A Seven Year Strategic Marketing Profile of Retail and Service Business Bankruptcy

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Abstract

It is recognized that certain well-known disadvantages present a strong element of vulnerability for the retail and service business firm. Limited management experience and inadequate marketing skills are recognized as major causative factors leading to higher business mortality rates. This study found that previously determined areas of vulnerability are still prevalent in the business community. However, it denotes that strategic pre-planning and continuous strategic planning are essential steps leading to increased business longevity.

Introduction

The process of bankruptcy has an adverse effect on the retail and service business owner as well as those who are associated with that business during its viable life. It is essential for the retail and service business owner to carefully consider and review the desired customer market which is composed of (1) a determinable group of people with needs and/or wants to be filled, (2) disposable income to spend for desired products and services, and (3) a willingness to spend it [8]. Careful selection of products and market information along with a predetermined knowledge of capital needs and cost of capital interwoven into an adequate business plan is generally accepted as a basic requirement. If some or all of these requirements are not met, the prospect of a viable and successful retail and service business is greatly depreciated with the firm often included later in lists of business failure.

Unqualified entrepreneurs appear doomed from the start and others who are reasonably well qualified may fail to adequately prepare for business entry and may fail to adjust to developing problems after entry. Scarborough and Zimmerer cite a condition called "Resource Poverty" as a major cause of business mortality. Resource poverty is explained as a lack of adequate capital, business experience, outside advice, omission of management specialists as well as a poor location and inadequate market demand [7]. Another measure of business vitality is the increasing number of businesses formed each year. Annual formation of new businesses crossed the 600,000 mark during 1983 of which only half survived as long as 18 months and only one in five as long as ten years [6].

There appears to be little uniformity in conceptualizing business failure with past studies reflecting a disarray of suspected pitfalls. Documented reasons for business failure are difficult to obtain. One of the most frequently stated problems facing business owners today has been the failure to strategically plan for the operation and development of their business [1]. Of course, strategic planning and strategic planning review includes all aspects of business such as market segmentation, product demand, business location, operating capital and adequate sales. According to Dun and Bradstreet, nine of the ten business casualties can be traced to the underlying factors of business inexperience and aptitude [3]. Other research generally indicates that business failure is largely the result of poor marketing skills and management practices. This includes the general problems of inexperience and/or knowledge in the field of business being entered, insufficient capital and inadequate cash flow, poor location, lack of market information and insufficient sales.

In most firms, the rigors of competition cause the retail and service business owner to be painfully conscious of marketing weaknesses [2]. Today many firms, in finding decreasing or insufficient sales, seek to improve sales by reducing their gross profit margin or simply not increasing gross profit margin in the face of increasing costs [5]. It is expected that more specific determination of reasons for business failure should serve as a basis for corrective action for future business owners to use in minimizing future business mortality.

Survey

This study sought information from the owners of retail and service business firms which had completed the federal bankruptcy process during the late 1980's. After testing the questionnaire, a total sample of 939 bankrupt retail and service business owners were mailed a questionnaire, along with a cover letter, explaining the reasons for collecting specific causative reasons for their business failure. Information was requested concerning specified demographic data, knowledge of certain marketing characteristics, professional pre-business assistance, the operating environment, and other reasons given by the owner which helped lead to the business demise. A total of 361 returns (38%) were available for review. Although a higher percentage of returned questionnaires would have been desirable, it is felt that a sufficient number were returned to indicate some of the causative reasons for such business mortality. It was felt that such causative reasons might indicate future "trouble spots" that might be correctable and further minimize future retail and service business mortality.

The research was a descriptive study which used a convenience method for securing the population sample information.

The age of the business owner is a factor in the profile of retailers and service businesses that go bankrupt because most people do not start their career as the owner of a business. The graying of America has caused an increase in the number of people over age 55 who went bankrupt over the seven year period.

Retailers and service business owners in the age group 41-50 had the highest percentage of business failure with a response percentage rate of 37. The second largest group was the 31-40 year old group having a 24 percent response. According to the list of names of the people who went bankrupt in the 31-40 age group, there seems to be a larger number of women who went bankrupt in this group than in the older groups.

TABLE 1

Survey Results

	Total Number	Total Return
1981	78	34
1982	95	39
1983	101	48
1984	126	51
1985	144	46
1986	181	61
1987	214	82
	939*	361*

*Seven Year Total

TABLE 2

Analysis By Question

Age

Age In Years	Raw Score	Response Percentage
21-30	21	6
31-40	86	24
41-50	135	37
51-60	74	20
over 60	31	9
No Response	14	4
	361	100%

TABLE 3

Education:

Years Completed	Raw Score	Response Percentage
Less Than High School Graduate	31	8
High School Graduate	82	23
One Year of College	17	5
Two Years of College	61	17
Three Years of College	29	8
College Graduate	74	20
Graduate School	54	15
No Response	13	4
	361	100

This question may point out a limitation to this seven year study. Highly educated people are more likely to respond to a survey. The educational level of the respondents was very high with 67 percent having attained some college credit. But leaving this limitation aside, having a high degree of education may not keep a person from going bankrupt.

