



Downtown Economics

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Ideas for Increasing Economic Vitality in Community Business Districts

Restaurant Failures

Factors Linked to Business Closings

Restaurants are a dominant business category in downtowns of varying size and can make up significant portion of the street-level business mix. Nationwide, for every two retail stores there is one restaurant. The health of these food-service businesses is critical to the overall image and economic well-being of an entire downtown district.

To help existing and prospective restaurant operators and guide the development of the downtown dining and entertainment sector, it is important to understand why restaurants fail. An article in the *Cornell Hotel and Restaurant Administration Quarterly*, "Why Restaurants Fail" (Parsa et al.)* examines research on why restaurants go out of business. Information from this article, including failure rates and factors linked to those business closings, are summarized here.

Restaurant failures can be grouped into three general reasons: economic reasons such as decreased profits from diminished revenues; marketing reasons such as decisions to reposition or consolidate operations; and managerial reasons due possibly to management's limitations and incompetence. Data from the research indicate the following:

- The failure rate for first year restaurants studied was 26-percent and 60-percent after three years. This is far less than commonly believed (i.e. 90-percent failure in the first year). The longer a company is in business, the less likely it is to fail.
- Small independents had higher failure rates than large franchised restaurants. The various segments in the restaurant industry have varying levels of failure, i.e., Mexican restaurants reported the highest three-year turnover rate.
- Failure rates were highest in zip code areas with the highest restaurant density. This suggests the need to carefully examine market saturation.
- Even though the number of restaurant failures is high, they typically do not leave significant financial burden on the local community, unlike failures in other industries.

The following are findings from the study that help describe factors linked to restaurant success and failure.

1. **Well-Defined Concept.** Successful owners can describe their concept beyond just food production. They have a clear, distinctive concept that drives all activities from business operations to employee and customer relations. Failure can occur if a restaurant tries too many things to appeal to too many people. Some of the most successful restaurants do not have elaborate strategic plans, but instead have adapted and changed along the way.
2. **Organizational Life Cycle and Family Situation.** Restaurant owners often point to their family as the reason to grow, change or leave the business. "Family and spousal support is essential for the success of a restaurant." Successful owners are typically good at balancing their family and work lives, or they are not married. Businesses sometimes close when they are unable to make family sacrifices or lack the high energy level to motivate themselves and employees.
3. **Location.** Location can influence a restaurant's failure. While a restaurant can benefit from proximity to competition (restaurant cluster), it must be able to differentiate itself from its competition. The research suggests a poor location can be overcome by a great product and operation, but a good location cannot overcome a bad product or operation.



Photo Source: Wikimedia Commons

4. **Planning.** Growth requires extensive prior planning. All decisions should make long-term economic sense. However, successful management requires the owner-manager be ready to change those plans in relation to external forces. Some restaurants fail because they were unable to manage rapid growth or changes while adapting to environmental challenges. These businesses often show inadequate planning.
5. **Family Pressures and Sacrifices.** Successful operators are able to make a substantial time commitment to both the restaurant and to the family. This can include limiting the meal periods or remaining open for fewer hours. The research found that quality of life issues are more important than previously believed in the growth of a restaurant. Many failed owners were no longer willing to give up their quality of life.
6. **Well Defined Strategy is not Critical.** While a clear concept is essential, a well defined strategy was not found to be as critical to a restaurant's success. This finding suggests that restaurant operators must be flexible in their strategy so they can take advantage of opportunities as they arise.
7. **Preoccupation with Competition is not Critical.** Competition was viewed by most owners as a tool for self-measurement, but not necessarily something that required a defensive strategy. However, successful operators are able to differentiate their business from the competition. One failure factor facing independents is the ability of their chain competitors, with size and corporate resources, to outspend the independents and gain greater market share.
8. **Defined Target Market not as Critical.** The research indicates successful restaurant owners are not necessarily able to precisely define their target market in terms of demographic or psychographic descriptions. At the same time, some failed operators could accurately pinpoint their target market. However, knowing the nature of the market is critical for success. Many restaurants fail because they are unable to understand, adapt to, or anticipate market trends.
9. **Marketing Strategy not as Critical.** While many successful owners attribute their success to relationship marketing, failed owners often place blame on the intensive marketing efforts of their competitors. Advertising may not be important to the success of an independent operator. Most of the successful operators in the research indicated

a strong belief in not advertising and not using promotions. However, the restaurateur must pay attention to community and customer relations so it is perceived to be a part of the community.

10. **Owners Skills and Knowledge.** It is critical the owner-manager have skills to run a restaurant. Important characteristics include knowledge, drive, skills, determination and passion. Management inadequacy, incompetence, inefficiency and inexperience have been found to be consistent themes in explaining small-business failures. Accordingly, success requires that management directs the marketing, oversees product quality and standardization, ensures proper financial management/controls, and decides when and how to adapt. Continuing education and professional growth, as well as adapting desirable technologies leads to better management productivity.

Overall, the research indicates the internal environment (operational and personal factors) was determined to be more critical than the external environment (including competition and customers) in contributing to restaurant viability. Family and quality of life decisions were especially important factors in the growth and development of a restaurant. The factors discussed in the research should be considered as they relate to the individual restaurant as well as the overall business district.

Restaurant Planning Tools On-Line

The University of Wisconsin – Extension has developed free, on-line materials for restaurant planning. This resource provides existing and prospective business operators with market analysis techniques and downloadable financial planning software. Excel workbooks have been developed specifically for restaurants and their unique chart of accounts. The easy-to-use software allows the user to develop 12-month operating budgets and 5-year pro forma income and cash flow statements. The software is especially useful as it allows the user to do “what-if” and “break-even” analyses. The web address is:
[Hhttp://www.uwex.edu/ces/cced/tourism/](http://www.uwex.edu/ces/cced/tourism/)

*Why Restaurants Fail was published in the Cornell Hotel and Restaurant Quarterly, August 2005. Authors: H. G. Parsa, Ph.D., The Ohio State University; John T. Self, Ph.D., California State Polytechnic University; David Njite and Tiffany King, The Ohio State University

For more information on the Cornell Hotel and Restaurant Quarterly, see: <http://www.hotelschool.cornell.edu/research/chr/pubs/quarterly>.

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