Entrepreneurship

Lecture - 06
Why Startups Fail

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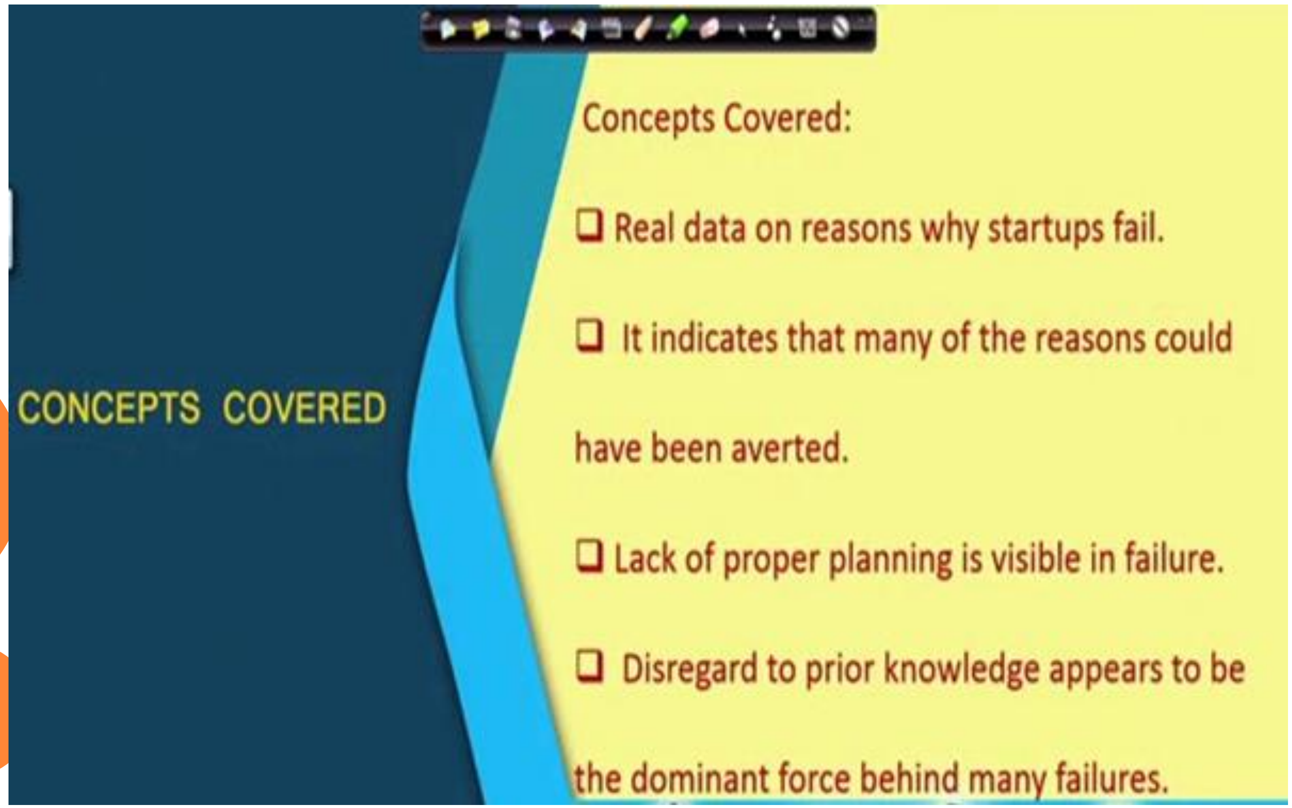

Why Startups Fail

- "All I Want To Know Is Where I'm Going To Die So I'll Never Go There. " - Charlie Munger

- Fail early, fail often, but always fail forward."

— John Maxwell, Failing Forward: How to Make the Most of Your Mistakes

"If you're not failing, you're probably not really moving forward."

— John C. Maxwell, Failing Forward: How to Make the Most of Your Mistakes

Why Startups Fail

Causes of Failure of Startups

- You may read many post-mortems (some call them obituaries) on failed startups following the link below to understand what the founders attribute to their failures:
- https://www.cbinsights.com/research/startup-failure-post-mortem/

Why Startups Fail

- A brilliant idea and passion to start a venture is essential for success of a venture. But there are myriads of other things that define success or failure.
- One fatal mistake: understanding the technology is the same as understanding the business. A corollary to this is - building a new generation product guarantees success of a business.
- So, people start business in the domain they are expert in but not knowing dozens of other things.
- They may be good technicians and not good managers or good entrepreneurs. Michael E. Gerber, the author of E-Myth, calls it *entrepreneurial Seizure*.

