# Why Companies Fail CEOs offer every excuse but the right one: their own errors. Here are ten mistakes to avoid.

**By Ram Charan and Jerry Useem Reporter Associate Ann Harrington**

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(FORTUNE Magazine) ï How many more must fall? Each month seems to bring the sound of another giant crashing to earth. Enron. WorldCom. Global Crossing. Kmart. Polaroid. Arthur Andersen. Xerox. Qwest. They fall singly. They fall in groups. They fall with the heavy thud of employees laid off, families hurt, shareholders furious. How many? Too many; 257 public companies with $258 billion in assets declared bankruptcy last year, shattering the previous year's record of 176 companies and $95 billion. This year is on pace, with 67 companies going bust during the first quarter. And not just any companies. Big, important, Fortune 500 companies that aren't supposed to collapse. If things keep going like this, we may have trouble filling next year's list.

Why do companies fail? Their CEOs offer every excuse in the book: a bad economy, market turbulence, a weak yen, hundred-year floods, perfect storms, competitive subterfuge--forces, that is, very much outside their control. In a few cases, such as the airlines' post-Sept. 11 problems, the excuses even ring true. But a close study of corporate failure suggests that, acts of God aside, most companies founder for one simple reason: managerial error.

We'll get to the errors in a moment. But first let's acknowledge that, yes, failures usually involve factors unique to a company's own industry or culture. As Tolstoy said of families, all happy companies are alike; every unhappy company is unhappy in its own way. Companies even collapse in their own way. Some go out in blinding supernovas (Enron). Others linger like white dwarfs (AT&T). Still others fizzle out over decades (Polaroid). Failure is part of the natural cycle of business. Companies are born, companies die, capitalism moves forward. Creative destruction, they call it.

It was roughly this sentiment that Treasury Secretary Paul O'Neill was trying to convey when he said that Enron's failure was "part of the genius of capitalism." But aside from sounding insensitive, O'Neill got one thing wrong. Capitalism's true genius is to weed out companies that no longer serve a useful purpose. The dot-coms, for instance, were experiments in whether certain businesses were even viable. We found out: They weren't. Yet many recent debacles were of companies that could have lived long, productive lives with more enlightened management--in other words, good companies struck down for bad reasons. By these lights, Arthur Andersen's fall is no more part of the "genius of capitalism" than the terrorism on Sept. 11 was part of the "genius of evolution."

By "failure," we don't necessarily mean bankruptcy. A dramatic fall from grace qualifies too. In the most recent bear market, for instance, 26 of America's 100 largest companies lost at least two-thirds of their market value, including such blue chips as Hewlett-Packard, Charles Schwab, Cisco, AT&T, AOL Time Warner, and Gap. In the 1990 bear market, by contrast, none did, according to money management firm Aronson & Partners.

The sheer speed of these falls has been unnerving. Companies that were healthy just moments ago, it seems, are suddenly at death's door. But this impression may be misleading. Consider, for instance, a certain Houston institution we've heard so much about. There was no one moment when its managers sat down and conspired to commit wrongdoing. Rather, the disaster occurred because of what one analyst calls "an incremental descent into poor judgment." A "success-oriented" culture, mind-numbing complexity, and unrealistic performance goals all mixed until the violation of standards became the standard. Nothing looked amiss from the outside until, boom, it was all over.

It sounds a lot like Enron, but the description actually refers to NASA in 1986, the year of the space shuttle Challenger explosion. We pull this switch not to conflate the two episodes--one, after all, involved the death of seven astronauts--but to make a point about failures: Even the most dramatic tend to be years in the making. At NASA, engineers noticed damage to the crucial O-rings on previous shuttle flights yet repeatedly convinced themselves the damage was acceptable. Companies fail the way Ernest Hemingway wrote about going broke in The Sun Also Rises: gradually, and then suddenly. (For some solutions, see box "Three Quick Fixes.")

What undoes them is the familiar stuff of human folly: denial, hubris, ego, wishful thinking, poor communication, lax oversight, greed, deceit, and other Behind the Music plot conventions. It all adds up to a failure to execute. This is not an exhaustive list of corporate sins. But chances are your company is committing one of them right now.

Softened by success

"Those whom the gods would destroy," Euripides wrote nearly 2,500 years ago, "they first make mad." In the modern update, the gods send their victims 40 years of success. Actually, it's a proven fact: A number of studies show that people are less likely to make optimal decisions after prolonged periods of success. NASA, Enron, Lucent, WorldCom--all had reached the mountaintop before they ran into trouble. Someone should have told them that most mountaineering accidents happen on the way down.

