Why Startups Fail

What’s in it for me? Increase your startup’s chances of success by learning to identify fatal weaknesses.

If you’re the founder of a startup, you’ve embarked on a journey that demands grit, ingenuity, and courage. Like a captain sailing past shipwrecks in treacherous waters, you know the chances of ruin are high. If you want your startup to survive the journey and go on to scale, you need a clear map to steer you past common – but sometimes unseen – risks. One useful navigation tool is a framework that evaluates how different components of a startup are functioning and where pressure points lie. These blinks explore just such a model, one that identifies six core reasons why even the best or most promising startups can fail – even in the hands of experienced founders. Using it will keep your startup on a pathway to success. In these blinks, you’ll learn

the four crucial opportunities you need to succeed; why having millions of dollars’ worth of venture capital doesn’t guarantee success; and how companies with growing customer numbers can still fail.

To evaluate the health of your startup, you need a reliable framework.

Professor Tom Eisenmann of Harvard Business School is an expert on startups. But after over 20 years of research, he had a huge wake-up call. Looking at two ventures founded by former students of his – one of which he’d had so much faith in that he’d even become an investor – he couldn’t pinpoint why they’d both failed. It completely unnerved him. So he started analyzing why startups fail, looking beyond typical excuses like blaming the economy. This research led him to create a framework that identifies four crucial opportunities every startup has. To achieve success, a startup needs to capitalize on these opportunities and ensure they’re working together. You can use this framework to check the health of your own venture and course-correct where necessary. The key message here is: To evaluate the health of your startup, you need a reliable framework. The opportunities that Eisenmann identified are your startup’s resources, which work together to create, build, manage, and sell a product or service in a profitable way. The first is your brilliant idea. As founder, you’ll have come up with a unique solution that meets a specific customer need. It will effectively solve an important problem that customers face – and be different from anything else on the market. The second is technology and operations. These are the systems you need to build your product, deliver it to customers, and maintain products after sale. This will include the ways you manage inventory and shipping, as well as sales and booking platforms your customers use. Third is your profit formula. This projects the revenue you’ll earn through sales, as well as the cost of earning that revenue – including your operational costs. A solid profit formula helps you confidently manage your cash flow. Finally, there’s marketing – how you’ll communicate with potential customers and entice them to buy your product. Hopefully your marketing strategies will be so effective that your customers will become loyal brand ambassadors, so you can rely on them for repeat sales. These four opportunities are supported by the people involved in your startup – you and your cofounders, your hardworking team, the investors providing you with venture capital, and any partners offering guidance or expertise. If your opportunities are a racehorse, collectively these people are the jockey. To win the race, they need to complement both each other and the startup as a whole.

Founders who lack industry knowledge fail.

In March 2012, Harvard Business School graduates Alexandra Nelson and Christina Wallace launched Quincy Apparel – a company which promised that its unique sizing system would provide women with business clothes that fit well. Nelson and Wallace were astute founders. They'd done market research, held trunk shows where women could try on samples, and raised $950,000 in seed capital. Initially, sales were promising, and 39 percent of women who purchased items in the spring bought more in the fall. But problems were emerging behind the scenes. While the founders had recruited some fashion experts, they themselves didn't have industry knowledge. This ultimately led to the collapse of the company – less than a year after its launch. The key message here is: Founders who lack industry knowledge fail. As cofounders, Nelson and Wallace were the perfect pairing – at least on paper. Wallace was charismatic and could sell Quincy's vision. Nelson, a trained engineer, was analytical: the perfect person for managing strategy and operations. She'd also spent the summer after graduation working at Hermès on inventory optimization. But neither Nelson nor Wallace understood the specialized roles that garment manufacturing requires – like pattern making, sample making, and technical design. In fact, they thought they'd manage garment design themselves and hire just one production manager to oversee manufacturing. This lack of knowledge created a range of operational issues – from ordering unsuitable fabric to not understanding sizing conventions. Quincy's garment return rate was 15 percent higher than Nelson had projected, and 68 percent of those customers returned items because of poor fit. This meant that Quincy had failed to deliver its core promise – business attire that fit well – and all those returns ate into profit margins. Quincy had three of the author's core opportunities in place – a great idea, solid marketing, and a viable profit formula. But its operations weren't sound, due to its founders' lack of knowledge. This weakness led to its undoing. If your startup belongs to a sector outside your expertise, put some measures in place to compensate for your lack of knowledge. Bring on a cofounder with the right experience, or develop a partnership with an expert who can provide you with advice. Alternatively, equip yourself with enough industry knowledge to guide your recruitment strategy. That way, you'll have a clear picture of how to build the team you need and avoid fatal mistakes.

