THE THREE YEAR GLITCH
Why Getting It Right Early Is The Key To Start-up Success
WOULDN’T IT BE GREAT IF GOOD IDEAS COULD ALWAYS BE TURNED INTO SUCCESSFUL BUSINESSES...
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Why Getting It Right Early Is The Key To Start-up Success
Wouldn’t it be great if good ideas could always be turned into successful businesses? If people who work hard were assured success as entrepreneurs? If businesses that were popular were also always viable?

The truth is that there is no guarantee that your business will survive - even if you have a great idea for a business, work hard and your product or service is well received. The sad fact is that good businesses fail every day – and many in their first three years.

Why? Because, as mundane as it sounds, entrepreneurs often fail to get the basics right and put their livelihoods at risk as a result.

In my experience, entrepreneurs are always strong on ideas. They work hard to make their dreams a reality, but sometimes they forget that simple numbers can be the difference between success and failure. Too many lay weak foundations and see the house fall down around them.

Money is the lifeblood of any business. They say “cash is king” and they are half right, but there is more to business survival than just having money. It’s what you do with it that counts: I say “cash care” is the real king.

Poor financial management is the number one reason that so many businesses fail within three years of launch. This report explains why new business owners need to get organised and implement better accounting systems to improve their chances of success.

At Intuit, we are passionate about small companies and are driven by the desire to solve important problems that their owners face every day. That includes providing practical help to save entrepreneurs time in getting to grips with their finances, accounts and taxes so they spend more time with their customers in the business. We’re proud to unveil this report at MADE: The Entrepreneur Festival.

This report provides an insight into some of the problems that new start-ups face in the U.K. and the steps early-stage business owners need to address to improve their chances of surviving past their first three years. I hope you find it as enlightening as we do.
EXECUTIVE SUMMARY

For this special report we polled 500 small business owners and sole traders from across the U.K., all of whom have been in business five years or less, asking them for their thoughts on the challenges they have faced in starting up a business. We also conducted interviews with a number of entrepreneurs who shared their advice on how to do it right, and what they had got wrong.

The research points to some of the reasons why so many new businesses fail in their first three years. A total of 64 per cent of the businesses polled started with less than £5,000 and 44 per cent had either run out of cash or come very close since launch.

With such narrow margins for error, this report provides a timely message to early-stage businesses that financial management is a key ingredient of success as an entrepreneur. The results provide a salutary reminder that cash-flow, or more precisely the lack of it, is still one of the number one killers of new businesses.

If you take one message from this study, it is that The Three Year Glitch can affect anyone – even the very best entrepreneurs – and that getting your finances sorted using simple systems will let you focus more time, not less, on building your business.
small business owners and sole traders polled across the U.K. were early stage (less than three years old)
said the first year of business was stressful in some measure
launched their business with less than £5,000 were self-financed
would do it differently if starting again
spend more than a day a week managing their finances and administration
spend more time managing their finances and administration than they had expected to rely on pen and paper or spreadsheets to track their business performance
have either run out of cash or come very close employers have missed payroll due to financial difficulties
have experienced some form of trouble with late payment said “winning customers” was one of their biggest challenges
have made mistakes with HMRC and for 14 per cent it resulted in a fine or an overhaul of financial processes.
Small businesses with fewer than 50 employees are the lifeblood of the U.K. economy. They account for 99.2 per cent of the U.K.’s total stock of companies, 47.1 per cent of private sector employment (10.6 million people) and account for 35 per cent of private sector turnover. 4.28 million businesses in the U.K. have fewer than 10 employees.

By any measure, the U.K.’s sole traders and entrepreneurs play a critical role in creating wealth, jobs and improved prospects for millions and have been lauded by the government as the “doers and grafters” who will get the U.K. economy motoring again.

For many, the cut and thrust of being an entrepreneur is a tantalising prospect. The U.K. is one of the easiest places in the world to start a business and many people take the leap every year. But a word of warning; those who have failed consistently wish that they were better prepared from the outset.