The highest response came from the high school graduates with a 23 percent response rate. College graduates had the second highest response rate with 20 percent. Many of the respondents stated that their educational training was not in the same field as that of their business. Fifteen percent of the group had attended graduate school.

Fifty-two percent of the respondents stated that they "prefer to be independent" or "prefer to work for [themselves]." There seemed to be a common need for independence. This is somewhat of a common sense conclusion because people who like to work for someone else will probably not start a business.

"To make more money than you could make working for someone else" was rated as the third highest response with 21 percent of the respondents. These are retailers and service business owners who failed to envision the long hours required to manage a business, and they are often disappointed to find that their hourly earnings are considerably less than their previous annual earnings.

"No related business experience" was a major cause of these businesses going bankrupt. Seventy percent of the retail and service businesses that went bankrupt had owners with no experience in the

TABLE 4

Reasons For Going Into Business:

Reason	Raw Score	Response Percentage
Needed a Job	11	3
Prefer to Work for Yourself	92	25
Replace Current Job	18	5
Something to do After Retirement	19	5
Build a Business for Children	36	10
Prefer to be Independent	96	27
To Supplement Current Income	4	1
To Make More Money Than You Could Working for Someone Else	75	21
No Response	10	3
	361	100

TABLE 5

Experience

Experience	Raw Score	Response Percentage
Owned a Business Before	31	8
No Related Business Experience	251	70
Employed by Someone Else In A Related Business	79	22
	361	100

field. A business owner with no experience has a much higher probability of failure.

Thirty percent of the group had experience, so experience alone is not a guarantee of success. Many of the respondents stated that they did not know what they were getting into when starting or taking over a business.

TABLE 6

Financial Resources Borrowed:

Percentage Borrowed	Raw Score	Response Percentage
0	110	30
10	18	5
20	13	4
30	16	4
40	7	2
50	33	9
60	11	3
70	64	18
80	32	9
90	37	10
100	13	4
No Response	7	2
	361	100%

The highest percentage of persons borrowed no money. The majority of those who did not borrow money were in the service businesses which required very little investment. Examples are skilled craftsmen who needed only a truck and small tools, or service cleaning companies which needed very little cleaning equipment.

Fifty-three percent of the respondents borrowed 50 percent or more of their capital investment, with the largest group using 70 percent borrowed money. Forty-one percent of the total borrowed 70 to 100 percent of their capital to start the business. This question points out another major cause of bankruptcy which is not having enough money to start the retail or service business. Under-capitalization means starting a business on the wrong foot. After studying bankruptcy for seven years, the researchers recommend that a person not start a business with less than 50 percent capitalization.

TABLE 7

Total Investment:

Amount In Dollars	Raw Score	Response Percentage
0-500	36	10
501-1,000	14	4
1,001-2,000	4	1
2,001-5,000	0	0
5,001-15,000	69	19
15,000 & over	220	61
No Response	18	5
	361	100%

Most of the retail and service business owners did not realize that they were under-capitalized until it was too late to do something about the problem. Ten percent of the group put no money into the business to start it. Thirty-four percent put less than $15,000 into the business in the beginning.

TABLE 8

Breakdown Of 15,000 + Responses:

Category	Raw Scores	Percent of 15,000 +	Percent of Total
15,000-40,000	108	49	30
40,001-70,000	18	8	5
70,001-100,000	35	16	10
100,000 & over	59	27	16
	220	100%	61%

This breakdown clearly illustrates the wide range of sizes of the businesses, and that regardless of the amount of capital utilized, all businesses are vulnerable to the same managerial errors.

By referring to the percent of capital borrowed and matching the survey forms, another relationship becomes obvious: businesses with the highest capital investments also have the highest proportion of borrowed money.

Twenty-four percent of the respondents felt that they did not need anymore capital initially. Forty-two percent felt that an extra $500 to $30,000 of initial capital would have made their businesses a success.

The researchers' feelings before the results of the survey were tabulated were that under-capitalization was a major cause of bankruptcy. The excessive borrowing theory has proven correct, but in all

TABLE 9

How Much More Capital Do You Feel You Should Have Had To Begin Operations

Capital	Raw Score	Response Percentage
0	88	24
500-1,000	14	4
1,001-4,999	12	3
5,000-10,000	29	8
10,001-20,000	33	9
20,001-30,000	64	18
30,001-99,999	11	3
100,000-150,000	9	3
700,000 & over	21	6
No Response	80	22
	361	100%

fairness it cannot be concluded whether or not the businesses were under-capitalized without conducting an extensive evaluation of their financial statements and operating records.