Why Startups Fail

Entrepreneur, Managers, and Technicians

Each of us is an entrepreneur, a manager, and a technician with varying degree of them - Gerber in E-Myth .

Technician, manager, and entrepreneur personalities are all critically important for business success. But very few individuals can assume all three of them. Even if anyone can, it is difficult to function all three roles simultaneously.

We need to realistically assess how much we are entrepreneurs, manager and technician so that we can make a balanced team with complimentary skills.

Technicians are doers and would think that business will not run without him doing. During early stage, the technician thrive but when it comes to go-to-market phase it does not suffice. You need entrepreneurial vision.

As business starts growing, it needs managers for myriads of things such as logistics, finance, customer, brand, legal and many more business process management expertise.

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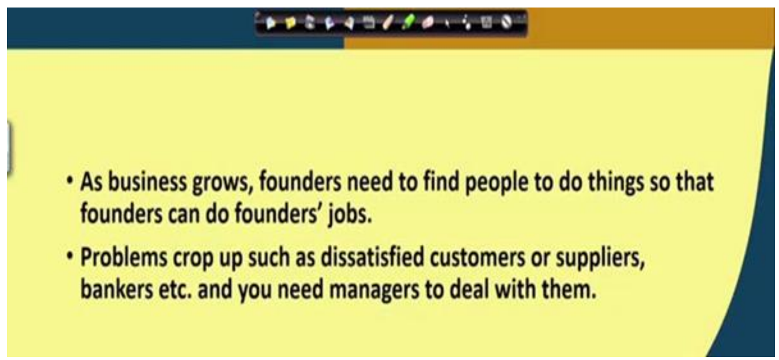

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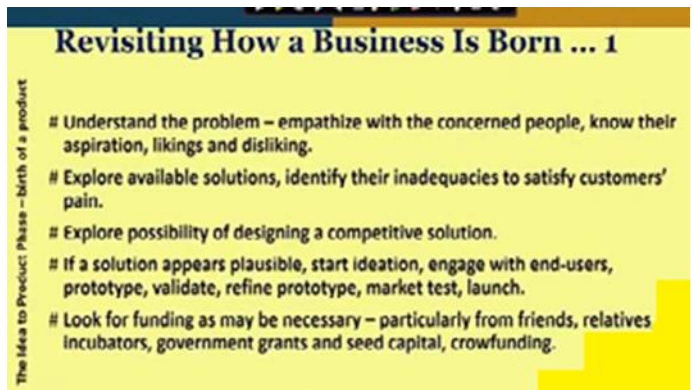

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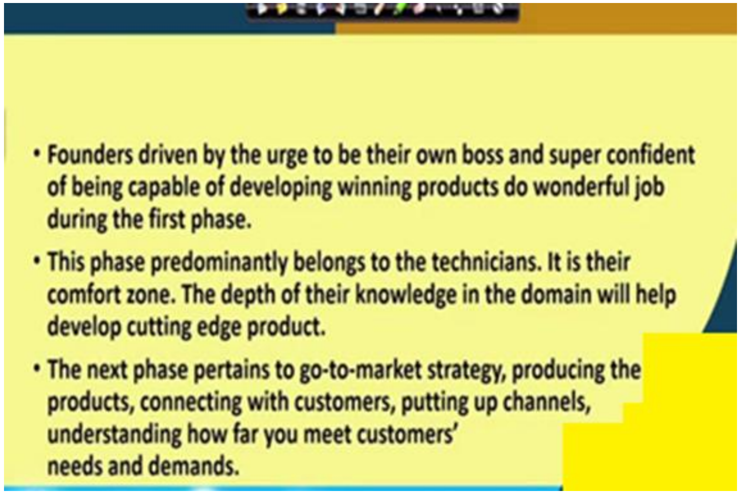

