SMALL BUSINESS: CAUSES OF BANKRUPTCY

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Abstract

The research in this paper shows the dramatic impact that small business has on our economy, from taxes to job provision. It emphasizes the importance of small business in the daily life, from patents to developing technology. However, the research also shows the tenuous times facing small business if the status quo remains. Changing bankruptcy codes may mean that people are less willing to risk opening a small business, which could create stagnation in our economy. Clear conclusions are drawn between failures in management, marketing, and financial aspects, and the health of the small business. The situations and examples discussed in this paper give clear, concise picture of the small business landscape, and how a small business can avoid becoming a statistic.

Introduction

For many people owning a small business and being financially independent is what the American dream is all about. Entrepreneurs see many advantages to small business ownership. Ideas such as, there is no boss to answer to (except maybe the customer), hard work directly benefits the owner not someone else, ownership is exciting and challenging and the owner is fully responsible for all successes or failures. Small business ownership has proven to provide opportunities for minority groups. For example 8.1 million women owned businesses in 1997, which is growth of about ninety percent over a ten-year period[*]. What most of these aspiring entrepreneurs don't realize is small business plays a critical role in the health of the U.S. economy.

Small business can provide the economy with efficiency, innovation, competition and job growth. The U.S. Small Business Administration acknowledges that according to the Global Entrepreneurship Monitor, "There is a strong correlation between national economic growth and the level of national entrepreneurial activity" (Small Business Administration, Advocacy Small Business Statistics and Research, 2002). The U.S. Small Business Administration: Off ice of Advocacy reported in 1995, "The importance of maintaining a viable, dynamic, and progressive role for small businesses in the American economy is beyond dispute. The nation's traditional values of individual initiative, social mobility, and political freedom are dependent on the free enterprise system which, in turn, depends upon the competition provided by a large and healthy community of small firms" (Office of the Chief Counsel for Advocacy, 1995). Small businesses are responsible for generating more than 50 percent of the U.S. private Gross Domestic Product. In 2001, small businesses were responsible for 29 percent of all U.S. exports. According to the U.S. Small Business Administration, small businesses are granted thirteen to fourteen times more patents per employee than large firms. And small business patents have a 50 percent greater chance of being in the top one percent of patents most commonly specified. Not surprisingly,

[*] All statistics in the introduction, unless otherwise noted, are taken from the U.S. Small Business Administration web site http://sba.gov/.

small firms employ 39 percent of the high tech industry. This is a clear declaration of efficiency and innovation. These facts alone prove the irreplaceable impact of small business on the national economy, but the most critical statistics may be in job creation and overall employment.

Small business plays a key role in the health of the economy by providing employment and job growth. In the U.S. small firms of 500 employees or less employee about half the private work force and provide 44.3 percent of total salaries. In 2001 small companies employed 57.4 million of the 115.1 million private workers. Small businesses have been responsible for creating between 60 and 80 percent of new jobs each year. In 2000 and 2001 small businesses created a net increase in new jobs of 1,150, 875, while large companies had a net decrease of 150,905 according to the U.S. Small Business Administration. All jobs created in these years were a result of small business. In 1995 the U.S. economy had a total of 22.5 million businesses with 16.5 million sole proprietorships, 1.6 million partnerships and 4.5 million corporations. Ninety-nine percent of these 22.5 million companies had 500 or fewer employees classifying them as small businesses. In 2003 the U.S. economy had a total of 23.7 million businesses, of which 17 million were sole proprietorships. Of these 23.7 million businesses, 99.7 percent employed 500 or fewer individuals. Small firms also employ key demographics in the economy. For instance, a small company is more likely to hire individuals who work part-time or are older in years.

The benefits of entrepreneurship and small business are undeniable for both the owner and the economy. In reality, as astounding as the statistics are for small business success, the statistics for failure are equally daunting. A common statistic repeated when an aspiring entrepreneur seeks advice from friends or family is "Nine out of ten new businesses fail within the first year." While not entirely accurate, this common shred of advice could be considered close. One source claims the failure rate for new business to be about 70 to 80 percent in the first year (Holland, 1998). Many small businesses do in fact fail, but business failure in the U.S. does not carry the same consequences or ideas of personal failure as in many other regions around the world. Many cases of failure can be chalked up to experience in learning what to do and what not to do. Failure can provide an invaluable understanding of what it takes to be a successful entrepreneur. This is an important aspect of small business in the U.S. where in most cases the owner will survive to try again.