Founders who don't understand their customers fail.

While studying at Harvard Business School, Sunil Nagaraj had an idea. He'd make software that matched potentially compatible singles based on behavioral data gleaned from their internet use – things like the TV shows they watched or the music they listened to. He'd license this software – which he called Triangulate – to dating companies, who'd offer it at a premium rate as an advanced form of matching. To find out if behavioral data could indicate romantic compatibility, Nagaraj ran a test with 100 volunteers. Unfortunately, the software he used didn't work on most of the volunteers' computers, so the results were skewed. Undeterred, Nagaraj plowed ahead and started engineering his software. But without market insight, he was flying blind. The key message here is: Founders who don't understand their customers fail. Nagaraj was impatient to build his matching software, and this enthusiasm led him to commit a common mistake – the false start. He invested time and money into his product before he even knew if there was consumer interest. Instead of conducting market research, he made assumptions about his customers, like assuming they'd be willing to pay a premium to be "triangulated." In reality, people don't find algorithms useful when they're deciding which dating profiles they like. It's not the same type of decision as choosing a financial service provider, for example, where they might not have any intuitive knowledge or experience to guide them. Nagaraj also failed to consider whether people would be OK with their internet usage being tracked so they could be triangulated – something many of us would consider a breach of privacy. This meant his idea – a crucial opportunity of his startup – was flawed. If Nagaraj had surveyed people using online dating services, he'd have realized this much earlier in the game. And armed with that information, he could've reconsidered his product before investing in it. To avoid false starts, it's crucial to resist the impulse to act prematurely. Like someone caught up in that first flush of romance, it's easy for a founder to rush into making their first minimal viable product, or MVP, before they've done their homework. An MVP is a functioning prototype that gives investors and potential customers a feel for your final product. But creating one is the second-to-last step before making a fully realized product – not the first! It can only happen once you've understood everything about your intended customer so you can workshop ideas and thoroughly design with their needs and preferences in mind.

Not analyzing early growth leads to failure.

In 2014, Lindsay Hyde launched a pet-care company called Baroo. Located in the basement of a residential building in South Boston, it offered pet owners "high-touch" services like grooming, dog walking, play dates, and feeding. It was an instant hit: seventy percent of pet owners in the building used Baroo's services. Excited by this initial success and the 6 percent commission they'd stand to make, four more apartment buildings signed up. Baroo then quickly expanded into 25 buildings in Chicago. A year later, Hyde set up in Washington, DC, and metropolitan New York. But despite this rapid expansion, by mid-2017, Baroo's financial health wasn't just poor – it was terminally ill. In February 2018, Hyde was forced to pull the plug. Her mistake? Failing to identify whether those early adopters in South Boston represented the broader market. The key message here is: Not analyzing early growth leads to failure. Baroo lacked several of Eisenmann's crucial opportunities and support networks. Its fast scaling led to the breakdown of its technology and operations, its team, and its relationships with partners and customers. But these side effects of Baroo's accelerated scaling weren't the root cause of its downfall. The spark never caught fire because of a false positive. False positives occur when founders misinterpret their startup's early success. They assume the mainstream market will embrace their product or services with the same level of enthusiasm that initial customers had. In Hyde's case, she believed that around 70 percent of pet owners in the buildings she expanded to would use Baroo's services. But that simply wasn't the case. Hyde had failed to consider the specific circumstances that led to that initial hype. First, the building in South Boston was brand-new, so few of its pet owners had existing relationships with local pet care services. Also, many of the residents belonged to a Hollywood film crew that had relocated to Boston for a shoot; they'd brought their pets with them and, flush with cash and short on time, they needed help caring for them. This clientele didn't represent the mainstream market at all. To avoid misinterpreting early success, analyze whether early adopters represent mainstream customers, or if your instant success resulted from exceptional circumstances. Scaling too quickly can lead to complete ruin, as it did in Baroo's case – so make sure there's mainstream market demand before you attempt it.