Consider the case of Cisco Systems. While by no means a failure, Cisco suffered a remarkable comedown in the spring of 2001--remarkable not only for its swiftness (its shares lost 88% of their value in one year) but also because Cisco, more than any other company, was supposed to be able to see into the future. The basis of this belief was a much vaunted IT system that enabled Cisco managers to track supply and demand in "real time," allowing them to make pinpoint forecasts. The technology, by all accounts, worked great. The forecasts, however, did not. Cisco's managers, it turned out, never bothered to model what would happen if a key assumption--growth--disappeared from the equation. After all, the company had recorded more than 40 straight quarters of growth; why wouldn't the future bring more of the same?

The rosy assumptions, moreover, persisted even when evidence to the contrary started piling up. Customers began going bankrupt. Suppliers warned of a coming dropoff in demand. Competitors stumbled. Even Wall Street wondered if the Internet equipment market was falling apart. "I have never been more optimistic about the future of our industry as a whole or of Cisco," CEO John Chambers declared in December 2000, still projecting 50% annual growth.

What was Chambers thinking? In The Challenger Launch Decision, her definitive book on the disaster, Boston College sociologist Diane Vaughan notes that people don't surrender their mental models easily. "They may puzzle over contradictory evidence," she writes, "but usually succeed in pushing it aside--until they come across a piece of evidence too fascinating to ignore, too clear to misperceive, too painful to deny, which makes vivid still other signals they do not want to see, forcing them to alter and surrender the world-view they have so meticulously constructed."

For the perpetually sunny Chambers, that "piece of evidence" did not come until April 2001, when cratering sales forced Cisco to write down $2.5 billion in excess inventory and lay off 8,500 employees. Chambers may have been operating in real time, but he wasn't operating in the real world.

## See no evil

With $6.5 billion in cash and a strong competitive position, Cisco will live to fight another day. Polaroid may not be so lucky. Like its fellow old-economy stalwart Xerox, Polaroid was a once-highflying member of the Nifty Fifty group of growth stocks that lost their luster over the years. Eventually the question "What does Polaroid make?" became a latter-day version of "Who's buried in Grant's tomb?" Polaroid, that is, made Polaroid cameras--period.

Time had passed the company by, you might say. Not exactly. Think about another company that once seemed doomed to fail: Intel. Back in 1985, competition from Japan was turning Intel's memory chips into cheap commodities, and observers were all but writing the company's obituary. Instead of going the way of Polaroid, though, Intel decided to exit the memory business entirely and become a maker of microprocessors. The key insight occurred when Intel founders Andy Grove and Gordon Moore sat down and asked themselves some tough questions. "If we got kicked out and the board brought in a new CEO," Grove asked Moore, "what do you think he would do?" Get out of memory chips was the answer. From there, they said later, it was just a matter of doing what needed to be done.

Polaroid and Xerox, by contrast, were slow to confront the changing world around them. Executives at both companies repeatedly blamed poor results on short-term factors--currency fluctuations, trouble in Latin America--rather than the real cause: a bad business model. By the time Xerox President (and now CEO) Anne Mulcahy came out and spoke the truth--the company had "an unsustainable business model," she told analysts in 2000--Xerox was flirting with bankruptcy.

Jim Collins, author of the influential management books Built to Last and Good to Great, has spent years studying what separates great companies from mediocre ones. "The key sign--the litmus test--is whether you begin to explain away the brutal facts rather than to confront the brutal facts head-on," he says. "That's sort of the pivot point." By forcing themselves to think like outsiders, Grove and Moore recognized the brutal facts before it was too late. Polaroid and Xerox didn't.

## Fearing the boss more than the competition

Sometimes CEOs don't get the information they need to make informed decisions. The main reason, says Daniel Goleman, a psychologist and author of the book Primal Leadership, is that subordinates are afraid to tell them the truth. Even when a boss doesn't intend to quash dissent, subtle signals--a sour expression, a curt response--can broadcast the message that bad news isn't welcome. That's why, according to a study by Goleman and two associates, higher-ranking executives are less likely to have an accurate assessment of their own performance.

Fear can have its uses, of course; Andy Grove has long espoused the value of competitive paranoia. But in unhealthy situations, employees come to worry more about internal factors--what the boss might say, what management might do--than about threats from the outside world. Certainly this was the case at Enron, where even alarm-ringer Sherron Watkins chose to express her concerns anonymously rather than hazard one of CEO Jeff Skilling's famous tongue-lashings. And she was one of the brave ones.