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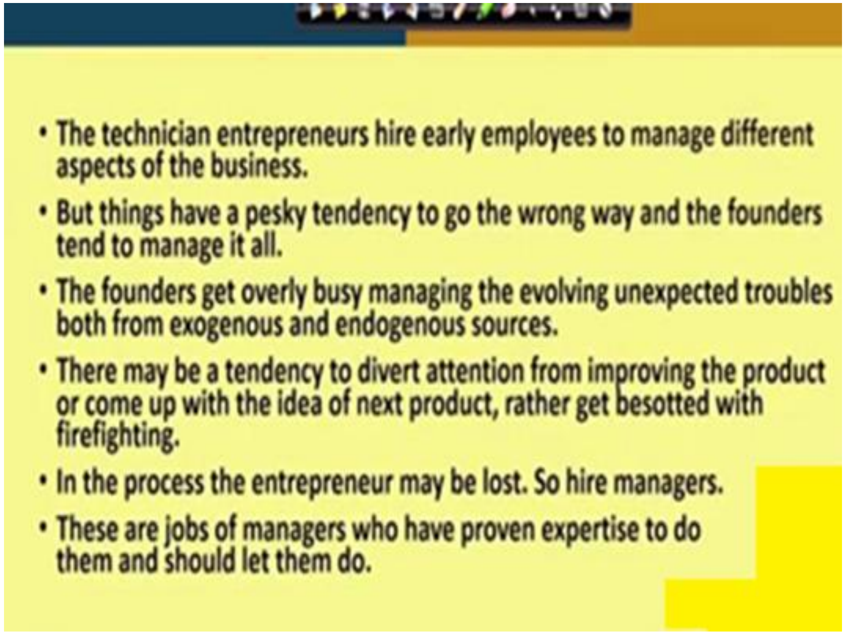


Why Startups Fail

Revisiting How a Business Is Born ... 3

The Growth Phase – The Growth Phase

- # Now that the product is in place, firms need to build other essential capabilities:
- # Operational and other ordinary capabilities, the routine activities, administration, and basic governance that allow any organization to pursue a given production program, or defined set of activities, more or less efficiently.
- # New product development, expansion into new sales regions, and other actions that constitute astute managerial decision making under uncertainty.
- # These are part of 'business process management' or dynamic capabilities (Teece 2018)

Why Startups Fail

Business Process Management (BPM) Is a Continuous Process

1) Brings about clarity on strategic direction,
2) alignment of the firm's resources, and
3) increased discipline in daily operations.

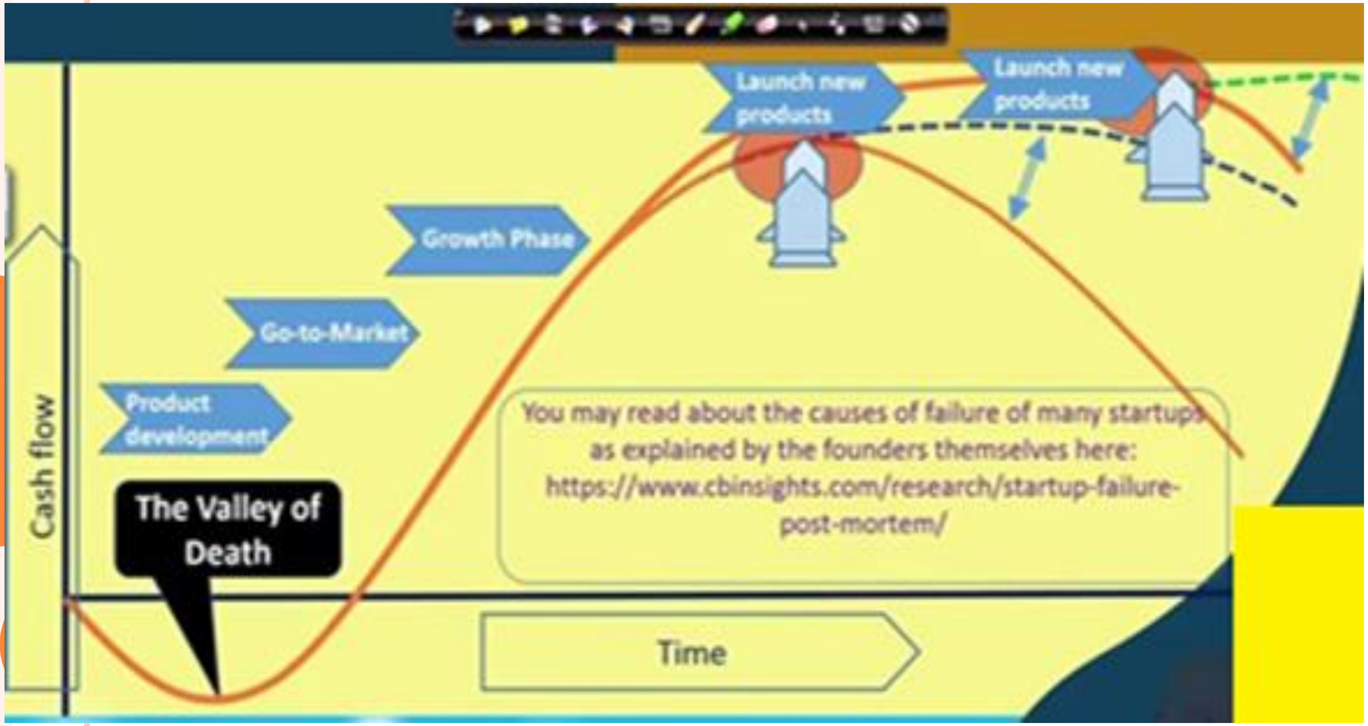
- BPM is an enterprise-wide, structured approach to providing the products and services that your customer's value most.
- It is grounded in the premise that you must take a process view in order to understand the products and services your customers value most.
- An understanding of the key business processes helps to meet key customer needs and you gradually realize the gap between customer expectations and your capability to perform.