New Business Success and Failure

In the U.S. each and every business day, many hopeful entrepreneurs will begin new businesses, while many others will close the door on a business that is less than five years old. About half of the 20 to 30 percent of new businesses that make it through their inaugural year of operation will survive beyond the fifth year anniversary (Holland, 1998). Because most data on newly created firms is based on business with employees, it is difficult to give accurate information on the number of sole proprietorship start up and failure rates for any given year. As such, the rates given in this section will be based on firms with employees.

The U.S. Small Business administration states that approximately two-thirds of new employer firms last two years and half survive at least four. They also estimate about ten percent of the employment businesses open and close each year. Yearly statistics, including bankruptcies can be seen in Table 1.

TABLE 1
Business Turnover in US (thousands)

Category	1997	1998	1999	2000	2001	2002	2003
New Firms	590.6	590.0	587.1	574.3	585.1	589.7	572.9
Firm Closures	530.0	537.9	530.5	542.8	553.3	569.0	554.0
Bankruptcies	53.8	44.2	37.6	35.5	40.1	38.5	35.0

Source: U.S. Small business Administration and The State of Small Business: A Report of the President.

The chances of small business failure could appear to be overwhelmingly high. This acts as a barrier to entry for many aspiring entrepreneurs. However, the U.S. Small Business Administration reports that about 33 percent of owners involved in a small business closure would consider the firm successful at its closing. Business failure is not an eminent conclusion for all small business entrepreneurs. Facts show that in most cases business failure is avoidable. All products have a business life cycle, which consist of product introduction, growth, maturity and decline. So, some failures are due to changing conditions in the market place. A good manager will monitor and prepare for these product cycles. The truth however, as reported by Dun and Bradstreet is that roughly 90 percent of small business failures are a result of poor management caused by a lack of knowledge (Texas Economic Development, n.d.). This lack of knowledge comes in many forms. Some general knowledge gaps may include understanding cash flow, poor location selection, lack of market information or understanding, and poor marketing practices. All of these knowledge gaps are avoidable through proper management. The greatest form of failure for small business is the failure that requires a bankruptcy filing. Michael Tentowski, Director of the Dan River Small Business Development Center states that 95 percent of small businesses fail with in five years and those failures often leads to a filing of bankruptcy (Hale, 2004). Dun and Bradstreet report that companies with less than 20 employees have only a 37 percent chance of surviving four years. But of these closures, only ten percent will close in bankruptcy. The good news is bankruptcy provides a vehicle for giving business owners a new start and like in business failure cases many of the same mistakes can be avoidable. The difference in a business that simply fails and one that is forced to file for bankruptcy often lies in the early detection of signs of failure. While not all bankruptcies are avoidable, most will generally be a cause of poor management.

U.S. Bankruptcy System

Bankruptcy in the U.S. is a process that allows businesses to satisfy their debts to creditors while providing the debtor with an opportunity for a clean slate to start over. Bankruptcy is accomplished with the filing of a petition for bankruptcy in a federal court. Once a bankruptcy proceeding has started, creditors cannot pursue debtors for payment until the bankruptcy process has reached its completion. The bankruptcy process may be initialized voluntarily by the debtor, or in some cases involuntarily through actions taken by creditors. Businesses must choose one of two bankruptcy methods. The business owner must choose between the liquidation method, Chapter 7 and the reorganization method, Chapter 11.

Chapter 7 involves the liquidation of company property and assets to pay debts owed to creditors. The business owner or representative will be required to provide the court with a description of the company's recent financial history and a list of all assets and debts. A court assigned trustee will be responsible for reviewing company information. The trustee will oversee the sale of property and distribute the proceeds to the company's creditors. The trustee may also choose to remove any remaining unpaid debt from the owner's liabilities. After all debts are settled, almost all Chapter 7 firms cease to operate.

Chapter 11 involves the reorganization of finances with the purpose of paying off debts and the continued operation of the business after the bankruptcy is complete. After the filing of the petition, the business then has 120 days to provide a reorganization plan to return the business to profitable status. The plan must provide details of how creditors will be repaid. In many cases, the plan will allow for extended payment options. All creditors must sign off on the reorganization plan before it will receive court approval. According to the American Bankruptcy institute, only 50 percent of small businesses receive court approval for reorganization plans and merely 25 percent complete the process as financially profitable (Forsman, 2001). An alternative to Chapter 11 is Chapter 13 bankruptcy, which uses the same reorganization principals, but involves small businesses with less than $100,000 in unsecured debts. See Table 2.