Startups that scale too quickly fail.

Fab.com – a flash-sale site that sold quirky furniture and household items – had everything going for it. It was in the hands of experienced entrepreneur Jason Goldberg, who'd successfully founded another startup and raised over $170 million in venture capital for Fab. In its first 12 days, it sold $600,000 worth of product. Three years after launching, the company had expanded into Europe. But it was burning through $14 million a month to stay afloat. To reduce costs, it laid off 80 percent of its US workforce and focused on the European market instead. By year four, Goldberg had to shut down US operations completely. In growing too quickly, the company had pushed itself off a cliff. The key message here is: Startups that scale too quickly fail. Like many startups that fail after a few years, Fab was a victim of the speed trap. Speed traps occur when there's strong initial success plus plentiful investment that finances rapid growth. But sometimes, that initial success represents a saturation of the market. In its second year alone, Fab spent $40 million on advertising – one of a startup's core opportunities. But even this didn't significantly expand its customer base, which had stubbornly plateaued. To avoid the speed trap, use the RAWI test. RAWI stands for Ready, Able, Willing, and Impelled. First, evaluate whether your startup is Ready to scale. Does it have a proven business model, a customer base with scope for growth, and a high enough profit margin to survive if customer growth rates are lower than expected? Second, ask if your startup is Able. Can it access the resources it needs to scale quickly, including staff? And will it be able to train and manage a larger staff body? Third, decide if you're Willing to scale. As founder, scaling will increase your workload and stress levels. Raising more venture capital to scale will dilute your equity – meaning more pressure for less money. Finally, is the startup Impelled? Are you only scaling because competitors have emerged and you want to win market share? If this is the case, make sure the cost of gaining new customers doesn't outweigh profit. By reviewing each of these points on a quarterly basis, you can better evaluate whether it's the right time to scale. Don't charge ahead if there's limited scope for growth.

Startups without the right senior management fail.

Dot & Bo was an e-commerce company that sold home decor as curated packages, which were designed to look like sets from imaginary TV shows – think "Einstein's Office." Founded by seasoned entrepreneur Anthony Soohoo in early 2013, its ever-expanding customer base generated $15 million in revenue in 2014 alone. This huge demand placed extraordinary pressure on the warehouse and shipping teams, so Soohoo hired a Vice President of Operations. His chosen candidate had an impressive CV but no experience in e-commerce operations. This lack of experience undermined the whole company, even though it continued to have solid customer growth. When

Soohoo realized this, he hired a new VP of Operations. But by then, it was too late. In September 2016, Dot & Bo went into liquidation. The key message here is: Startups without the right senior management fail. When that first VP of Operations came on board, his initial task was to select an enterprise resource planning – or ERP – system. ERPs manage operations, like tracking inventory and deliveries. But the system the VPO chose couldn’t handle the variations between different suppliers’ delivery times. Because of this, the customer service team was inundated with queries about missing or late deliveries. They couldn’t keep up with rising demand, and email response times dragged out to eleven days. To make matters worse, the system was so shoddy that staff often couldn’t tell where a delivery was. To compensate for delays, staff express-shipped orders – which cut into profit margins. At the same time, social media hype increased sales; this placed even more pressure on operations that were now hanging by a thread. Superficially, Dot & Bo’s operational problems could be blamed on technology, but it was the VPO’s lack of sector experience that led to the company’s demise. Someone with specialist knowledge would have chosen a better ERP – one that could cope with Dot & Bo’s complex supplier model. If you want your startup to survive scaling, you need the right senior management team in place. And that means hiring specialists over generalists – even if they have impressive experience. Remember, without the right jockey, your racehorse won’t cross the line. If you’re not at the stage where you can afford a senior specialist, find a mid-level one instead. They’ll come with a cheaper price tag while still having the expertise your company needs to support its growth.

Overly ambitious ventures are susceptible to failure.

