Analysis of the Failure of E-Commerce Businesses: A Strategic Management Perspective

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ABSTRACT

The emergence of the Internet created significant opportunities for entrepreneurial individuals. However, while many of the businesses that were started are successful and striving, the vast majority of them have ceased operations, due primarily to lack of profits. This paper examines the causes of the failure of the e-commerce businesses.

INTRODUCTION

The emergence of a new technology can produce significant opportunities. And how individuals go about taking advantage of the resulting opportunities can be a process for all in the society to learn from. The opportunities created by the emergence of the Internet are tremendous; and many business analysts are happy to see the large number of people who are taking advantage of the opportunities. In the e-commerce arena, a significantly large number of businesses were started to take advantage of the opportunities that the Internet provide. However, while many of these businesses are successful and profitable, the vast majority of them have had to shut down due to lack of profitable business activities.

At least 210 Internet companies went out of business in 2000 (Webmergers.com 2000). And about 125 (60%) of the failures occurred in the fourth quarter of the year; about 40 of the companies went out business in December 2000 alone. The December closures represents at least $1.5 billion in lost investments. In terms of business sectors, about 75% of the failed companies were in the consumer (B2C) sector and 30% were content providers.

For many experts, the large number of failures came as a surprise because the Internet was regarded as a dynamic environment that provided infinite opportunities for conducting business. According to Hinssen (2001), the year 2000 was characterized by an extreme optimism about the new economy; and this irrational optimism was stimulated by rosy outlooks painted by analysts of Internet-based services. The resulting feeling of euphoria led to exaggerated market capitalizations for most of these companies.

However, just as positive as the outlook has been for the Internet based companies, the sentiment suddenly changed when investors started to realize that the companies could not meet the huge expectations; certainly not in an overcrowded market that demanded enormous investments in
technology and skills (Hinssen 2001). The resulting collapse saw many of the companies lost over 80% of their market capitalizations. And it is estimated that between 12,000 and 15,000 employees lost their jobs as a result of the company closures (Webmergers.com 2001).

There are several examples of well known Internet-based businesses that failed. The list provided by Hinssen (2001) include companies such as: Pets.com, Furniture.com, Bid.com, and Auctions.com. Other businesses include Boo.com, Toysmart.com, ValueAmerica.com, and Petstore.com (Sherman 2001). The major factor that worry business analysts and venture capitalists and other investors is that this trend is expected to continue - i.e., the majority of new e-commerce businesses are expected to fail.

**PURPOSE OF THE PAPER**

The purpose of this paper is to analyze the causes of the failure of the e-commerce businesses. The analysis is conducted from a strategic management perspective. Consequently, the paper advances the hypothesis that if top management of the failed companies had formulated and implemented effective business strategies, many of them would have survived and strived; and some of them would not have been started in the first place. The basic premise is that the strategic management formulation process would have revealed inherent weaknesses in the business model of most of the companies, and hence, corrective measures would have been taken by top management.

**WHY BUSINESSES FAIL IN GENERAL**

It has been argued that between 68 and 80 percent of all businesses fail within the first five years of their existence (Clark 2000; Monk 2000). The reasons why businesses fail are numerous; and many of them are predictable. In an attempt to answer the question of why businesses fail, Mason (2000), provides a list of possible reasons, which included the following: The basic idea was wrong; Start-up capital was inadequate; There was wasteful use of capital; A lack of stubborn staying power; A lack of financial know-how; Inability to deal with a variety of people - suppliers, customers, employees; Bad pricing; Ignorance of government restraints; and Taking the competition too lightly. Clark (2000) noted that the four most common reasons for business failures are: Poor organizational management; Unbalanced managerial experience; Lack of managerial ability; and Lack of market-specific experience.

These reasons are similar to those reported by Birley and Niktari (1996), in their study of owner-managed businesses. A key finding of the study was that two-thirds of the respondents believe that the business failure could have been avoided if corrective action had been taken to address the problems. And the problems included issues such as: a poor management team with insufficient experience; inappropriate mix of skills; a weak business concept; and a lack of planning. Summarizing their findings, Birley and Niktari noted that about 80 per cent of the reasons for failure identified related to managerial issues. And also, it was perceived that 41 percent of owners had relied too heavily on intuition and emotion in their decision making.

**POSSIBLE CAUSES OF THE FAILURES OF E-COMMERCE BUSINESSES**
The major reasons for the failure of Internet-based businesses, as stated by the owners of the failed businesses are as follows: (1) Faulty business model - 47%; (2) Technology - 17%; (3) Management - 15%; (4) Too many parties - Lack of focus - 9%; (5) Advertising Waste - 7%; and (6) Users not ready - 3% (Ritchie 2000).

These are some of the same reasons reported by Scully (2000). Specifically, Scully noted that Internet businesses failed because of: Poor business plan, Lack of senior management operations experience, Lack of leadership, and Lack of vision.

Consistent with the findings reported by Birley and Niktari (1996), and the issues discussed by Mason (2000), Clark (2000), and Monk (2000), the overwhelming reasons for business failures relate to managerial issues. And the most important managerial issue of them all is strategic planning.

WHY A STRATEGIC MANAGEMENT PERSPECTIVE

David (2001) defines Strategic Management as ‘the art and science of formulating, implementing, and evaluating cross-functional decisions that enable an organization to achieve its objectives’. In this sense, strategic management implies the integration of management, marketing, finance/accounting, production, research and development, and information systems to achieve organizational goals. As Suutari (1999) noted:

The strategy of a business is the master plan that establishes its direction and sets out the priorities and action that determines its future. It should have, as its primary objective, a competitive advantage that enables it to outperform its competitors, or merely survive.