TABLE 2
Bankruptcy System Highlights

Faster and Simpler than Chapter 11	Business is likely to continue
Only one court visit	No sale of property
Property sold	No trustee appointed
Appointed trustee to manage	Longer and more complex than Chapter 7
Unlikely to continue operation	Debts must be paid

Source: Legal Match.com

There has been a large increase in bankruptcy filings in recent years. Bankruptcy filings have soared from 348,000 in 1984 to 1.5 million in 2001. Most of the increase is due to personal bankruptcy filings. Small businesses are responsible for some of the increase. A common abuse of bankruptcy filings by small business increases is due to repeat bankruptcy filings. An individual will create a small business, develop a large sum of debt, and then file bankruptcy for a fresh start to repeat the cycle. Some dishonest entrepreneurs use this business strategy for personal wealth creation.

In response to increased filings and abuses, both the U.S. House of Representatives and U.S. Senate passed separate bankruptcy reform legislation in 2001 that many claim would have a negative impact on small businesses. However, the legislation stalled while in a bipartisan conference to iron out the differences in the two versions. The reform legislation, termed "Bankruptcy Abuse Prevention and Consumer Protection Act," called for the assignment of trustees to the small business filing Chapter 11 to determine its viability and placed paper requirements on small businesses that large companies do not have to provide. One reason for this may be that most small businesses do not seek the bankruptcy solution until it is too late and there is no viable reorganization for repaying debts. The new legislation also required the filing of paperwork for debts, assets and cash flow within days of filing. This is documentation that many small businesses cannot organize in such a short period of time. Although the measure was never signed into legislation, bankruptcy reform may still be in the future as a threat to small firms. In 2004, talks of a bankruptcy reform bill still exits under the same, "Bankruptcy Abuse Prevention and Consumer Protection Act," name.

Differentiating Between Failure and Bankruptcy

Not all small business failures should be classified as such. Many small businesses are created to exist for a specified period of time. Other closures are considered a success by the owner as he or she moves on to other fazes of life such as retirement or a more lucrative job in another company.

When attempting to identify the causes of bankruptcy in small business, one inevitably comes to the conclusion that the differentiation between the use of the terms failure and bankruptcy is nearly impossible to define. While only around ten percent of all small business failures are actually conceded in bankruptcy, it can be stated that bankruptcy is a direct entity to the causes of failure. Citing Sheperd 1994, in the paper *Trade Credit and Small Business: A Cause of Business Failures?* Bradley and Rubach define failure as "the organization stops performing those functions that are expected of it." Bradley and Rubach also cited Sherperd in identifying bankruptcy as an entity of failure as "the filing of a bankruptcy petition (Chapter 7, 11, or 13) reveals the failure of an organization and bankruptcy is recognized as a manifestation that an organization is no longer functioning properly." The researcher must recognize that in most all cases the causes for bankruptcy and failure will be the same. The use of bankruptcy statistics and specific surveys will provide for a more in-depth view into actual bankruptcy. The researcher will interrelate the use of failure and bankruptcy and provide bankruptcy specific material when identifiable.