Why Startups Fail

The Valley of Death

- The "valley of death" is referred to the phase of startups when they fail to either generate sufficient cash flow or attract fund from external sources such as investors to cover the negative cash flow occurring during the early years (say during the first to third years).
- The majority of startups (some study places it at 90%) fail at this phase.
- Very few startup businesses generate positive cash flow (net of cash inflow and outflow) during the early years.
- On the other hand, many fail to come up with a validated prototype or proven business model that the investor would feel confident about. The investors usually prefer a somewhat proven business model.

Why Startups Fail



Why Startups Fail

Of his many failed experiments, Thomas Edison once said:

"I have learned fifty thousand ways it cannot be done and therefore I am fifty thousand times nearer the final successful experiment."

We neither have the resources to try fifty thousand times to reach to success nor we have the time, tenacity, or guts.

But we surely have access to one thing: we have access to information on why many ventures failed. These are analogous to experiments done by some people several thousand times and we learn from their failures–what tends to go wrong and where should we focus.

Why Startups Fail

- Startups fail even after raising significant amount of fund and sales.
- Studies on recent developments show that 70% of the start-up failed after raising first round of fund.
- It also reveals that 70% of upstart tech companies fail – usually around 20 months after raising the first financing.
- The statistics on consumer hardware startups are particularly brutal with 97% of the seed or crowfunded startups eventually dying or not gaining traction.