Most of us think our brilliant idea couldn’t possibly fail. Why spend time on a barrage of form filling and data crunching when you can plough straight ahead and start making millions?

The problem is that too many do fail and the statistics speak for themselves.

There were approximately 4.5 million businesses trading in the U.K. at the start of 2010, 1.1 per cent more than the same time the previous year, according to government figures. Startup rates are increasing, partly because people are becoming more aware of the opportunities associated with running your own business.

As more people start, more also become exposed to the risk of failure. In 2009, a total of 279,000 businesses shut their doors for the last time, according to the same government statistics. That’s 12 per cent of the total 2009 stock of firms in a single year.

Some of these were wound-up by their owners on a voluntary basis; others were subject to a court order and forcefully closed. But it is safe to say that none of the entrepreneurs running the firms had “business closure” as an exit strategy in their business plans.

Twelve per cent of firms in a single year is a huge number, and all but a handful were small businesses with the first faltering steps of enterprise still fresh in their memories. According to figures from the Office for National Statistics, on average, one in three new businesses fail in the first three years.

1 Department for Business Innovation & Skills – Business Population Estimates For The UK And Regions 2010 – 24 May 2011
ACCORDING TO FIGURES FROM THE OFFICE FOR NATIONAL STATISTICS, ON AVERAGE, ONE IN THREE NEW BUSINESSES FAIL IN THEIR FIRST THREE YEARS.

Of course, some of these businesses did the right things and yet still failed. They did the market research, tested the product or service and delivered it to the market in an efficient way. Not everyone who fails does so with their eyes shut and their fingers in their ears.

Some of those counted in the figures above fell foul of unavoidable circumstances: the credit crunch, a sudden fall in demand, the loss of a big client, or perhaps a wild swing in foreign exchange rates.

But the majority made a mistake somewhere down the line - one that they could point their finger at and say, “that was why”. One, indeed, that disrupted money flowing through the business.

The goal, not least for those involved in launching these businesses, is that more of them survive and grow. In many cases, it is a question of learning some hard truths early and getting the basics right in the very beginning. Those start-ups that want to wait until they are big and successful to put the right systems and processes in place are doomed never to get there.
Together with buying a house, getting married and having children, starting a business is one of the most monumental decisions you will ever make. It’s life changing; for many it means replacing the comfort of steady work and a regular salary with the chaotic and unforgiving winds that buffet all entrepreneurs.

There’s definitely a masochistic element to starting your own business. A total of 74 per cent of those polled consider the experience of starting up to have been anything between “quite” and “extremely” stressful.

For many, that stress undoubtedly comes down to money, from the issue of trying to earn it, to getting paid. Those polled said these are two of the biggest challenges facing new business owners.

This is compounded by the fact that 64 per cent of the sample actually started their businesses with less than £5,000, so the margin for error is miniscule. Only 12 per cent of those polled started their business with more than £25,000.

The research also highlights a possible sense of denial among those polled. While 33 per cent would learn from their mistakes and do things differently, 60 per cent of those polled would do exactly the same thing again.
Evidence suggests that those who fail to plan are the most troubled during the start-up phase, but writing a solid business plan can solve that.

“A business plan is a critical foundation step for any small business – even if it is basic,” says John Davis, managing director of Business Centric Services Group, a specialist provider of advice and services to small businesses. “Accompanied by some basic P&L projections and a cash-flow forecast, a company can get a picture of what is required.”

Fraser Doherty is a young entrepreneur who founded his business, SuperJam, as a teenager and has since gone on to sell millions of jars. “My best advice to anyone trying to start a business would be not to be afraid - so many people are terrified of giving their idea a shot and I think that is a terrible shame,” he says.

“I’d also suggest starting small. My story shows that you can start a tiny business in your kitchen at the weekends and with love and imagination it can change your life. It is also a great idea to find a mentor, someone who has been there and done it before who can share their lessons with you.”

If it’s pain avoidance you’re after, you know what to do. To fail to plan is to plan to fail, as they say, and for entrepreneurs it means getting the foundations of your financial future solidly in place before plunging headlong into business.