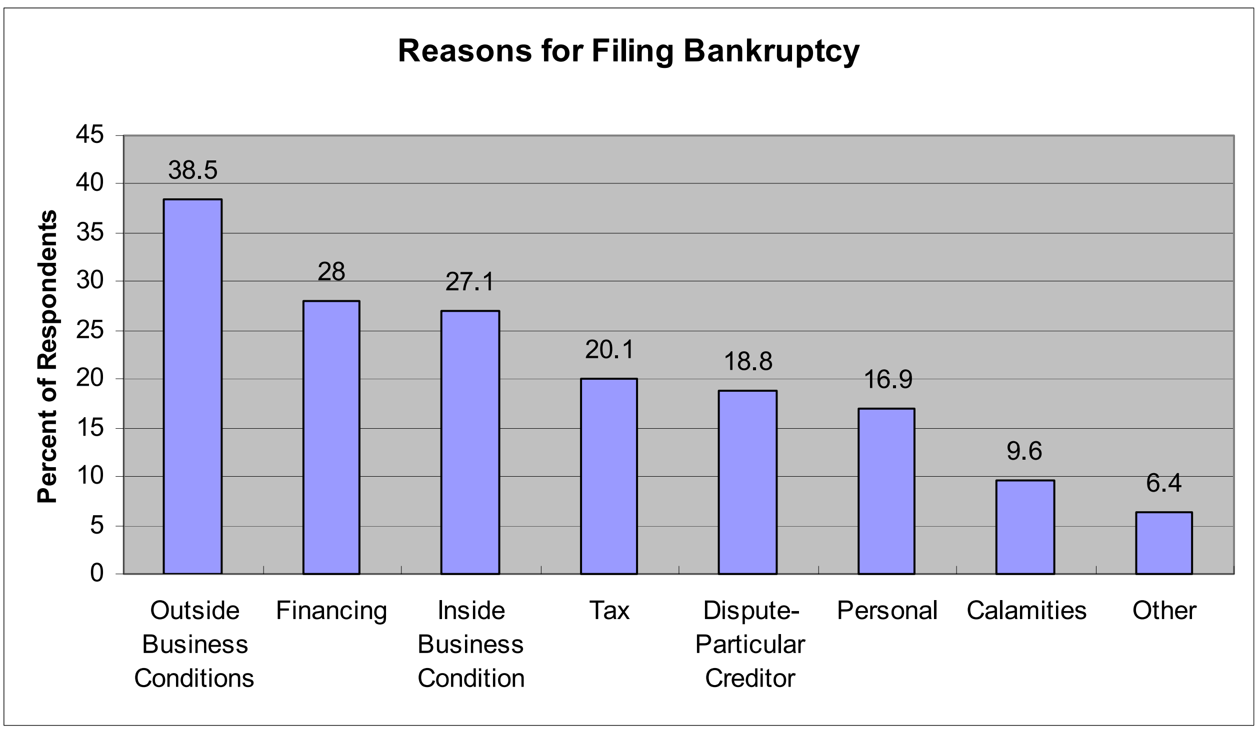
Small Business Bankruptcy

Small business has been identified as a key ingredient to the health of the nation's economy. It has also been shown that a large majority of small businesses end in failure. Bankruptcy has been identified as a last effort for failing businesses. Roughly 35,000 to 40,000 businesses file for bankruptcy each year. What are the major causes of business failures that end in bankruptcy?

The remaining sections of this paper will attempt to identify the many causes of small business bankruptcy in general terms.

In 1998 the U.S. Small Business Administration commissioned a research project concerning small business failure and bankruptcy. The results are found in the paper *Financial Difficulties of Small Business and Reasons for Their Failure.* The Chart below is a result of a survey given to small businesses that have filed for bankruptcy. While the respondents may not be entirely objective in their responses, it should be noted that 72.6 percent cited a business-oriented reason for bankruptcy that could be described as management, marketing or financial reasons. The respondents were not directed to a list of reasons, nor where they limited in number of responses. This gives an explanation to why the sum percentages are greater than 100.

Chart 1



Source: U.S. Small Business Contract # SBA-95-0403, Paper *Financial Difficulties of Small Business and Reasons for Their Failure*

The researchers of this survey grouped the responses into groups that break out as follows:

- Outside business conditions: includes increase in competition, insurance and general costs of doing business.
- Financing: includes loss of capital, inability secure new capital and high debt.
- Inside business conditions: includes management mistakes, location, loss of clients and trade credit problems.
- Tax: includes problems with the IRS.

- Disputes with a particular creditor: includes foreclosures, lawsuits, and contract disputes.
- Personal: includes illness and divorce.
- Calamities: includes fraud, theft, natural disasters and accidents.
- Other: includes buying time and involuntary bankruptcy filings.

Causes Grouped Into Marketing, Management and Financial

The causes of small business failure can be lumped into three major categories of marketing, management and financial. A lack of experience in any of these categories can lead to catastrophic failure and bankruptcy. In most instances a lack of knowledge and understanding or a lack of effort are the causes for failures relating to these three categories.

Many entrepreneurs underestimate the amount of effort that must be exerted in a successful small business (Texas Economic Development, n.d.). Small business owners must be individual self-starters with a high level of discipline. Entrepreneurs must emphatically understand that they are solely responsible for the success or failure of the business.

