Why Do Startups Fail? Because Hardware is Hard

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Few venture-capital investors have forgotten the story of Pebble: In 2012, after every VC firm on Sand Hill Road had passed on investing, the smartwatch startup raised more than $10 million on crowdfunding site Kickstarter. It was an unheard-of amount for a crowdfunding campaign, and the resulting hype made Pebble an internet sensation. Then the VCs, suffering from FOMO, begged Pebble to let them invest. The startup eventually raised a total of $59 million.

Investors have been loath to repeat the mistake ever since. Venture funding for hardware startups hit an eight-year high in 2016, with investors pouring $4.4 billion into 624 startups, according to data provider CB Insights.

Likewise, hardware entrepreneurs are eager to use a successful crowdfunding campaign as evidence of customer demand for their product. If tens of thousands of people are willing to donate money or pre-order a product that doesn't yet exist, surely millions will want to buy it in a store, the thinking goes. More than half of gadget startups raised their first funding on a crowdfunding website, according to CB Insights.

But it takes time and a lot of money to bring hardware to market, and in the last year a number of well-funded hardware startups have flamed out spectacularly. Wearable startup Jawbone, backed by $930 million, sold its assets earlier this year. E-cigarette company Njoy, backed by $181 million, went bankrupt last year and liquidated its assets. Kitchen appliance maker Juicero, backed by $100 million, shut down over the summer. And Fuhu, a tablet startup; Zeebo, a gaming console; and Hello, a sleep tracker; which each raised more than $50 million, have ceased operations.

Amid the failures, it's increasingly clear that crowdfunding success does not automatically equate to widespread consumer demand. A new study from CB Insights analyzes the failures of 382 hardware startups, finding that the biggest reason they fail is a lack of demand for their products. In other words, a popular crowdfunding project can be deceptive. According to the report:

> Startups are likely raising money to get to a limited release stage, and then finding that there is not a large enough market for their product to justify a larger raise and production at scale.

The study cites overspending as the second reason for failure and waning interest after an initial crowdfunding campaign as the third. On the surface, the reasons aren't too different from the reasons all startups fail. A prior report from CB Insights found that the top reason unsuccessful startup founders believe their companies failed is the lack of a market need for their product.

That may seem obvious, but the cult of entrepreneurship encourages startup founders to ignore signs that their idea won't work. Building the future around one's own vision requires a bit of irrationality. Startup mythology largely ignores failures, in favor of the rarer successes. As Steve Jobs famously said, "A lot of times, people don't know what they want until you show it to them.”

It's an inspirational idea, but most startups fail to live up to it. Crowdfunding exacerbates this problem of false hope, making customer demand appear stronger than it actually is. Investors wowed by buzzy crowdfunding campaigns would do well to remember how the Pebble story ended: In December 2016, the startup shut down, selling its assets to competitor Fitbit.