Robert Welch, founder of smallcarBIGCITY, the vintage Mini Cooper tour company that launched in 2009, thinks planning should come with a big scoop of realism. His advice: “Double your predicted costs and halve your predicted turnover in your business plan; accurate forecasting and analysis of your costs are fundamental.”

“Set up an automated order processing system from day one that ties into your accounting software; pay more for an established accountant from a reputable firm so that you can navigate the tax system without getting in trouble.”

Too many entrepreneurs fail quickly because they exaggerate the likely impact of their product or service. If you catch yourself thinking: “If I can just capture one per cent of the market”, stop yourself and imagine what would happen if you got zero per cent in your first year.
How stressful have you found managing the finances of your business since starting up?

YEAR 1
- Very Stressful: 15%
- Stressful: 20%
- Somewhat Stressful: 38%
- Not At All Stressful: 26%

YEAR 2
- Very Stressful: 13%
- Stressful: 20%
- Somewhat Stressful: 39%
- Not At All Stressful: 28%

YEAR 3
- Very Stressful: 17%
- Stressful: 17%
- Somewhat Stressful: 38%
- Not At All Stressful: 28%

Base: Owners, founders and senior employees from UK companies with 20 employees or less, operating for 5 years or less.

How much start-up capital was available when the business was launched?

- £0 - £1000: 42%
- £1001 - £5000: 22%
- £5001 - £10000: 12%
- £10001 - £25000: 8%
- £25001 - £50000: 5%
- £50001 - £100000: 3%
- £100000+: 4%
- Don’t know: 4%
Too many entrepreneurs fail quickly because they exaggerate the likely impact of their product or service. If you catch yourself thinking: “If I can just capture one per cent of the market”, stop yourself and imagine what would happen if you got zero per cent in your first year.
For many new business owners, managing their finances is one of the most difficult and challenging aspects of starting up. A total of 75 per cent of those polled admitted they relied on spreadsheets or pen and paper and many admitted to having no external help. In 55 per cent of the businesses polled, the owner is solely responsible for managing the finances.

Many feel that they are spending more time on it than they had expected, with more than one in four saying they were working on it “all the time”.

“I do sometimes feel out of depth with finances as I have no training in accounts other than what I have taught myself,” says Alyssa Smith, owner of Alyssa Smith Jewellery, a successful international jewellery business launched straight from North Hertfordshire College, where she is now entrepreneur in residence. She says: “Learning how to keep an effective accounts system is one of the biggest challenges for any small business.”
The reality is that managing your finances efficiently is as important as winning new clients when it comes to keeping a young business ticking over. Spend more money than you make and you’ll fail, regardless of how brilliant or busy the business is. Knowing what’s coming in and what’s going out remain the absolute fundamentals in running a successful venture.

Paul Lindley, founder of Ella’s Kitchen, makes the case well. The former chartered accountant has built his organic baby and toddler food brand into a £30 million-a-year success story in the past five years. He says: “Everyone says ‘cash is king’ and it’s true. Spend more time on stress-testing your cash flow forecasts with scenarios than focusing on the P&L scenarios; it’s cash that can put you out of business quicker.

“Think creatively around your cash collection cycle and make reducing it a key performance indicator. Remember: ‘If you don’t ask, you don’t get’.”

So it’s no surprise that our survey group of 500 entrepreneurs and sole traders put some effort into organising their incomings and outgoings. What is surprising is just how long some entrepreneurs spend on the task.

According to the data, just under one in 10 spend more than one day a week on non-core tasks, including accounting, legal and HR work. A further 18 per cent devoted between five and eight hours (the equivalent of a full working day) on it.

Less than a quarter said they spent under one hour per week on non-core work. Get organised and you can reduce the time you spend managing your finances.

Andre Campbell of Enfuse Youth, a successful youth education service dedicated to making young people enthusiastic about the career options available to them, says: “Financial discipline is a must when starting out; you have to be willing to sacrifice in the short term in order to reap the benefits further down the track.”
“Anything you can implement to save you time is worthwhile when it comes to handling finances,” adds Ronnie Nag, managing director of the telecommunications business Quore.