Entrepreneurs often start a business in an industry or product line similar to a field they have worked in and gained significant knowledge. They often are technical experts in their business. Many times though, the owner does not have the managerial background and experience for making their business a success. A small business manager must manage human resources, strategic planning, inventory and all other business operations. Small business owners must also manage financial decisions such as trade credits, accounting, payroll, working capital and taxes and regulations as well as economic trends. Owners are also responsible for marketing activities including, not only advertising, but market research, customer feed back, selection of location, awareness of competitors and changes in consumer trends. While not all causes of bankruptcy fall into these categories, a look at the specific causes of bankruptcy will show that in most cases failure will be because of poor decisions in management, marketing and finances.

Specific Causes of Small Business Bankruptcy

Table 3

List of Specific Causes that Lead to Bankruptcy	
Under Capitalization	Loss of Key Person
Lack of Planning	Growing Pains
Trade Credit	Lack of Technology
Tax Burdens and Regulations	Poor Location
Personal Issues	Natural Disaster
Unrealistic Expectations	Poor Record Keeping
Poor Cash Flow	Failure to Use Advise

Unrealistic Expectations

Many entrepreneurs do not understand the wares of owning a small business. They assume it will be a success from day one. They have misconceptions about the amount of money that will be generated by the business. They also underestimate the percentage of reinvestment that will be required for the business to continue. On average most new businesses require a year or more before becoming profitable. Another misconception of new entrepreneurs is the amount of time and effort that must be invested into the business. If an entrepreneur opens a new business with hopes of free time, he does not realize that over half of small business owners work more than 60 hours a week.

Personal Issues

Personal problems often indicate business problems for small firms. “About one out of six so-called business bankruptcies are initiated because of a personal problem of the business owner” (Sullivan, Warren & Westbrook, (1998). Divorce and illness are the most common issues involved. In the paper *Financial Difficulties of Small Business and Reasons for Their Failure* the authors report that a personal bankruptcy was also filed by more than one in ten of the business bankruptcies surveyed.

Under Capitalization

A number of entrepreneurs don’t know where to go to ask for a loan. A bank, credit union, investors or the U.S. Small Business Administration could provide funding to start a firm. Many people assume banks or institutions will provide a loan for 100 percent of start-up costs based solely on a good idea. In fact, financing is much more difficult to come by and is a reason for many small business failures. An aspiring entrepreneur must have a percentage of the loan being requested, a good credit score, and the means to pay back the loan.

Most banks and institutions are tight with the amount they want to loan for small businesses. They only want to provide for the minimum. In some cases this is due to the requesting entrepreneur not understanding how much money his or her new firm will require. Often, entrepreneurs underestimate the money and time required to make a business profitable. There are always unforeseen issues or problems when starting a new business. It takes two to three times the amount of capital estimated to reach profitability.

For many small businesses the lack of start up capital causes a shortcoming before the business reaches profitability. It is much more difficult to raise capital the second or third time after the company has appeared to not meet projections. “As James Schermerhorn, Edward Lowe Foundation has written, Overcapitalization can’t kill a small business, a capital shortfall can” (Glocal Vantage, Inc, n.d.).

Natural Disaster

Though not common, natural disasters can play a role in small business failures and bankruptcies. Disaster can be classified as anything naturally occurring in the environment, including death. The large majority of small businesses are sole proprietorships. Obviously, the death of this individual would require the business to no longer exist. Other types of natural disaster include fire, irreparable damage to a critical facility, destruction of key equipment or the death of a key employee. Logistical changes such as the introduction of a new bypass can also be considered a natural disaster.

Poor Cash Flow

A lack of cash flow is often the biggest failure indicator. A lack of cash flow could cause a business to fall behind on wage payments, rent, and insurance and loan payments. A lack of cash flow also could inhibit the company's ability to reinvest for future profits such as the ordering of products or supplies and marketing execution. When a company is borrowing to pay off past debts, it is usually a sign of disaster to come. Statistics show companies that don't enter a state of profitability within eighteen months are at a high risk of bankruptcy (Hale, 2004). A significant shortage of cash flow limits the company's ability to respond to outside threats. This is critical for fledgling businesses since new threats seem to appear everyday.

Poor Location

It is common knowledge that, for most businesses, the selection of location is a critical decision in determining success or failure. Marketing ideas such as population density, foot and vehicular traffic, number of local competitors and number of surrounding non-competing firms should be considered when selecting a business location. It would stand to reason that the failure of a business due to location is solely related to a lack of or poor marketing research. Oddly enough, research has shown marketing research is only a fraction of the problem. A survey of businesses that filed for bankruptcy in 1983 shows that 55 percent of respondents chose their business location based on already owning the property, the most convenient vacant building and lower rent prices (Bradley & Saunders, 1985). Another reason many business owners choose their location is based on the properties convenience to home. None of these reasons for selecting a location is viable and obviously doomed the businesses from the beginning.

