

Success and Failure

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1. Discuss the reasons why so many small businesses fail.

A significant proportion of new businesses will fail within the first 24 months of operation. There are a number of underlying factors that contribute to this statistic. Many individuals are unprepared when starting a business. Preparation is not as simple as coming up with an idea but rather involves a wide range of activities. Individuals tend to focus too much on their core idea, and neglect the basics. Many businesses do not consider simple questions such as where their customers are going to come from, how they are going to maintain a steady cash flow, or what possible on-costs might exist. Many new businesses are run by individuals without expertise or experience in running a business and subsequently fail to address the attention to detail required. In short, the two major reasons for small business failure are a lack of appropriate business planning and poor cash flow management which contributes to a lack of working capital.

2. Explain why it can be difficult for businesses to sustain their competitive advantage over time.

Competitive advantage refers to a particular aspect of a business that is superior to its competitors. For example, a competitive advantage for McDonalds is the speed with which they serve their customers. Competitive advantage is often the key to success for many businesses. Industry leaders such as McDonalds are successful due to the competitive advantage they have developed. Subsequently, many competitors seek to imitate the competitive advantage developed by the market leader. This is what makes it harder for businesses like McDonalds to attract customers purely based on speed of service delivery. Competitors such as KFC offer a similar service which makes competitive advantage harder to sustain. Another example would include a price leadership strategy. Businesses seeking to maintain a competitive advantage through providing lower prices may find that competitors will lower their price. This removes the competitive advantage achieved by the first business.

3. Consider how the following businesses might sustain a competitive advantage.

a) Flash Window Replacements Pty Ltd

b) Dr Assaad's general medical practice

c) Paton Renovations, a company that organises interior design and renovations for older homes

a) Flash Window Replacements could develop a high service-quality competitive advantage. They could implement a company wide strategy that improves customer service. This might involve offering a 24 hour service, training staff in customer service skills, and relationship marketing strategies which encourage repeat customers. The overall strategy would build up a reputation for the business which is hard to imitate.

b) Dr Assaad could develop a competitive advantage based on reducing customers' waiting times. Dr Assaad could hire other GPs and offer a waiting time guarantee. Many patients would see this as an incentive to go to his practice as waiting times can be very long in other centres. Dr Assaad could maintain this competitive advantage by hiring more doctors than other practices. Although this would increase costs, Dr Assaad could charge a slightly higher fee to cover the costs. Many patients would be willing to pay this fee in order to avoid a long wait.

c) Paton Renovations could develop a cost leadership strategy. The business could seek to reduce costs throughout the business. In doing this, they could have a lower price than their competitors. Even if competitors lower their prices; they will not be able to sustain this lower price as they have not reduced costs. Eventually, competitors will have to find another way to compete with Paton Renovations and the competitive advantage will have been sustained.

4. Outline how technological change might affect each of the above businesses.

Many businesses have been drastically changed by technology over the last 20 years. Many businesses have found that traditional paper based systems cannot compete with computer systems. Businesses like Flash Window Replacements, and Dr Assaad might find that computers could be used to make appointments, and record customer details. This means that staff also need to be trained in the new systems. Other advances such as the internet and e-commerce have revolutionised the way in which businesses interact with their customers. Flash Windows, Dr Assaad and Paton Renovations could all develop websites and e-commerce systems that allow customers to pay for their goods online. Aside from information technology changes, businesses have to consider changes in technology that are specific to each industry. For example, Dr Assaad must make sure that he remains up to date with technology within the medical industry.

5. Explain how a business can avoid becoming over-extended in its finances.

Businesses should identify a level of gearing that is suitable for that business. When expanding; the business should try to finance using a mix of equity and debt finance that does not disrupt this gearing balance. When utilising debt finance, businesses should not only consider the current level of interest but also the potential for interest rate rises. Interest rates fluctuate, and it is possible for them to rise. As they rise, business costs increase which may cause profitability and cash flow problems. In order to avoid these problems, businesses should factor these uncertainties into decision making.