TABLE 10

How Long Did You Think It Would Take You To Generate Enough Income To Break Even?

Years	Raw Score	Response Percentage
Less Than One Year	111	31
One Year	93	26
Two Years	53	14
Three Years	36	10
Four Years	17	5
Five Years	21	6
No Response	30	8
	361	100%

Fifty-seven percent of the respondents felt they could break even in one year or less. Most retail or service businesses will take two to three years to break even. The problem lies in the fact that the business owner becomes a victim of inflated expectations. Some respondents felt they would make a profit from day one.

TABLE 11

Did You Realize A Profit On A Consistent Basis?

Answer	Raw Score	Response Percentage
Yes	184	51
No	177	49
	361	100%

Fifty-one percent of the bankrupt businesses reported making a profit. These retail and service businesses could be making a profit on a consistent basis but still be losing money. If the business is consistently making a very low profit and occasionally realizing a large loss, then the profits may not be able to offset the loss. Although the business is showing a profit on it's income statement, the allowance for bad debts could be understated. Some of the profit-making businesses had cash flow problems that led to their bankruptcy.

Table 12

Business Origin:

Method	Raw Score	Response Percentage
Started a New Business	270	75
Purchased an Existing Business	91	25
	361	100%

Seventy-five percent of the respondents started a new business. One of the reasons for this high percentage is that if a person is low on cash, it a lot easier to start a new business than to buy an existing business. An existing business that is worth purchasing will have an inflated price that the seller attributes to goodwill. A business that has an established clientele can more appropriately attach the value of goodwill to the proprietor rather than the building and fixtures. The owner built the business with his/her personality and relationship with his/her regular customers. When the business changes ownership, the customers will continue to patronize the business for a while out of habit. This will give the new owner a chance to win and develop a positive relationship with the regular customers, but the new relationship is entirely dependent upon the new owner's ability to satisfy the wants and needs of the customer.

Table 13

The Business Location Was:

Answer	Raw Score	Response Percentage
Good	213	59
Adequate	127	35
Poor	14	4
No Response	7	2
	361	100%

To most of the respondents, location was not considered as a contributing factor to the fact that their business went bankrupt. But as one can see by the next question, location had to be a problem for many of the retail and service businesses.

Fifty-nine percent of the respondents felt they had a good location and 35 percent felt they were in an adequate location. The following two questions will help to reveal the basis for their opinions by pointing out why the particular location was chosen and how many competitors were in the area.

Most of the businesses that went bankrupt in the seven year period did not give location enough time or energy. The largest response group gave their choice of location as "most convenient vacant building" with 32 percent. Twenty-two percent of the respondents listed "near similar business" or "near supportive business" as their reason for choosing the location which showed that some research had been done.

This question can be both good and bad because some businesses are aided by being located near competitors whereas other businesses need to avoid locating near their competition. Fifty-four percent of the businesses had 0-2 nearby competitors. This was not a major factor in the failure of the businesses. The researchers know that this would not be true for every business.

Table 14

Primary Reason For The Location:

Reason	Raw Score	Response Percentage
Owned the Property	41	11
Most Convenient Vacant Building	117	32
Only Building Available	2	1
Near Similar Business	25	7
Near Supportive Business	52	15
Lower Rent	33	9
Other*	77	21
No Response	14	4
	361	100%

*Breakdown of "other" responses:

	Raw Score
Directed By Franchisor	20
Existing Business Was Purchased	19
Fast Growing Area	12
Location Was Home	17
Location Was Owned By A Friend	9
	77

TABLE 15

Number Of Nearby Competitors:

Answers	Raw Score	Response Percentage
0	101	28
1-2	96	26
3-4	64	18
5-10	39	11
10-20	50	14
No Response	11	3
	361	100%

TABLE 16

Professional Assistance Prior To Opening:

Answer	Raw Score	Response Percentage
Accountant	92	25
Attorney	69	19
SBA	53	15
Consultant	33	9
SBDC	2	1
None	105	29
Other*	7	2
	361	100%

*The "other" response is "People In The Business."

The largest group of retail and service businesses had no professional assistance. Twenty-nine percent of the respondents had no professional assistance. They either could not afford the service, in which case they were probably undercapitalized and should not have attempted the venture anyway, or they did not know the potential advantages of professional assistance. Another consideration is that they were aware of the potential advantages, or lack thereof, because 69% who used professional assistance failed. Forty-five percent of the respondents used accountants and/or attorneys prior to opening. One assumption is that accountants and attorneys simply provided "how to" information, and no advice concerning feasibility of success based on the individual circumstances of the retail or service business. If this is the case, there is a serious misunderstanding of the role of accountants and attorneys in the area of consulting. The accountants and attorneys probably try to avoid giving advice in order to limit their potential liability.