“It is a lot easier to keep tabs on the finances of your company nowadays and many accounting packages are simpler to use than a spreadsheet if you are not overly familiar with accounting practices.”

Of those polled, 54 per cent are getting by with manual spreadsheets for calculating P&L. A surprising one in five (21 per cent) admitted to using pen and paper, thereby increasing the likelihood of human error creeping into the system, often one of the biggest contributors to financial distress.

Only a quarter of those polled said they used either desktop or online accounting software, despite its affordability, which suggests a certain degree of entrepreneur inertia. By getting started with spreadsheets or pen and paper, many business owners find it very difficult to graduate their systems as their businesses grow, thereby compounding the problems they face in managing their accounts.

Tristram Mayhew, founder of the successful treetop adventure firm GoApe!, believes that ensuring visibility is the way to go: “Create reliable cash flow forecasting that looks at least six months ahead. Many good young businesses go bust by not realising they will run out of cash.”

When asked about their dealings with HMRC, 31 per cent admitted they had made mistakes and 14 per cent said it led to either a fine or a financial overhaul and review of processes.
1 in 10 business owners spend more than a day a week on non-core tasks

75% are using manual processes (spreadsheets and/or pen and paper) to do their accounting

55% of the business owners are solely responsible for the finances

31% have made mistakes with HMRC and for 14 per cent it resulted in a fine or an overhaul of financial processes.
“FINANCIAL DISCIPLINE IS A MUST WHEN STARTING OUT; YOU HAVE TO BE WILLING TO SACRIFICE IN THE SHORT TERM IN ORDER TO REAP THE BENEFITS FURTHER DOWN THE TRACK.”

Andre Campbell
Enfuse Youth

What financial management support does your business have?

<table>
<thead>
<tr>
<th>Support Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>In-house finance specialist</td>
<td>7%</td>
</tr>
<tr>
<td>External accountancy support</td>
<td>39%</td>
</tr>
<tr>
<td>Neither of these - All done by the owner</td>
<td>55%</td>
</tr>
</tbody>
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Base: Owners, founders and senior employees from UK companies with 20 employees or less, operating for 5 years or less
Those who selected ‘In house finance specialist’ or ‘Neither of these – it is all done by the owner’ for the previous question were then asked: How do you keep track of your finances?

What were the most challenging financial elements of starting up your business?

- Keeping records and staying on top of it all: 43%
- Dealing with VAT and taxes: 29%
- Managing cash flow: 29%
- Getting people to pay on time: 28%
- End of year filing: 27%
- Tracking expenses: 20%
- Understanding VAT and when to register: 9%
- Invoicing: 7%
- Managing payroll (inc. PAYE and NI contributions): 7%
- Other: 3%
- Don’t know: 3%
- None of the above / there were no challenging elements: 9%

Base: 312 owners, founders and senior employees from UK companies with 20 employees or less, operating for 5 years or less.
The road to entrepreneurial achievement is littered with hazards. These come in many forms: staff; location; sales; marketing; legal and customers, to name only a precious few.

But journeyman entrepreneurs and experts agree: the biggest pitfalls and hurdles – the ones that are most likely to derail your business – revolve around the thorny subject of money.

Making it, hanging on to it, housing it, not spending too much of it and certainly not being fined – these are all things you have to consider and successfully negotiate. It’s a fact our entrepreneurs know only too well.

Jessica Grosvenor, founder of Freelance Training & Consultancy, says she got round the problem in part by taking on zero debt: “We were determined to set the business up without any lending from the banks, which was a challenge.

“We started on a private commercial basis and networked and networked to get our name out there. As a result we are now in a position where we owe nothing to the banks. Organisation and patience was key.”

Our survey shows that cash-flow, getting paid on time and managing finances all featured in the top five biggest challenges faced by businesses in their early years. Winning customers - or finding new sources of money - was number one, with more than two-thirds of respondents pointing to this as a source of sleepless nights.
IT SEEMS OBVIOUS BUT IT’S VITAL TO RECOGNISE THE IMPORTANCE OF FINANCIAL MANAGEMENT PROCESSES FROM DAY ONE. TOO MANY START-UP BUSINESSES GET WRAPPED UP IN THE EXCITEMENT OF THE IDEA AND FINANCES GET SIDELINED, HOWEVER IT’S IMPORTANT TO INSTILL THAT LEVEL OF DISCIPLINE FROM THE START.