The same problem hampered Samsung Chairman Lee Kun Hee in 1997 when he decided to take Samsung into the auto business. Knowing the car industry was a crowded field plagued by overcapacity, many of Samsung's top managers silently opposed the $13 billion investment. But Lee was a forceful chairman and a car buff to boot. So when Samsung Motors folded just a year into production, forcing Lee to spend $2 billion of his own money to placate creditors, he expressed surprise: How come nobody had spoken up about their reservations?

During World War II, Winston Churchill worried that his own larger-than-life personality would deter subordinates from bringing him bad news. So he set up a unit outside his generals' chain of command, the Statistical Office, whose primary job was to feed him the starkest, most unvarnished facts. In a similar vein, Richard Schroth and Larry Elliott, authors of the forthcoming book How Companies Lie, suggest designated "counterpointers," whose function is to ask the rudest questions possible. Such mechanisms take information and turn it into information that can't be ignored.

Overdosing on risk

Some companies simply live too close to the edge. Global Crossing, Qwest, 360networks--these telecom flameouts chose paths that were not just risky but wildly imprudent. Their key mistake: loading up on two kinds of risk at once.

The first might be called "execution risk." In their race to band the earth in optical fiber, the telco upstarts ignored some key questions: Namely, would anyone need all of this fiber? Weren't there too many companies doing the same thing? Wouldn't, uh, most of them fail? "People seemed to say, 'Maybe--but it's not going to be us,'" says Darrell Rigby, a Bain & Co. consultant who studies managing during times of turbulence. "Everyone thought they were immune."

On top of execution risk was another kind, which we'll call liquidity risk. Global Crossing--run by Gary Winnick, formerly of the junk-bond house Drexel Burnham Lambert--loaded up on $12 billion of high-yield debt. This essentially limited Winnick to a cannonball strategy: one shot, and if you miss, it's bankruptcy.

Bankruptcy it was. Given the utter violence of the telecom shakeout, you might say it was inevitable. But other telcos did manage to escape the carnage. BellSouth, dismissed as hopelessly conservative during the Wild West years, emerged with a pristine balance sheet and a strong competitive position. Its gentlemanly CEO, Duane Ackerman, was guided by a radical idea: "being good stewards of our shareholders' money." What a concept.

Acquisition lust

WorldCom founder Bernard Ebbers liked to eat. He ate MCI. He ate MFS and its UUNet subsidiary. He tried to eat Sprint. Wall Street helped him wash it all down with cheap capital and a buoyant stock price. Pretty soon WorldCom was tipping the scales at $39 billion in revenues. But there was a problem: Ebbers didn't know how to digest the things he ate. A born dealmaker, he seemed to care more about snaring new acquisitions than about making the existing ones--all 75 of them--work together. At least Ebbers was up front about it: "Our goal is not to capture market share or be global," he told a reporter in 1997. "Our goal is to be the No. 1 stock on Wall Street."

The results were frequently chaotic. For a time, sales reps from UUNet competed head-to-head with WorldCom sales teams for corporate telecom contracts. Smaller customers complained they had to call three different customer-service reps for their Internet, long-distance, and local-phone inquiries. If there is such a thing as negative synergy, WorldCom may have discovered it.

Not that acquisitions are always so bad. General Electric combines its acquisitive nature with an impressive ability to break down acquisitions and integrate them into existing operations. But too often CEOs succumb to an undisciplined lust for growth, accumulating assets for the sake of accumulating assets. Why? It's fun. There are lots of press conferences. It's what powerful CEOs do. And like Ebbers, whose WorldCom stock has lost 98% of its value, few wonder if their eyes might be bigger than their stomachs.

Listening to Wall Street more than to employees

No one likes a good growth story better than Wall Street. And in the late 1990s, no one was telling a better one than Lucent CEO Rich McGinn. He knew how to give Wall Street what it wanted--explosive top-line growth--and in return, Wall Street turned McGinn and his team into rock stars. For a bunch of former Bellheads, it was intoxicating stuff.

But while McGinn was busy performing for the Street, there were at least two groups he wasn't listening to. The first was Lucent's scientists, who feared the company was missing out on a new optical technology, OC-192, that could transmit voice and data faster. They pleaded in vain for its development, then watched as rival Nortel rolled out OC-192 gear to thunderous success. At the same time McGinn was neglecting Lucent's salespeople, who might have told him that his growth targets were becoming increasingly unrealistic. To meet them, employees were pulling forward sales from future quarters by offering steep discounts and wildly generous financing arrangements, largely to dot-coms. "As we got further and further behind," Chairman Henry Schacht later explained, "we did more and more discounting."