Poor Record Keeping

In the paper *Poor Planning and Marketing Causes Small Business Bankruptcy,* Don Bradley III conducted a survey of small business owners located in the south and southwestern U.S. that filed for bankruptcy between 1995 and 1996 and reported that 58 percent of respondents did little to no record keeping. Keeping good detailed records of sales, expenses and debts alone is critical for the survival of any business. This is especially true for volatile small businesses. How can any financial planning be done when there is no understanding of cash on hand, outstanding credits and current expenses? Poor record keeping makes it virtually impossible for owners to know the financial status of his or her company. The fact is many small firm owners don't want to complete this menial task, regardless of its importance.

Growing Pains

While the opportunity for expansion is a great sign of an operations success, does rapid growth mean future prosperity or could it lead to hard times? Small businesses tailored to battling for sales and surviving may not be prepared for the nuances of success that leads to expansion. The small company must have a strong financial position to avoid many expansion pitfalls. Business owners cannot expect for promising sales and current growth potential to guarantee operations expansion and funding. The small business must be prepared for increased customer credits and an increase in expenses and overhead. A sudden decrease in demand during a time of expansion, due possibly to an economic downturn, could lead to stagnant excesses in inventory and unpaid expenses creating potential for insolvency. As Jeff Bailey, a writer for The Wall Street Journal has written, "Balancing the desire to grow against the desire not to go bankrupt is the smart entrepreneur's job" Bailey, 2003).

Loss of Key Person

Many small businesses rely heavily on one or a few select individuals. This may be an owner, partner, foreman, salesman, technical expert or many other key persons. Their impact on the company is so great that the loss of this key person can disable the business and lead to bankruptcy. The most obvious causes of the loss of a key person are illness or death. Other causes are disputes among individuals or inability of the company to provide competitive compensation. A key person may be lured away from the small business due to a lack of financial compensation such as salary, profit sharing, life insurance, disability insurance and health benefits. Small businesses may protect itself against the loss of a key person because of death or illness with key man insurance. Key man insurance offers the company a sum of money should the key person be lost. The idea is to give the company financial resources to reorganize for survival.

Lack of Technology

Whether technology, has provided increased quality, efficiency or durability, it has always played an important role in products and services provided to consumers. Business owners have had to ensure that they are offering the most recent technologies to consumers regardless of their industry. Providing the most recent advances has been a key requirement for small businesses to stay competitive. However, not all small business owners utilize technology in business operations.

Today's technology offers the small business owner endless possibilities for increased efficiency, control and marketing. There are some technologies that may be to expensive for all small businesses to integrate, but advancements in cheap personal computer power and wide spread use of the internet provide entrepreneurs with many options to improve business operations. Personal computers offer many efficient applications for document creation, record keeping, creating marketing materials, web page management and storing customer information in small databases. The Internet opens many avenues for marketing and sales. A business owner can research markets, competitors or industries, and create databases of customer email addresses for newsletters and direct marketing and place advertisements based on key words for customers interested in the firm's products or services. Using both a personal computer and the Internet a small business can develop a web site that will open new sales channels and broaden its market.

Considering the benefits of the Internet, it is not surprising that a survey of bankrupt small businesses shows that 84 percent of those firms did not use the Internet for sales or advertising (Bradley, 1999).

Poor Planning

Poor planning or a complete lack of planning is one major reason small businesses have a short life expectancy. In discussing planning for business, Glocal Vantage, Inc describes planning as follows: "Planning is not about what you will do in the future. It is about the future implications of present decisions and actions" (Glocal Vantage, Inc, n.d.). The importance of researching demand for product or service, identifying the target market, calculating necessary capital and selecting a location are all critical facets of planning that lead to determining a clear business plan. Research shows the lack of a mission statement and objectives has a direct correlation to the number of bankruptcies (Bradley, 1999).

Another area of planning entrepreneurs should consider is the managerial duties that will be required in day-to-day operations. The owner will not simply be selling the product and talking to customers. In most cases he will be involved in all aspects of the business and should not underestimate the impact of these activities on his or her time and availability. Proper planning plays a critical role in the success of small businesses and should not be overlooked.