6. Traditionally, one of the most common types of small business has been the local corner store. Over recent decades, many of these have gone out of business. Identify what factors you think explain the decline of this kind of business?

Corner stores have declined for a few main reasons. Corner stores traditionally relied on convenience as a source of competitive advantage. People living nearby could pick up household necessities at nearby local stores. With the motor car, this has become less of an issue. It is easier for individuals to travel further in order to purchase last minute items. Secondly, the products traditionally sold in these stores now have longer life span due to technology advances. Items like milk can be purchased for the entire week. This permits consumers the ability to shop at supermarkets where they can purchase groceries for the entire week.

Consumers have also become attracted to supermarkets as they have become a 'one-stop-shop' for meat, fresh produce and other groceries and are usually cheaper than other shopping locations.

7. Thinking about the factors that influence the success and failure of business, are there any strategies that could be used that would make a corner store business more likely to survive?

Corner store businesses could shift their focus from convenience groceries, to selling other items. Many successful corner stores have focused on takeaway food, or snacks and sweets. Corner stores could also distribute newspapers and other items of convenience. By selling these items, corner stores are shifting reliance away from items that are now commonly purchased in supermarkets. In doing this, they are increasing their chance of survival.

8. Evan runs a dairy farm and associated dairy products business known as Best Cows. Evan owns his farm, but has borrowed money to buy the equipment for operating the business. He has around \$130,000 owing to him, but the distributors to whom he sells are slow in paying. He now needs \$60,000 urgently to meet this month's loan repayments and wage bills. He has no other financial resources and is now worried that his business – which was otherwise doing well – is in trouble. State the advice you would give to Evan.

There is no need for Evan's business to fail due to a liquidity problem. On paper, Evan's business is viable as he has \$130,000 in accounts receivable which is more than enough to cover the \$60,000 repayment. However, the \$130,000 is not a liquid asset as it is slow to come in. Evan should implement a strategy that encourages his customers to pay sooner. He could implement a discount for early payment, or establish a rigid credit period which results in a fee if overdue. As an immediate solution to his problem, Evan could sell his accounts receivable to a factoring firm which would provide him with the funds quickly.

9. Define the term factoring. Explain how factoring can help a small business avoid cash flow problems.

Factoring refers to the sale of accounts receivable. Businesses often sell goods and services on what is known as trade credit. Cumulatively this trade credit is referred to as accounts receivable. Accounts receivable is an asset to a business as it represents money owed to that business. However accounts receivable is not as liquid an asset as cash because trade credit can be slow to come in. Subsequently many organisations can experience cash flow problems despite appearing to be in a favourable position on paper. Because of this; many businesses sell their accounts receivable to firms that specialise in collecting accounts receivable. A factoring firm will pay a business a portion of the outstanding amount in exchange for the collection rights. For example if a business is owed \$1000 from various customers, a factoring company may pay that business \$900 for the rights to collect its accounts receivable. The factoring firm will then collect the accounts and make a profit (assuming it can collect more than \$900 in accounts).

10. Think of some companies that have been around for fifty years or longer. Discuss the factors that you think have contributed to their survival when so many of their competitors have failed.

Coca-Cola has maintained a prime position within the market by being seen as a fashionable drink. Coca-Cola has always marketed itself as a product that you can be seen with. Although products have been produced with a similar taste to Coca-Cola; none of them have challenged Coca-Cola's position in the mind of consumers.

Ford began with the idea of production efficiency. This emphasis has continued. However, new competition from Japanese companies has meant that Ford has had to re-invent its strategy. Ford has adapted to the market by focusing on particular segments of the market.

Qantas had traditionally enjoyed a duopoly position within the market as granted by government legislation. Since the deregulation of the airline industry, Qantas has had many challengers aiming to compete with them on the premise of price. Most have had little impact as Qantas has been able to satisfy the upper end of the market.