It could only last so long. After Lucent stock had lost more than 80% of its value and he had replaced McGinn as CEO, Schacht sat down with FORTUNE to ponder some hard-earned lessons. "Stock price is a byproduct; stock price isn't a driver," he said. "And every time I've seen any of us lose sight of that, it has always been a painful experience." Top management needs to understand what the folks on Wall Street want--but not necessarily give it to them.

Strategy du jour

When companies run into trouble, the desire for a quick fix can become overwhelming. The frequent result is a dynamic that Collins describes in Good to Great: "A&P vacillated, shifting from one strategy to another, always looking for a single stroke to quickly solve its problems. [It] held pep rallies, launched programs, grabbed fads, fired CEOs, hired CEOs and fired them yet again." Lurching from one silver bullet solution to another, the company never gained any traction.

Collins calls it the "doom loop," and it's a killer. Kmart is another victim. In the 1980s and early '90s, Kmart was all about diversification, shifting away from discounting to acquire stakes in chains like Sports Authority, OfficeMax, and Borders bookstores. But in the 1990s a new management team divested those stores and decided to revamp Kmart's supply chain by investing heavily in IT. That lasted for a while, until a new CEO, Chuck Conaway, decided that, actually, Kmart would try to beat Wal-Mart at its own game. This unleashed a disastrous price war that in the end proved to be one mistake too many. "When you look at companies that get themselves into trouble," says Collins, "they're often taking steps of great, lurching bravado rather than quiet, deliberate understanding." Did somebody say AT&T?

## A dangerous corporate culture

Arthur Andersen, Enron, and Salomon Brothers were all brought down, or nearly so, by the rogue actions of a tiny few. But the bad apples in these companies grew and flourished in the same kind of environment: a rotten corporate culture. It's impossible to monitor the actions of every employee, no matter how many accounting and compliance controls you put in place. But either implicitly or explicitly, a company's cultural code is supposed to equip front-line employees to make the right decisions without supervision. At Salomon Brothers the culture did just the opposite. The transgressor there was Paul Mozer, a trader who in February of 1991 improperly overbid in auctions of U.S. Treasury bonds. While it was another improper bid on May 22 that finally did him in, the critical event occurred in April, when Salomon Chairman John Gutfreund learned of the February overbid by Mozer and failed to discipline him. Mozer evidently took Gutfreund's lack of action as a green light.

Salomon's culture of swashbuckling bravado encouraged risk taking without accountability. Enron's culture encouraged profit taking without disclosure. Andersen's culture engendered conflicts of interest without safeguards. Rotten cultures produce rotten deeds.

## The new-economy death spiral

Alan Greenspan has his own theory on failure. Testifying about Enron in February, he noted, "A firm is inherently fragile if its value-added emanates more from conceptual as distinct from physical assets.... Trust and reputation can vanish overnight. A factory cannot." The speed of some recent crackups would seem to confirm his thesis. The first domino falls when questions are raised, sometimes anonymously. Wrongdoing is suspected. Customers delay new orders. Rating agencies lower their debt ratings. Employees head for the exits. More customers defect. And voila, you have what former Enron CEO Jeff Skilling has called "a classic run on the bank."

Is it possible to halt one? Yes, but only if you stop the spiral from building up speed. Salomon broke the cycle by hiring Warren Buffett as interim CEO--essentially a giant credibility infusion. By waiting several months to step down, on the other hand, Arthur Andersen CEO Joseph Berardino lost whatever chance he had to avoid disaster. Once started, the spiral can bring a company whose main assets are people and ideas to its knees with breathtaking finality.

## A dysfunctional board

What was Enron's board thinking? Of all the infamous moments in the company's demise, perhaps the least explicable was the board's decision to waive Enron's code of ethics to accommodate CFO Andrew Fastow's partnerships. "A red flag the size of Alaska," says Nell Minow, founder of the board watchdog group Corporate Library. Even Enron directors belatedly agreed with this assessment. "After having authorized a conflict of interest creating as much risk as this one," the board's special investigation committee wrote in a February report, "the board had an obligation to give careful attention to the transactions that followed. It failed to do this.... In short, no one was minding the store."