Trade Credit

The use of trade credit is a common practice used in small business to provide temporary financing. A trade credit involves the delivery of products to another business and allowing delayed payment for those products. Most small businesses operate with both supplier and creditor trade credit practices. The use of trade credit is basically a requirement for competing in small business.

Trade credit affects a small businesses cash flow. Since cash flow is extremely important to the survival of a small business, late payment or non payment can lead to financial failure and possibly bankruptcy. "Ineffective working capital management, especially the extension of trade credit and its nonpayment, has been identified as a cause for small business failure" (Bradley & Rubach, 2002). Sixty-six percent of bankrupt businesses responding to a survey claimed that nonpayment had a negative effect on its financial position (Bradley & Rubach, 2002). The late payment of products or services already delivered can put the crediting small business in the detrimental position of having to take on additional short-term debt due to a lack of cash flow. This is especially true when the credit is to a major buyer. The more threatening trade credit problem is when the company receives credit and never provides payment due to bankruptcy. The credit issuing company may or may not receive payment from the liquidation of the defunct company. Trade credit is often to low in the hierarchy of allocation to receive payment. Even if payment is finally rendered, it may be too late for the issuing company to salvage its financial position.

Tax and Regulation Burdens

Burdens brought on by tax codes and regulations have a significant impact in determining the success of small businesses. Small business owners spend an incalculable amount of time determining whether the regulation applies or not, whether his or her business is in compliance, and what, if any action needs to be taken. Christopher Bond, a US Senator from Missouri, asks the following question regarding endless tax codes and regulations, "And when is that entrepreneur supposed to find the time it all takes and still be able to keep his or her business afloat?"

When it comes to filing taxes, small businesses have over 200 IRS forms and schedules, with over 8,000 lines, boxes and data requirements, that may need to be used (United States, Congress, Senate, Committee on Small Business, 1999). This does not include the more than 700 pages of instructions for completing these forms. Small businesses account for nearly 600 billion in tax revenue, almost 40 percent of the 1.7 trillion annually (United States, Congress, Senate, Committee on Small Business, 1999). Small businesses pay 63 percent of regulatory costs in the U.S., but employ less than 53 percent of the work force (Office of the Chief Counsel for Advocacy, 1995). The U.S. Small Business Administration Office of Advocacy conducted research on the impact of taxes and regulations and stated the following quote in the paper *The Changing Burden Of Regulation, Paperwork, And Tax Compliance On Small Business*: "This research and other available data lead to the conclusion that the average annual cost of regulation, paperwork, and tax compliance for firms with fewer than 500 employees is about $5,000 per employee, compared with about $3,400 per employee for firms with more than 500 employees." This is a significant financial difference for small businesses competing with large firms.

These numbers are all quite daunting. It is easy to understand how these hardships translate to financial and management difficulties for small business owners. The U.S. government is aware of these challenges for small businesses and continues to search for an answer to level the playing field.

Failure to Use Advice

Some small business owners neglect to seek advice from external sources. Many external firms or agencies could provide direction or solutions for small business problems. Advice is available from accountants, attorneys, business and marketing consultants and government agencies such as the U.S. Small Business Administration. A good business owner will identify the areas where help is needed and inquire to possible solutions. It is not enough to gather advice. The firm must believe and act on it to receive the benefits.

Conclusion

Evidence suggests that failure rates of small businesses in the United States are related to the nature of a capitalistic market in relying on competition where only the strongest survive. The causes for small business failure and ultimately bankruptcy are many. A successful entrepreneur is, no doubt, the consummate businessperson who must be a jack-of-all-trades. It is evident that nearly all entrepreneurs have the opportunity to control their own destiny. Success is obviously not a guarantee, but nor is failure. A well-rounded businessperson who has carefully planned and prepared with a clear vision of who and what the company is will have an excellent opportunity for success.

Some of the major causes of bankruptcy are poor planning, lack of financing, lack of business experience and lack of personal discipline. Anyone considering opening their own business should have not only the vision of where the business is going to end up, but a strong business plan. An important part of this business plan should be an exit strategy in case the business runs into problems. No business should start with just enough money to actually open the door. Many entrepreneurs do not realize that it takes two to three years for most businesses to turn a profit. Even though you are your own boss, the customer still controls a lot of your life and how your time is spent. Therefore, self-discipline becomes a very important element of being successful in owning a small business. Along with self-discipline, an individual should possess experience in the industry in which they are trying to establish their business. It is always a good idea to work for someone in the industry and make your mistakes on their money rather than on your own money.

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