportunities, they haven't negated the need for solid operational fundamentals. In the second of two articles, Jirsch Sutherland Partner Andrew Spring outlines the further triggers that may lead a business venture to fail.

Lack of scaling ability

As new revenue opportunities arise, businesses will probably need access to more resources. Likewise, if an opportunity is no longer performing, the ability to draw back and bring cost levels down to a normalised position is equally as critical. Serious problems can arise when the ability to achieve either is flawed.

"Scaling up or down relates to things like human resources, equipment, or further lease requirements through a new site," explains Andrew Spring, Jirsch Sutherland Partner. "To do this successfully, businesses need good fundamentals. The inability to expand or contract or scale up and down is often a reason why they end up losing money.

"I was recently appointed to an e-commerce start-up business that experienced enormous growth during its initial two years. Unfortunately, the business was not prepared logistically to handle the demand and was forced to make 'knee-jerk' decisions with long term consequences, such as employing more staff and taking a second premises lease. When demand dropped away just as quickly, the business was burdened with the extra overhead that quickly eroded the profits that had been made."

Assigning the wrong people to key roles

Putting the right people in the right jobs might sound like common sense, but it doesn't always happen. Not surprisingly, disaster can easily strike when key tasks are assigned to personnel without the appropriate skill sets.

"You don't know what you don't know, and you've got to be prepared to understand that you don't know it all," says Andrew. "Often we see businesses that have ended poorly by virtue of the fact that the person who's really good at making widgets decides to open a business and then takes on the task of actually selling them. Of course, making widgets is nothing like selling them. That's why it's essential to find the right people for the right role within a business. You can't have a technician trying to sell."

Inability to plan for succession

The passing of the baton is a defining moment in the life of any business.

Done correctly, succession can lay the platform for many years of further success. Done incorrectly, however, and decades of hard work and hard-won reputations can come undone almost overnight.

Andrew Spring

“Businesses involved in a succession plan can fail because the party that established and grew the business understood all the key elements of success, while the incoming next generation have never had to understand it,” says Andrew.

“Previously, this group may have only worked in one element of the business. As a result, it’s hard for them to judge a good decision at the right time. In family businesses, often the kids have really been sheltered from the true decision-making. That means they’ve got to start from the beginning as well.”

Andrew recounts a matter he worked on recently that involved a retail business owned and operated by the father for 25 years. “Upon his retirement, his son, who had worked in the business for over 10 years, assumed control,” Andrew explains.

“The son had previously managed the bricks and mortar stores of the business. Despite significant operational improvements during his tenure, the retail environment had changed. The business was not sufficiently equipped to handle the e-commerce and digital marketing environment and sales spiralled.”

Seeing the signs

While experiencing serious problems and pitfalls can be stressful for any business, it doesn’t necessarily have to end in insolvency. According to Andrew, recognising the symptoms and seeking early intervention can help save even the most risky of situations.

“In isolation, some of the issues we’ve discussed are not fatal for businesses if people seek early intervention or advice,” he says. “If any of this starts to ring true then it’s really about beginning a conversation. Speak to your accountant or an insolvency specialist and find out your options. My view is that in business, it’s very easy to fail. It’s actually very difficult to succeed. Problems and issues can easily arise. The key is to recognise shortcomings and act to solve them as quickly as possible.”