Despite a decade's worth of shareholder activism, Enron's board was not an anomaly. The sorry fact is that most corporate boards remain hopelessly beholden to management. "I was never allowed to present to the board unless things were perfect," says a former senior executive at Xerox, whose board includes Vernon Jordan and former Senator George Mitchell. "You could only go in with good news. Everything was prettied up." At many boards, the CEO oversees meetings, hand-picks directors, and spoon-feeds them information. "Directors know relatively little apart from what management tells them," says John Smale, a former CEO of Procter & Gamble and onetime chairman of General Motors.

Unless, that is, the board demands more. "The CEO is always going to want to turn the board meeting into a pep rally," says Minow. "You've got to say to him, 'Look, I'm a busy person. I don't have time for the good news. What I need for you to tell me is the bad news.' It's like what Robert Duvall says in The Godfather: 'I have to go to the airport. The Godfather is a man who likes to hear bad news immediately.' That should be emblazoned on every corporate governance policy sheet."

Paul O'Neill may have been wrong about his assessment of Enron, but he was right about something else. "The great companies don't make excuses," he said recently, "including excuses about how they didn't do well because the economy was against them or prices were not good. They do well anyway." It's true. And it's something to think about the next time you hear a CEO railing at the gods.

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# Top 10 Reasons Why Small Companies Fail

From The Business Monthly website.

For a presentation on the pitfalls of entrepreneurship at last month's High Tech Council breakfast, moderator Tom Wiggins of Sienna Partners did a survey of 15 local high tech companies to identify the reasons small companies fail.

As principal of a consulting firm that specializes in helping early stage medical and high tech companies, Wiggins was familiar with many of the problems these companies encounter. Here is his compilation of the reasons, many of them cited by several companies.

**10 Underestimating time to complete major milestones:** As they say, "E. coli happens," so don't underestimate the time it will take to get a job done. Think about the home projects that require more than one trip to the hardware store.

**9 Technical reasons:** The technology is just too hard to master given the available funds, or the technology needs a breakthrough that isn't going happen soon.

**8 Failure to recruit experienced management:** Leadership that has experience bringing products to market is very important. Don't hire a leader who thinks he knows it all. Egos will kill the company.

**7 Failure to raise adequate funds:** Don't underestimate what it's going to take to get the job done. Remember, not all things are going to work the first time.

**6 Failure to develop infrastructure/partners:** Don't think you can do it all yourself. Hire the right people to get the job done, outsource or partner.

**5 Misuse of funds or lack of understanding cash flow:** A few simple rules apply-no perks for anyone, i.e., company car, club memberships, lease rather that buy, buy used not new, don't buy anything that's not key to success. Remember that most customers don't pay in 30 days; understand what is normal for your industry.

**4 Lack of technical or marketing focus:** It is very important to focus and not try to be everything to everybody, find a niche and dominate that market, then expand. Make sure your product has a customer focus.

**3 Misstep in hiring:** Not putting together the right team can make it very difficult. You need employees with the relevant experience; finding people who can work well in small teams is key. To be a successful small company requires hard work. Egos, once again, have no place in small companies. If you have someone who is not working out, you need to take action. Remember, "One rotten apple can spoil the barrel."

**2 Failure to plan for success:** What if your market opportunity becomes larger than you expect? How are you going to meet demand? Lack of planning is often a key to failure.

**1 Failure to plan for failure:** What if you are met with problems? Do you have alternative strategies? Understanding when to stay on course or switch to an alternative plan is very important. Once again the lack of planning is often a key to failure.

Three local high tech entrepreneurs then told their own stories of the problems they've encountered, often illustrating some of the points from Wiggins' survey.

Charlene Riikonen, CEO of Cera Products, which makes rice-based rehydration products for people who have become dehydrated from illness or exercise, told of several unsuccessful attempts to infuse cash into the venture. A set of angel investors wanted to add a high-priced management team, and a large sports nutrition company wanted to add ingredients to the products.

"We never really came to an agreement" with the nutrition company, which had been buying large quantities of Cera powder, Riikonen said. "When we refused to sign the agreement, they refused to buy the last batch of 50,000 pounds." That batch is now being sold to the U.S. military for use by Rangers, Seals and other special forces in places like Afghanistan.

Clarence Wooten, now head of Wooten Ventures helping startup companies gain financial backing, described himself as a "serial entrepreneur" who had started four companies since high school. In many cases, as he struggled to get financing, he has been what he called an "entre-po'-neur."

His last firm, ImageCafe, which developed a format for companies to customize web sites at an affordable price, was sold to Network Solutions outright after Wooten couldn't come to terms on an investment from the company that controls Internet domain names. Given the collapse of the dot.com bubble, "If I hadn't sold out, I'd probably be bankrupt now," he said.