“...”

Tom Marchant
Founder of Black Tomato
The only non-cash related challenge in the top five was “getting the work-life balance right”. Presumably this is also a symptom of constantly winning, chasing, spending and accounting for money.

And no wonder; 44 per cent of those polled admitted to having either run out of cash or having come very close. Only 28 per cent said they had always maintained a “strong cash position”.

“It seems obvious but it’s vital to recognise the importance of financial management processes from day one,” says Tom Marchant, founder of Black Tomato, the tailor-made travel company. “Too many start-up businesses get wrapped up in the excitement of the idea and finances get sidelined. However it’s important to instill that level of discipline from the start.”

The implications of this are clear in our results. Among those responding, 25 per cent admitted they had either missed payroll due to financial difficulties or come close.

Some of the causes are pretty clear too: principally the spectre of late payments.

Four in 10 said payments were overdue “sometimes” while nearly one in five (19 per cent) said getting paid was either often a problem or that it was a critical concern that impeded the business.

Luke Lang, co-founder of equity crowd funding website Crowdcube, advises: “Make sure that you invoice on time or even early and then chase regularly. Running credit rating checks on customers is also a good way of avoiding late payment early.”

For many small businesses, simply automating these processes can make an enormous difference in terms of cash flow. Preparing professional-looking invoices, tracking payments and sending reminders to assist with prompt payment can all help ensure that the cash they are owed is sitting in their account rather than somebody else’s.
How big a challenge have you found getting paid by your customers / clients?

- No challenge at all - we deal direct with public who pay by cash / card: 18%
- No challenge at all - all invoices are paid on time: 21%
- Small - we have late payments sometimes: 40%
- Quite big - we often have late payments: 13%
- Critical - late payments are a constant issue: 6%
- Don’t know: 2%

What are the biggest challenges your business has faced so far?

- Winning customers: 68%
- Work / life balance: 52%
- Cash flow: 40%
- Getting paid: 31%
- Managing finances: 23%

Base: 500 owners, founders and senior employees from UK companies with 20 employees or less, operating for 5 years or less
To some degree, entrepreneurs are bolstered or hindered by the economic conditions that provide a backdrop to their business. The year 2000 might not have been the best time to start a dotcom, while 1990 was probably a bad time to create a property portfolio.

Today, international economic factors weigh against businesses across the world.

It has forced governments to make hard decisions about where to invest and where to cut spending. The main objective is to balance the books, cut the debt and eliminate countries’ exposure to the risk of default.

But with a lack of cash, where does it all leave entrepreneurs? Those polled said they are uncertain about the future.

Of the 500 founders and business owners polled, only 17 per cent believe trading conditions improved over the last six months. 44 per cent believe they got worse.

And yet despite the downbeat forecast, 51 per cent of those polled expect their businesses to grow over the next year.
But many entrepreneurs feel that ministers have a tough balancing act on their hands, and that tax and regulation are a part of modern life.

“The Government could remove red tape,” says Ronnie Nag at Quore. “Today, everything is geared toward employees. HMRC could be a bit more understanding but, saying that, they can be if you just talk to them.”

Sophie Hodgson of SHH Comms, a public relations business, agrees that more help would be a good thing: “People setting up their business need hand holding – HMRC should have a dedicated help line.

“Despite having followed all the rules, at least to my knowledge, I am still petrified that through no fault of my own I’ll have done something wrong and I’ll be landed with a huge fine.”

Confidence is also high when it comes to assessing personal performance. When asked to gauge how well they handled the financial aspects of running a business in its early stages, 89 per cent thought they ranged from “okay” to “very well”. This is despite the evidence to the contrary and suggests that perhaps a healthy dose of realism is in order. As Andy Grove, former CEO of Intel, famously said, “Only the paranoid survive”.