Entrepreneurs play an important role in society – their ability to dream big and pursue ambitious projects drive life-changing innovations. That’s what Shai Agassi aspired to do back in 2007, when he dreamed of making electric cars mainstream and reducing the environmental impact of household vehicles. But despite this honorable mission and $900 million worth of investment, his company, Better Place, sold fewer than 1,500 cars. Venturing into uncharted waters always encompasses an element of risk. Agassi’s problem? His vision was just a little too ambitious. The key message here is: Overly ambitious ventures are susceptible to failure. To pull off his project, Agassi had to rely on a multitude of factors outside his control. For instance, to make his electrical vehicle affordable, he needed enough customers to embrace it. He also needed them to have confidence in recharging and battery exchange stations. And he needed several car manufacturing partners to collaborate because not every customer wanted the same car model. In the end, Agassi didn’t manage to create a product with enough market appeal and the required infrastructure at a price point that would yield returns. Initial research had shown that 20 percent of households in Israel, where Agassi was launching Better Place, would consider buying one of his vehicles – even if it cost 10 percent more than a regular car. Agassi had been banking on selling to at least half of those households, but he didn’t even manage that. If your concept is high-risk like Agassi’s, there are steps you can take to mitigate some of that risk. First, keep in mind that humans are afraid of radical change, even when it’s for a good cause. Moderate your innovation so that customers don’t need to go too far out of their comfort zones to incorporate it into their lives. Second, create nonfunctioning prototypes, and get feedback from focus groups. This will help guide the next stage of design while also gauging people’s interest in the product – always a tricky issue if you’re bringing something completely new to the market. Finally, don’t fall into the trap of inflating market demand just to impress investors. All you'll end up doing is setting sales targets you can't reach. By being honest about your potential customer pool, you'll make it easier to project how long it will take to recoup any investments.

Recovery from failure is possible.

The unfortunate truth is that most startups fail. But failure doesn't mean that all is lost. After the collapse of Quincy Apparel – the women's clothing startup – Christina Wallace hit rock bottom. Her experience as a founder had left her with a failed startup, a broken dream, and crippling debt. Wallace had no choice but to get a job. And while she couldn't imagine ever leading a startup again, she was happy to work for one. A role at an immersive training program in New York City called the Startup Institute was her first step to recovery. And she went on to found another startup, an EdTech company supporting women in science, before ending up teaching at Harvard Business School. The failure of her startup didn't hamper her long-term success at all. The key message here is: Recovery from failure is possible. When you're in the throes of failure, a pathway to success might seem as hard to find as a unicorn in your local park. But by following the Three Rs, you can walk that path all the way to the finish line. The first phase a founder experiences after failure is Recovery. If your startup fails, you'll likely find yourself in a state of financial ruin, as Wallace did. It's common for founders to accrue massive credit card debt while simultaneously deferring their salary to maximize investment in their company. At the same time, you'll find that your personal relationships have deteriorated too; all those long hours at work have forced you to neglect your loved ones. This sense of isolation gets compounded by failure's negative emotions – things like grief, shame, or guilt. To avoid getting depressed, find ways to support yourself during this time. Implement healthy lifestyle habits, give therapy a shot, and reconnect with activities you enjoy. Once you've processed those difficult emotions, you can move on to the second of the three Rs: Reflection. In this phase, you'll identify what you've learned by exploring your experiences objectively. This can be challenging. Our egos always try to preserve us by blaming someone else for our own mistakes. But if you can overcome this tendency, you'll be in a position to gain valuable knowledge. The final phase of your journey is Reentry. Despite the hardship of failure, around 50 percent of unsuccessful entrepreneurs found new startups. You might be concerned that your previous failure will send potential investors running, but there's a way to avoid this: articulate how what you've learned in Phase Two has informed your new business plan. That way, you can demonstrate to investors that you're starting afresh from a place of experience and wisdom.

Final summary

The key message in these blinks is that: When startups fail, there's a temptation to oversimplify why they weren't a success. But these explanations are rarely accurate or insightful – so 50 percent of founders who go on to launch another startup are at risk of repeating their mistakes. By using a solid framework to regularly evaluate your startup's health, you'll be able to identify where you need to course-correct before it's too late. And in the event of failure, that framework will guide you in conducting a postmortem, so you'll have a better chance of success next time. And here's some more actionable advice: Hire an executive coach. Founders are, by nature, passionate and determined. But some are so focused on their goal that they develop tunnel vision and end up dismissing advice and feedback alike. This causes their relationships to break down – often at moments when backing from their team is essential. Avoid this by working with a professional coach who will help you build awareness about your workplace practices. They’ll help you moderate your leadership when you need to, so you can lead a productive enterprise.