Rhonda Friedman of Coagulation Diagnostics described a series of mistakes that the company has made in developing an assay of coagulation needs in patients.

Some of the lessons learned, Friedman said, included: "The best is the enemy of the good. É Don't be afraid to pull the plug on biomedical products-prolongation of the inevitable wastes precious cashÉ. There's no such thing as being too rich." In worrying about dilution of ownership from the addition of later rounds of venture capital, she said, "A small percent of something is better than a large percent of nothing."

And finally when it comes to building a team of employees, " a rotten apple does spoil the barrel," Friedman said.

## WHY COMPANIES STAGNATE AND FAIL

There are many causes why Companies either fail or stagnate, but four reasons continue to come up in almost all cases.

1. **The Company has no Vision, Strategy or Strategic Business Plan,**
2. **Weak or ineffective management**
3. **Lack of information and control systems,**
4. **Under capitalization.**

The first reason, lack of vision, no clearly delineated strategy and no strategic business plan is one reason seen in almost all-failing companies. Without clear focus on the company's strategy as to how they face the market - "What They Bring To The Party", the company will have lost its way and the members of the company organization will inevitably be working at cross purposes. This acts as a drag on a company's momentum. Lack of focus leads to continual unplanned reaction to situations as they develop. This leads to "Fixes" rather than solutions and, in most cases, costs that were not anticipated. This problem must be solved before any productive work can be done on the other problems.

Weak or ineffective management is seen in many small companies but is most prevalent in family owned and run organizations. In many of the smaller companies, the owner is very competent at whatever the company does - stamping, machining, molding, etc., but neither he nor his employees have had much exposure to managing a modern business. There is significant resistance to change forced by the market conditions. The second generation family members of these companies are usually not as good as the prior generation at the basic function of the company and have received their management training from the prior generation - the worst of both situations.

A lack of information and control systems further aggravates the situation. Typically we find companies that are only reacting to problems and are always behind. Events control them; they do not control events. Managers lack information on the overall situation and tend to concentrate only on what they can see, sometimes to the detriment of the overall company. Lack of control systems allows for significant deviations in buying, inventory, scrap and receivables. Companies of this type do not know their true costs and require substantially more working capital than should be necessary for a company of their size.

Under capitalization is the one problem everyone would probably mention first if asked why companies fail. The truth is that while many companies are undercapitalized, the ones that fail do so because of the three problems discussed above and a failure to manage their growth. Growing too rapidly causes as many if not more failures than those that fail because of insufficient business. Over commitment to new business without the necessary resources will do damage both to the new business but also to a company's current business.

When a company stagnates or begins to fall back, its time to call in help, before your lenders force you to do it. An experienced consultant can analyze a company's situation very quickly and work with the owner or Chief Executive to develop the necessary actions to get back on track and to grow the business. This is money well spent and will result in improved outlook, more productive employees and better relations with lenders, suppliers and customers.

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# Why Do Most Business Startups Fail?

*By gimmesome*

## Don't Become a Statistic

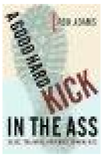
New research by the U.S. Bureau of Labor Statistics shows that nearly six in ten businesses shut down within the first four years of operation. While not as calamitous as the 90% failure rate often repeated as fact, the BLS statistics are sobering for anyone tempted to invest their time and personal savings in launching a startup. To avoid becoming a statistic yourself, I have assembled the top reasons so many new businesses fail.

### 1. Poor Execution

***When you're the boss, the only place you should point fingers is at the mirror.***

As I have described elsewhere, strong execution-rather than a clever idea- is crucial to the success of new businesses. It stands to reason, therefore, that poor execution is the downfall of most startups that go bust. There are several ways you can avoid execution failure. First, you should conduct an honest evaluation of your skills and only pursue opportunities that are aligned with your strengths. Entrepreneurs who are blinded by greed or arrogance are more prone to getting in over their heads. It's also wise to surround yourself with talented people who aren't afraid to speak up when you're headed off a cliff.

Companies with inept leadership usually fail in the first year or two, but even established companies can stumble badly when they outgrow the capabilities of the founding team. Bill Gates led Microsoft from inception to its current position as one of the largest and most successful companies in history, but this is seldom the case. As a founder, you need the discipline to know when to hand over the reigns to a professional manager who can take your business to the next level.