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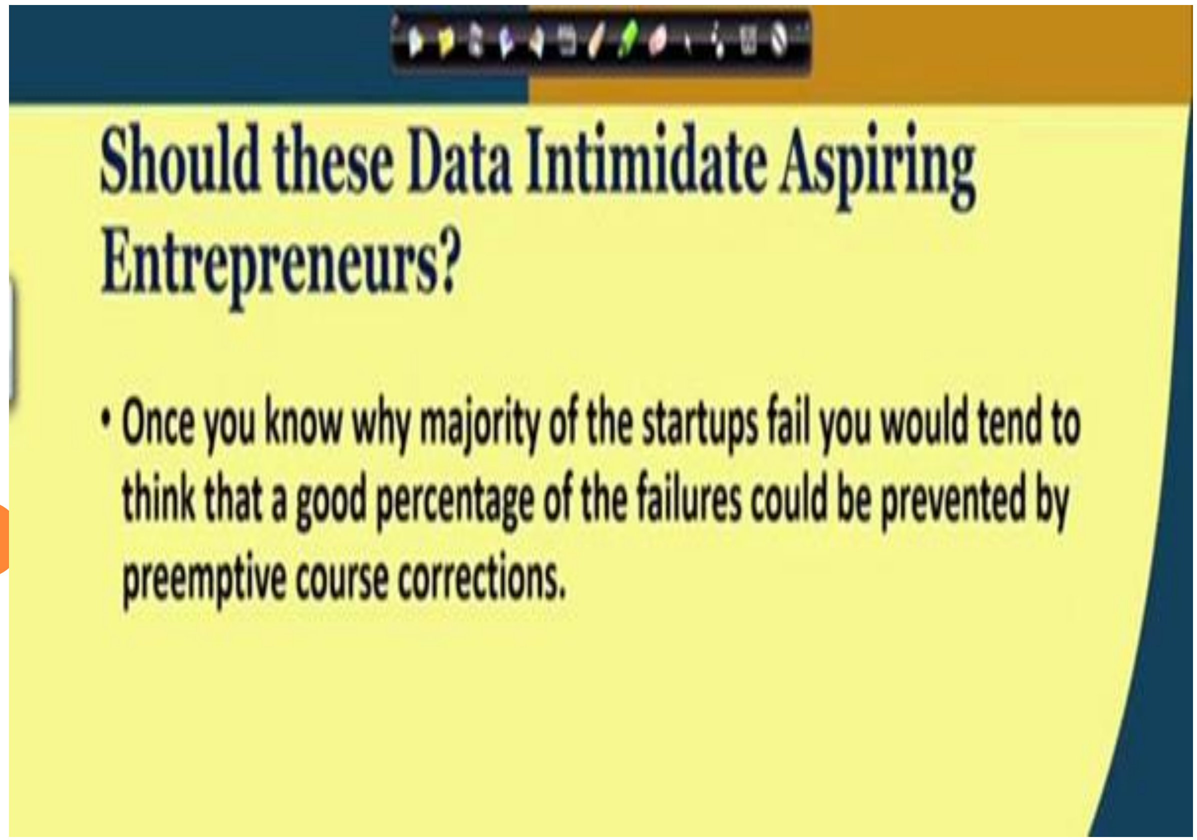

Why Startups Fail

- Almost always, more than one reasons are responsible for business failure and the real reasons are hard to uncover.
- Through extensive research on 101 failed startups www.cbinsights.com has documented the reasons for their failure.
- A glimpse on the list would give valuable insights on the things that should deserve attention for preemptive actions.
- It would also help to understand early symptoms of chronic ills and take decision to pivot and avoid further loss.

