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Why do young enterprises fail?

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The first years of an enterprise are the most difficult ones. Firms that pass the market test most certainly remain in the market for longer. But why is it that only every second start-up achieves a successful market entry? As shown in a current study by KfW and the ZEW in cooperation with Creditreform – the KfW/ZEW Start-Up Panel – the success of businesses depends strongly on taking the right strategic decisions at the time of commencing business operations.

Almost every tenth new company goes bankrupt in the first five years

Within the first five years after start-up, about 40 % of businesses disappear from the market. About one fifth of these businesses (or every tenth newly founded firm) files for bankruptcy and must make financial and social sacrifices. Every third business ends up closing its doors because the founder's expectations are not met or it becomes apparent that the business concept does not work.

Lack of own start-up capital makes establishing a business onerous

Up to 90 % of the founded enterprises use start-up capital in their first business year. The enterprise's financial clout to pay business costs from current receipts does grow with each passing year. However, by the fifth business year every third young company must contribute additional funds (its own or borrowed) to the enterprise. In the fifth business year, nearly one fourth of young enterprises (23 %) draw on funds from external lenders.

Business financing cannot be taken for granted

Even if only 15 % of enterprises report financing problems with external lenders in the first year of business, almost half (44 %) of these young enterprises face dif-

ficulties with third-party lenders in the following year. In other words, financing difficulties can be quite persistent. Accordingly, adequate preparation for obtaining funding should be given a high priority.

Those who lose sight of the "bare numbers", lose out in the long run

The key is to keep an eye on the turnover / cost ratio. A favourable turnover / cost ratio in the enterprise not only reduces the frequency of drawing on own funding or that of external lenders, it also reduces the chance that financing difficulties arise in the first year of business. This is even more important as financing difficulties in one business year make financing problems in the following year more likely.

Financing difficulties are a alarm signal

The study shows that the appearance of financing difficulties is accompanied by a higher risk of failure. Financing difficulties arise when external lenders are not convinced of the viability of the business concept or do not believe the entrepreneur can implement the business idea. Therefore entrepreneurs are well-advised to take the reluctant or critical attitude of potential lenders seriously and check their own business idea or negotiation performance for weaknesses, that is, to use it as constructive feedback and not become discouraged.

Industry and management experience pay off

The entrepreneur's professional experience in the industry of the respective young enterprise, or management experience through previous leadership positions in other companies has direct and indirect positive impacts. In companies run by entrepreneurs with these experiences, the rate of staff turnover declines and with it

the personnel costs. Right from the beginning the personnel management must be as professionally organised as possible. Otherwise young enterprises risk losing employees that may be difficult to replace. Furthermore, high costs of staff turnover can worsen existing business problems and lead to market exit.

Team start-ups are not necessarily more successful

The study could not confirm that start-ups launched by teams are more successful than start-ups launched by individuals. In fact, in the first business year the risk of a team start-up failing is somewhat higher, but the difference between team and individual start-ups disappears later. Although team start-ups can build upon a more stable foundation of know-how and resources, this requires, however, that the team partners complement each other both personally and in terms of their abilities and goals.

Growth yes, but not by all means

Young enterprises that pursue a risky growth strategy can fail due to overly ambitious growth. Moderate growth in an enterprise's first years is often more conducive for long run success. Innovation is worthwhile for entrepreneurs, as it allows them to create market niches and thereby to leave their own mark in the market. Detailed results can be found in the current report on the study.

[KfW/ZEW-Gründungspanel 2012 „Start mit Strategie. Beschäftigungsfluktuation und Finanzierungsverhalten junger Unternehmen“](#) ("Launch with a strategy. Employee turnover and financing behaviour of young enterprises"), Mannheim, November 2012.