A plausible conclusion that can be drawn from the many reasons why the e-commerce businesses failed is that many of them did not do much of any strategic planning; and for the few that did, the planning and decision making process was based mostly on intuition (Davis 2000). The importance of strategic planning for e-commerce firms cannot be overstated. And the nature of the strategic planning that is needed is one that is based not on intuition alone, but, on both intuition and analysis. This is because the environment in which these firms are operating is relatively new and froth with uncertainty and uneasiness on the part of consumers and institutional clients alike. As Henderson (1979) noted:

The accelerating rate of change today is producing a business world in which customary managerial habits in organizations are increasingly inadequate. Experience alone was an adequate guide when changes could be made in small increments. But intuitive and experience-based management philosophies are grossly inadequate when decisions are strategic and have major, irreversible consequences.

HOW STRATEGIC PANNING COULD HAVE HELPED
The benefits that a firm can derive from strategic planning are enormous. If conducted properly, the strategic management formulation process would have revealed inherent weaknesses in the business model of most of the e-commerce companies, and hence, corrective measures would have been taken by the top management of the business organizations. For example, strategic planning process could have revealed that most people are still more comfortable buying things from brick-and-mortar outlets than from the Internet, according to a 1999 National Retail Federation report (Tweney 1999). The same report showed that seventy-seven percent of those surveyed said they like being able to return purchases in person.

In her analysis of the short-comings of Internet businesses, Davis (2000) noted that the lack of a solid business plan led to eToy=s dismal holiday performance during the holiday season of 2000. And in a study by PricewaterhouseCoopers Management Consulting Services, the findings show that Internet start-ups were unlikely to achieve long-term success because their founders were opportunists who ignore traditional business principles in the hope of short-term gains (Hatter 2000).  

The survey found that Internet businesses were ignoring their customers, and focusing more on leadership and strategic partnerships, and less on the fulfillment of customer needs. The study found that only 15% of the Internet businesses believe customer fulfillment is important to their short-term success. This contrasts with traditional companies, where 31% rate customer fulfillment, along with strong advertising and marketing, as the most important factors for the immediate success of an Internet-based business (Hatter 2000).

LESSONS LEARNED

There are many great lessons that small businesses can learn from the failures of Internet companies. In an editorial in the Small Business Information Newsletter (2001), the lessons that can be learnt from Internet failures were grouped into three categories: (a) What Were They Thinking?, (b) Me Too, and (3) I'm So Smart I Can Do It All.

The first category (What Were They Thinking?), consists of those individuals who fall into the "build it and they will come" trap. These are entrepreneurs who thought you could stick any old idea on the Internet and people would buy it. The lesson learned here is that just because someone has an idea does not mean it is any good. The fact of the matter is that most ideas people develop are bad (Small Business Information Newsletter 2001).

The second category (Me Too) is made up of individuals who looked around to see what others had come up with, and then copied them. This is nothing new in business; however, it seems that in the case of Internet businesses, they did not even try to scrutinize the ideas thoroughly (Small Business Information Newsletter 2001).

The third category (I'm So Smart I Can Do It All), consists of individuals who had it made, and then blew it. They had a good idea and then got greedy or arrogant. Some tried to grow too fast by moving into new markets or product lines. They thought that they had the golden touch and could do no wrong (Small Business Information Newsletter 2001). This group could have used an invaluable advice regarding strategic decision making that states that: (1) Strategic decisions should not be dominated by personal preferences; (2) Corporate culture should not dictate strategy; (3) Strategy must recognize the company's core competence; (4) Experience is not necessarily the
best teacher.; and (5) Beware of over-confidence in assumptions about the shape of the future (Suutari 1999).

So what can we learn from our three failure models?

The answer is that there is nothing new. The New Economy is really just the Old Economy setting up business on a new street. Online retailers are still just retailers. Sure it’s a little different, but they have to follow the same business and economic rules as their brick and mortar peers. You still have to research, plan, manage and finance carefully, no matter if you are online or on Main Street. (Small Business Information Newsletter 2001).

And finally, Drobik (2000) noted that the lesson learned from the failure of Internet companies such as Boo.com is for businesses is to ensure that strategies and technologies are aligned with reality and that the attributes of physical businesses are not all forgotten.

CONCLUSION

The notion that between 68 and 80 percent of all new businesses fail would tend to compel one to think that the majority of the e-commerce business did not have much of a chance of succeeding. Nevertheless, it is still important to understand why these businesses failed. An analysis of this nature can be helpful to the large number of up-and-coming entrepreneurs, particularly, since it is less costly to learn from the mistakes and blunders of those before you, than from your own (Littleguy.net 2000).

The lack of a strategic focus may have doomed many of the Internet businesses that sprang up to take advantage of a promising and evolving technology. The legacy of the failed Internet businesses may not be the fact that there were started by individuals who may have been shortsighted with respect to the importance of a good business model and an effective strategic plan.

In a report from the Brookings Institution, Litan and Rivlin (2000) argues that the legacy of Internet businesses is the technology that they pioneered; the technology that will be embedded in the rest of the economy. The report noted that the Internet has the potential to increase productivity in a variety of ways, including: Significant cost reductions in many transactions; Increasing management efficiency, especially in the area of supply chain; Increasing competition; Increasing the effectiveness of marketing and pricing, and Increasing consumer choice and convenience.

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