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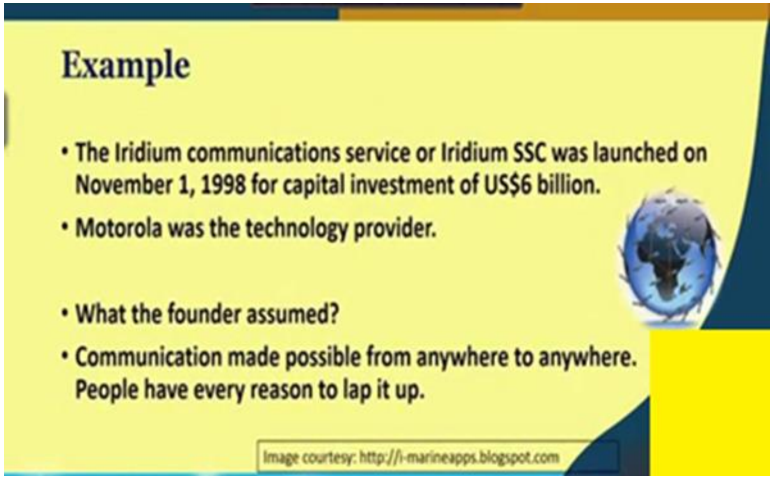
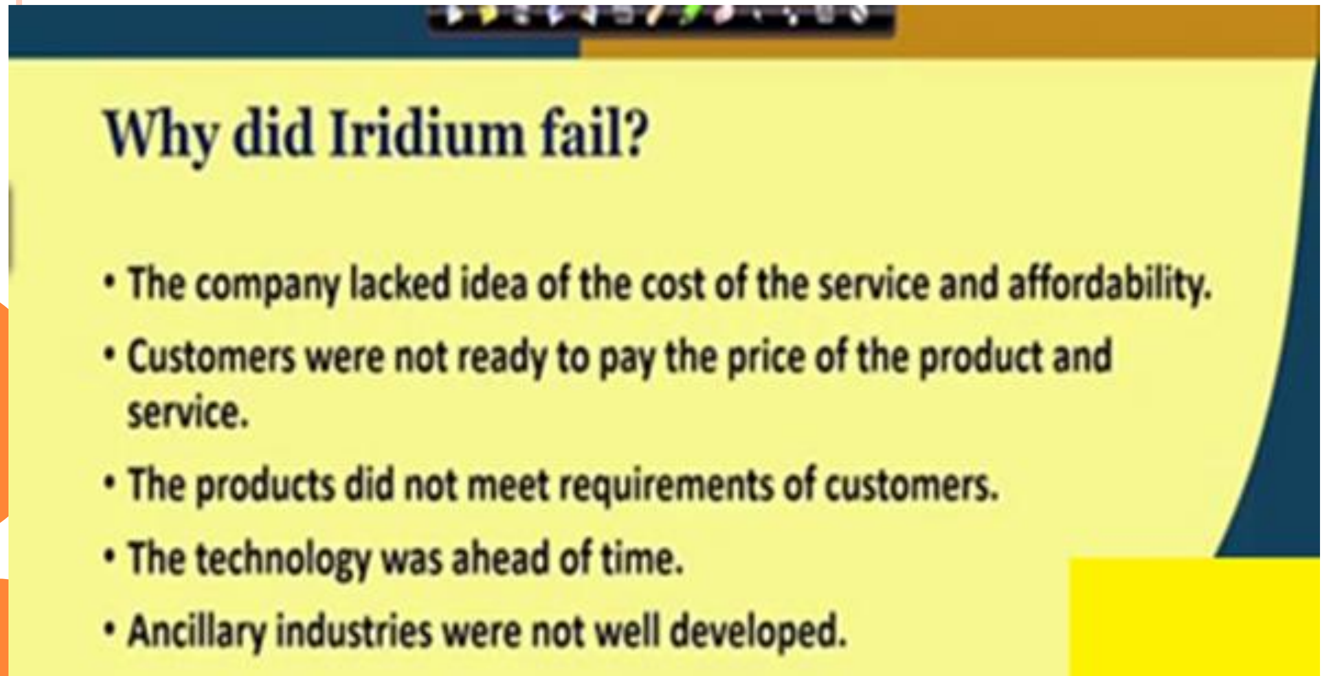


Why Startups Fail

Facts

- Nine months later, on August 13, 1999, filed for bankruptcy. Why?
- Every single call has to be routed through all satellites. Required entire constellation of 66 active satellites to make any call.
- The cost of service was prohibitively high for the most users.
- Indoor reception was poor, if at all possible.
- The hand held device was bulky.
- Calls were expensive.
- The present owners bought it for US$35 million.

Why Startups Fail



Why Startups Fail

- We have a tendency to overlook the fact that people are different and they are not likely to think what we are thinking. We must validate our proposition even before setting the journey and constantly get verification so that we are making the perfect customer-product fit and at the same time we are not adding features that they do not appreciate.
- Therefore, it is a seminal mistake to focus only on building the product that you think is brilliant and not getting it validated by customers.
- Many entrepreneurs do not make distinctions between 'must have' and 'nice to have' features and they end up spending too much time and resources building them only to realize that customers do not care about it.
- "Life's too short to build something nobody wants." - Ash Maurya

Why Startups Fail

- What we usually see is:
- A founder gets an idea >> builds the solution >>tries to sell it >> nobody buys the solution >> the founder runs out of money >> the startup dies.
- Your goal should be to solve a meaningful problem for customers in a competitive way.
- Get customers' feedback right at the beginning and never lose focus to the changing needs of the customers.

Why Startups Fail

Running Out of Cash (29%)

- The 2nd biggest reason for start-up failure is running out of cash.
- This may be triggered by lack of financial planning, failure to preemptively assess negative cash flow arrange the money, not growing fast enough and losing attractiveness in the eyes of investors.

Why Startups Fail

Example: Ran Out of Cash

- Drone startup Airware crashes, shuts down after burning $118M
- Here is what the founder wrote in obituary

"History has taught us how hard it can be to call the **timing** of a market transition. We have seen this play out first hand in the commercial drone marketplace. We were the **pioneers** in this market and one of the first to see the power drones could have in the commercial sector. Unfortunately, the market took longer to mature than we expected. As we worked through the various required **pivots** to position ourselves for long term success, we ran out of financial runway. As a result, it is with a heavy heart that we notified our team, customers, and partners that we will wind down the business."