A Good Hard Kick in the Ass: Basic Training for Entrepreneurs
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## 2. No Viable Market

***What if we launched a business and nobody showed up?***

Each day, entrepreneurs from the "build it and they will come" school of business invest their money in a cool idea with the hopes that customers will magically appear once they open the doors. All too frequently, these hopes turn out to be in vain. History is replete with ventures that crashed and burned because the founders spent all of their time and money developing a product without bothering to consider how to attract customers. Even worse, many did not really understand what customers valued and were willing to pay for. (Remember the "dot bomb" era of the not-so-distant past?)

It's imperative to research and validate the market *before* you launch your business. Talk to prospective customers and find out what they really need. Chances are, you will end up with a much more compelling offering than what you initially dreamed up on your own. Remember, **find the customers first**, then look for a solution.


Will It Fly? How to Know if Your New Business Idea Has Wings...Before You Take the Leap
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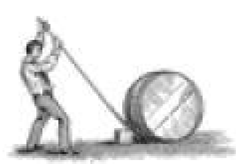
List Price: $27.95



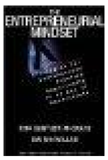
## 3. Too Much Leverage

***Give me a lever long enough and I will bankrupt my company.***

Mature companies can predict revenues over the next few quarters with some degree of certainty. These businesses can make prudent use of leverage, both financial (debt) and operating (fixed overhead costs) to improve equity returns.

Revenues projections for early-stage companies, on the other hand, can be all over the map. In this environment, it is dangerous to take on more than a token amount of debt or other fixed obligations (rent, salaries, etc.). With no margin for error, if revenues take longer to ramp up than expected-as they nearly always do-you may find yourself handing the keys of your business over to your creditors.

It's best to keep most costs variable at first and use equity to finance your startup until your business has been around a while and you develop some confidence in your ability to forecast sales. Delay making investments or taking on fixed obligations as long as you can. You'll know when it's time to rent a larger office space or hire that second shift when you've got a backlog of orders on the books.

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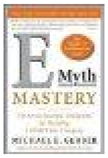
## 4. Undercapitalizing the Business

***Maybe you should've waited to order that red Ferrari after all...***

It's all too common for entrepreneurs to grossly underestimate the amount of time and capital necessary to reach cash flow breakeven, causing many promising ventures to shut down prematurely. Be conservative with your financial projections and plan on having adquate funds when you launch to cover all sunk costs (including startup losses) until your company becomes cash flow positive.

If you don't have enough savings to cover the required investment, it may be tempting to launch the business anyway under the assumption that you will be able to obtain funding at a later date. Whle staging investment has its advantages (preserving the option to abandon, higher valuation and-therefore-less dilution, etc.), this strategy can backfire and leave you unable to get the money when you need it most or force you to negotiate with banks and investors from a position of weakness. It's often better to change the business model to bring required investment in line with available resources.



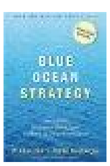
E-Myth Mastery: The Seven Essential Disciplines for Building a World Class Company
**Price:** $9.02
List Price: $16.95

## 5. Lack of Competitive Advantages

***Never bring a knife to a gunfight!***

Does your town really need another dry cleaner, pizzeria, or lawn care service? Entrepreneurs frequently start these me-too kind of businesses because of their simplicity and modest capital requirements. However, the lack of competitive barriers render them extremely vulnerable to new entrants, who will gladly cut prices to the bone to steal customers.

If you want your business to thrive, you need something that insulates it from competition. It could be a great location, a cool brand, proprietary technology, or a cost structure that cannot be easily replicated. None of these advantages is likely to be permanent, but they only need to shield you long enough for your company to take root. This will give you time to make investments that create additional barriers.

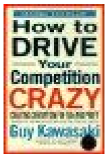


Blue Ocean Strategy: How to Create Uncontested Market Space and Make Competition Irrelevant
**Price:** $14.49
List Price: $29.95

## 6. Competing Head-to-Head with Industry Leaders

***Better sharpen those elbows...***

A sure sign of impending failure is an entrepreneur who plans to bootstrap his new business while competing directly against entrenched market leaders. Large businesses have enormous resources to deter competitors from entering their markets. Big companies can undercut your prices, outspend you on advertising, and choke off access to suppliers and distributors. I strongly advise against making a frontal assault unless you have a world-class team and very deep pockets. Even then, your chances of success are likely to be disappointing.



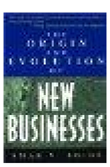



## 7. Picking a Niche That's too Small

***Don't be a market of one!***

Most small businesses compete successfully against larger rivals by specializing in a niche market. However, you still need to do your homework to be sure that the niche is large enough to support your business and that customers are not too expensive to find and serve. You may discover that niche markets can be just as fiercely competitive as the mass market. You need to figure out how fast your niche is growing and how much market share you will need to capture.