But what could the government do to help?

Almost two-thirds of respondents said tax breaks for early-stage businesses would be the most helpful measure that ministers could introduce. Just over half requested a reduction in the amount of paperwork that comes with running a business and a third wanted better access to funding.

THE UK IS PROBABLY SECOND ONLY TO THE US IN TERMS OF DEVELOPED ECONOMIES THAT MAKE IT RELATIVELY EASY TO SET UP A BUSINESS AND START TRADING. THE KEY NOW IS TO ENSURE THAT FINANCE AND BUSINESS SUPPORT IS MADE AVAILABLE TO NURTURE THESE FLEDGLING BUSINESSES TO BECOME THE NEXT APPLE OR GOOGLE.

Luke Lang
Crowdcube
PEOPLE SETTING UP THEIR BUSINESS NEED HAND HOLDING – HMRC SHOULD HAVE A DEDICATED HELP LINE. DESPITE HAVING FOLLOWED ALL THE RULES, AT LEAST TO MY KNOWLEDGE, I AM STILL PETRIFIED THAT THROUGH NO FAULT OF MY OWN I’LL HAVE DONE SOMETHING WRONG AND I’LL BE LANDED WITH A HUGE FINE.

Sophie Hodgson
SHH Comms

“Julia Lancaster, founder of The Vintage Affair, a crockery hire business, also believes things could be a little easier: “I had to purchase a lot of stock in my first year, so keeping track of all purchases and business expenses, such as mileage, was something I had to get used to. It’s easy to misplace a receipt and forget to keep a record of all outgoings.”

But in general, entrepreneurs are proud to play a part in getting the UK economy moving again and most believe that Britain is an excellent place to start and run a business.

“The UK is probably second only to the U.S. in terms of developed economies that make it relatively easy to set up a business and start trading,” says Luke Lang at Crowdcube. “The key now is to ensure that finance and business support is made available to nurture these fledgling businesses to become the next Apple or Google.”

Entrepreneurs are by definition a confident group whose top request is simply to be left alone to get on with it. Based on this poll, “getting on with it” is exactly what they plan to do.
51% expect to grow over the next year
11% say they handled finances badly or very badly in the early days

While 33 per cent would learn from their mistakes and do things differently, 60 per cent would do exactly the same thing again.
So what have we learned? Failure is part of being an entrepreneur, and all too often the reasons we don’t succeed are beyond our control. But business owners, sole traders and entrepreneurs can take steps to mitigate the risks.

- Secure the right level of funding to avoid struggling from the outset
- Write a simple business plan to know where you’re going
- Take time to understand your products and your market
- Get on top of finances early to help reduce problems down the road.

Spending time organising this at the beginning frees business owners to concentrate on the important reasons people start companies in the first place – introducing new products and services, finding new customers, closing a sale and making money.

But a high number of those polled are playing fast and loose with their finances and jeopardising their long-term prospects as viable businesses.

It is clear that financial management is a skill that many start-ups struggle with in their early years. It is critical that new business owners get on the right track, get better at managing their money and stay in business for longer.

Entrepreneurs are central to the Government’s vision for economic growth in the U.K. By founding companies, creating new products and services, employing people and generating wealth, they will play a vital role in the economic recovery. It’s therefore critical that they get all the support they can to help survive the first three years and thrive. That is surely the key to sustained economic growth.
IT IS CRITICAL THAT NEW BUSINESS OWNERS GET ON THE RIGHT TRACK, GET BETTER AT MANAGING THEIR MONEY AND STAY IN BUSINESS FOR LONGER.

METHODOLOGY

This report contains survey data gathered via an online survey administered by YouGovStone Ltd between August 24-30, 2011 to members of their online research panel of 300,000+ individuals. The sample targeted owners, founders and senior employees from UK companies less than five years old with 20 employees or less, and is representative across UK regions. The total sample size was 500.

All figures, unless otherwise stated are from YouGovStone Ltd. The figures have been weighted and are representative of all GB adults (aged 18+).

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