Why Startups Fail

- "At age 27, I started a business using money in my savings account," Lyneir Richardson CEO of Chicago TREND and Executive Director of the Center for Urban Entrepreneurship and Economic Development at Rutgers University Business School, says.
- "My business grew rapidly from $600,000 in revenue to over $7 million. I was recognized by the U.S. Small Business Administration as a Young Entrepreneur of the Year.
- "But I had three major problems. First, I had a **low profit margin** on the product that I was selling. Second, I had a lot of **payroll costs**. Third, there was a long **lag** time between sales and no consistent recurring revenue. I now know that these are classic symptoms of a company with poor cash flow. The saying is that 'Cash is King,' but in my view, the saying should be 'Cashf Flow is King.' Ultimately, I had to sell the assets of my company at a discount, and I went out of business."
- You can read the story at https://www.startups.co/articles/why-do-startups-fail

Another obituary: Running Out of Cash

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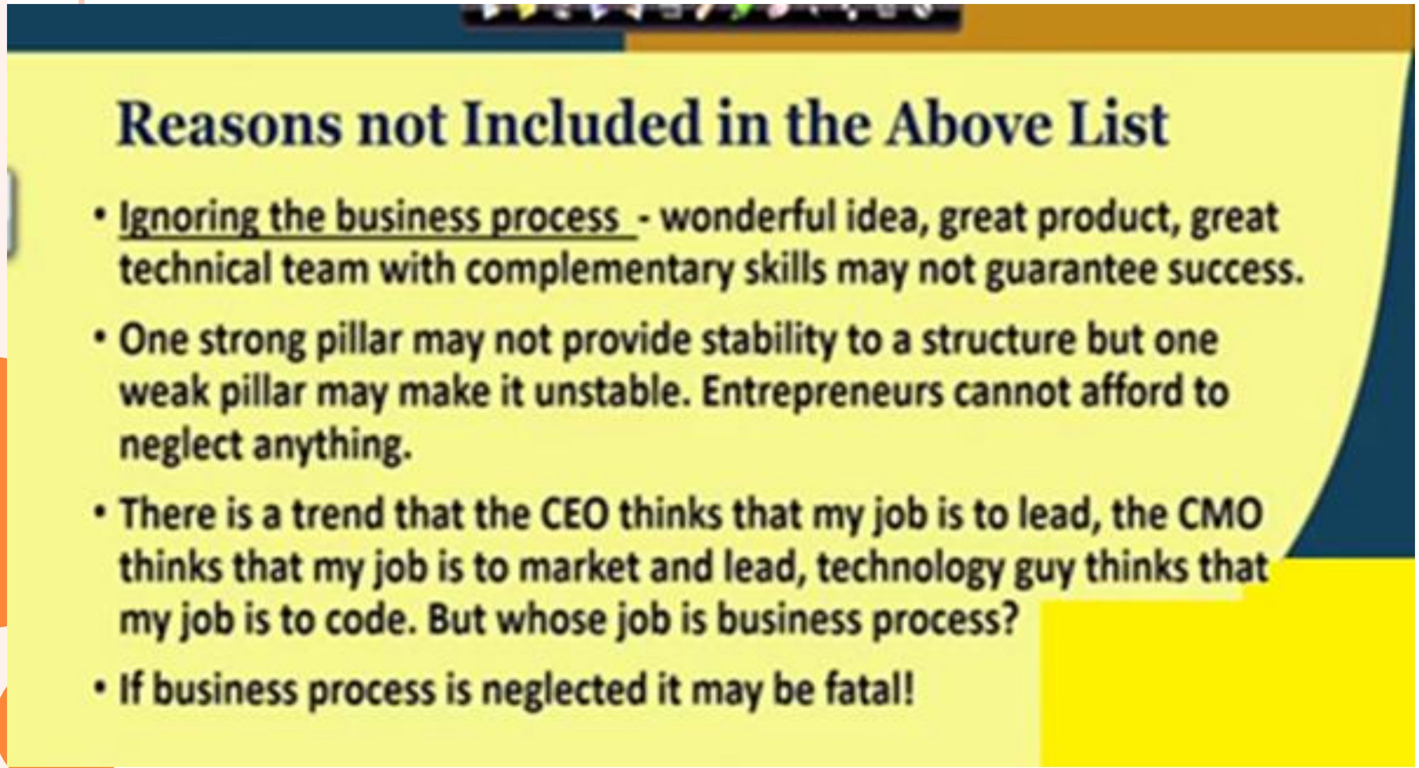