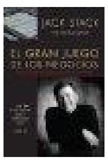
If your financial projections require you to hold more than a few percent of market share to remain profitable, be careful. Don't press ahead unless you can convincingly demonstrate to yourself how your competitive advantages will enable you to become the market leader.



## 8. Breakup of the Founding Team

***Breaking up is hard on you–and your company.***

A startup can be a high-stress environment, especially when you are struggling to turn the corner before the lights go out. At moments like this, disagreements about the direction of the company or the division of profits can lead to a rift among the founding team. Because people have to wear lots of hats in startups, the sudden departure of a key executive can doom a fledgling organization. This makes it imperative to structure agreements so that the founders and key hires are treated fairly and that everyone's interests are closely aligned with the success of the business.





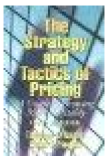

## 9. Poor Pricing Strategy

***The price is right?***

The most common method for setting prices is to start at the unit cost and then mark up the price to achieve a profit, so-called "cost-plus" pricing. Unfortunately, cost has little to do with how a product or service is valued by customers, which can lead to systematic underpricing. For example, if a widget costs $20 to manufacture, and you sell it to a customer for $25 when that customer would gladly have paid $35, you have left $10 worth of value on the table.

Even worse, cost-based pricing can lead to prices that are greater than what the market will bear. Because cost is related to sales volume (see CVP Analysis for more info), high prices lead to fewer sales, which in turn increases unit cost, leading to a further round of price increases.

As Thomas Nagle and John Hogan point out in The Strategy and Tactics of Pricing, failing to account for the effect of price on sales volume-and hence costs-has led to numerous business failures over the years once they enter a "death spiral" of price increases to allocate fixed costs across a smaller volume of sales. You should instead let anticipated prices, based on the product's perceived value to customers, determine the *cost structure*, not the other way around. Consequently, pricing strategy and customer value should be considered early in the planning of a new business, before investments have been made that will determine the cost of a new offering.




The Strategy and Tactics of Pricing: A Guide to Growing More Profitably (4th Edition)
**Price:** $54.49
List Price: $91.50

## 10. Growing too Fast

***What goes up...***

Growth is generally regarded as an indication of business success, but uncontrolled growth can-and does-kill entrepreneurial companies for two primary reasons. The first is that businesses need systems and infrastructure to scale properly, but few invest the time and effort to lay the foundations for growth in those first hectic years. That's too bad, because things tend to spin out of control when you put the pedal down. This can be especially problematic for companies that receive a large infusion of outside capital. It's the equivalent of trying to break the land speed record by strapping a jet engine onto a soap box racer. Don't be surprised when the wheels come off...

The second reason is that top-line growth requires additional investments in fixed assets (warehouses, machinery, trucks, etc.) and working capital (inventory, accounts receivable, etc.). At controlled rates of growth, companies are able to finance additional sales internally through their own cash flow. Hypergrowth, on the other hand, can suck up large amounts of cash, forcing businesses deep into debt or bringing the whole enterprise to a screeching halt. Many times, business owners are not even aware of the impending collapse, because they focus on *profitability* (as depicted on the income statement) rather than cash flow. Never forget that cash is the lifeblood of your business!

Why Companies Fail CEOs offer every excuse but the right one: their own errors. Here are ten mistakes to avoid. Article.Â  But a close study of corporate failure suggests that, acts of God aside, most companies founder for one simple reason: managerial error. We'll get to the errors in a moment. But first let's acknowledge that, yes, failures usually involve factors unique to a company's own industry or culture. As Tolstoy said of families, all happy companies are alike; every unhappy company is unhappy in its own way. Companies even collapse in their own way. Some go out in blinding supernovas (Enron). Others linger like white dwarfs (AT&T). Still others fizzle out over decades (Polaroid). Fail... Why do companies fail? Their CEOs offer every excuse in the book: a bad economy, market turbulence, a weak yen, hundred-year floods, perfect storms, competitive subterfuge--forces, that is, very much outside their control. In a few cases, such as the airlines' post-Sept. 11 problems, the excuses even ring true.Â  Companies even collapse in their own way. Some go out in blinding supernovas (Enron). Others linger like white dwarfs (AT&T). Still others fizzle out over decades (Polaroid).Â  But the bad apples in these companies grew and flourished in the same kind of environment: a rotten corporate culture. It's impossible to monitor the actions of every employee, no matter how many accounting and compliance controls you put in place.