TABLE 17

Research Analysis Before Opening:

Answer	Raw Score	Response Percentage
Location	54	15
Competition	69	19
Local Demand For Product/Service	78	22
Economic Conditions and Trends of The Community	29	8
Prior Performance (if an existing business)	12	3
None	74	21
Other*	34	9
No Response	11	3
	361	100%

*Responses to "Other"

	Raw Score
Previous Business Experience	13
Directed By Franchisor	11
Knew Customers	7
Test Market Survey	3
	34

Seventy-six percent of the respondents conducted some type of research prior to opening. The methods and extent of the research is highly questionable, otherwise the businesses would still be operating. "Local demand for your product/service" had the highest percentage with 22 percent. Twenty-one percent had done no research analysis at all before opening. Using no research analysis had to be a major factor in the retail and service business bankruptcy.

The 19 percent who researched the competition must have failed to conduct an analysis of the strengths and weaknesses of the competitors. The research most likely consisted of locating and counting the number of competitors, without evaluating the percentage of the market each competitor held and growth trends of the market place. If there are one or more businesses that are exhibiting unusually rapid growth to the detriment of the competition, then there are strong, established businesses that will greatly hinder the entry of new businesses into the market.

This could also be a direct cause of business bankruptcy due to the fact that 63 percent of the responding businesses maintained their own records. The reason for this is that if someone is hired

TABLE 18

Did Their Own Bookkeeping:

Answer	Raw Score	Response Percentage
Yes	228	63
No	133	37
	361	100%

to do the bookkeeping, they will do a better job than the owner. The retail and service business owner who is a specialist in his/her field will tend to neglect record keeping and fail to understand the importance of maintaining control over expenses and revenues. Even if the owner is very diligent in recording all income and expenses, he/she may not know how to interpret his/her own financial statements. This lack of interpretation could lead to cash flow problems.

TABLE 19

Records Kept Current:

Answer	Raw Score	Response Percentage
Yes	285	79
No	76	21
	361	100%

The words "bookkeeping" and "record keeping" can mean different things to different people. The retail and service business owners' perceptions of the purpose of keeping records is the problem. Bookkeeping probably means nothing more to most respondents than recording transactions for tax purposes. When a business suffers from a lack of cash flow, managers are prone to blame poor sales. Some costs are controllable, and at times cost control is overlooked as a possible remedy due to the over-emphasis on decreased income. The records may be current, but it is doubtful that they are used as a planning tool.

Poor marketing skills and management techniques can be listed as a cause for most of these closings. One contributing factor which was not due to management was "lack of skilled employees" with seventeen responses. Each respondent had his own perception of the primary cause of his/her business failure. The tendency of the owners was to focus on one or two events and ignore other existing weaknesses.

Conclusion

This survey reflected important considerations, although only a small percentage of total business closures are processed through bankruptcy. Demographic data revealed that a greater percentage of the bankrupt owners were in the middle-aged category. Perhaps some of those completing the bankruptcy process started their business after first working for other firms and later decided to start their own business. The educational level of the respondents seemed high with a majority having some college work. However, the higher educated person may have realized more benefit in providing information that could help others avoid such a drastic end for their firm.

The study confirmed the stated problem areas of limited preparation, inexperience, inadequate capital, insufficient cash flow, and poor location (though often not realized) as reasons for being forced (voluntarily or involuntarily) into the bankruptcy process. The stated problem areas given for the retail and service business failure often seemed to be symptoms rather than the real cause of their business failure. That is, each of the stated problem areas can be included under poor management

TABLE 20

Why The Business Was Closed:

Answer	Raw Score	Response Percentage
Insufficient Sales	44	12
Lack of Working Capital	83	23
Excessive Expenses	66	18
Excessive Bad Debts	47	13
Other*	101	28
No Response	20	6
	361	100%

*Breakdown of "Other" Responses

	Raw Score
One Bad Project	3
Economy	13
Note Demand By Financial Resource	4
Robbed by Help	11
Partner Died, Left No Will	3
Lack of Skilled Employees	17
High Interest Rates	9
Franchisor Went Bankrupt	7
Reorganization	34
	101

practices and inadequate marketing skills. The bankrupt business owners rarely attribute the business failure to their own personal inabilities but often give general reasons as the causative factors. That is, instead of acknowledging a lack of knowledge or business experience, a common reply is "lack of sales" or "poor cash flow." The data provided confirmation of the retail and service business owners' lack of attention to the necessity of pre-business planning as well as continuous planning during the life of the business operation. It is felt that these problem areas could have been eliminated, or at least minimized through the early recognition of each problem area.

We are convinced that the identification and analysis of the causes of business mortality will encourage future retail and service business owners to avoid the relatively high incidence of business mortality. Appropriate steps can then be taken to avoid critical mistakes through strategic business plan development and maintenance for the firm.

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