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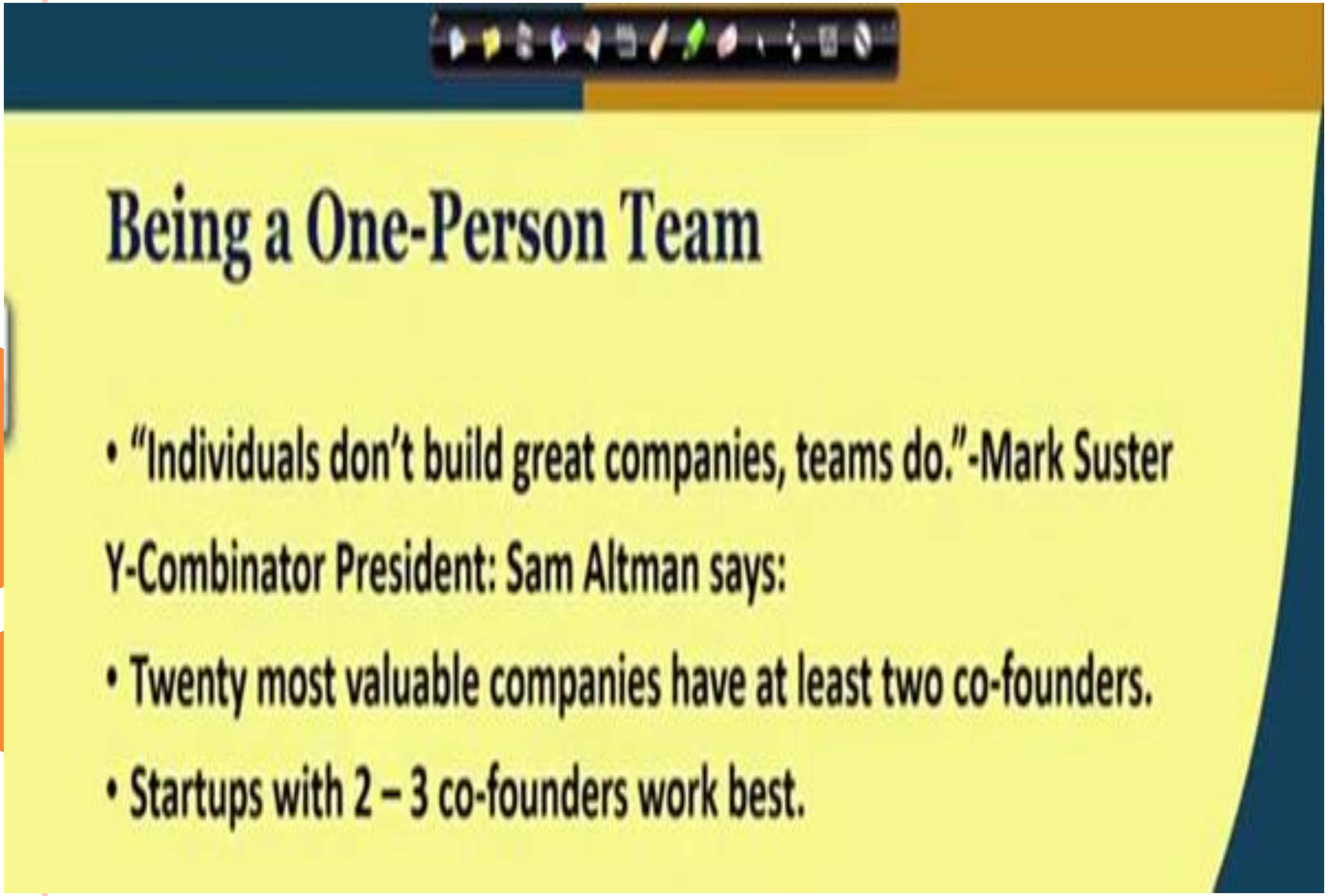

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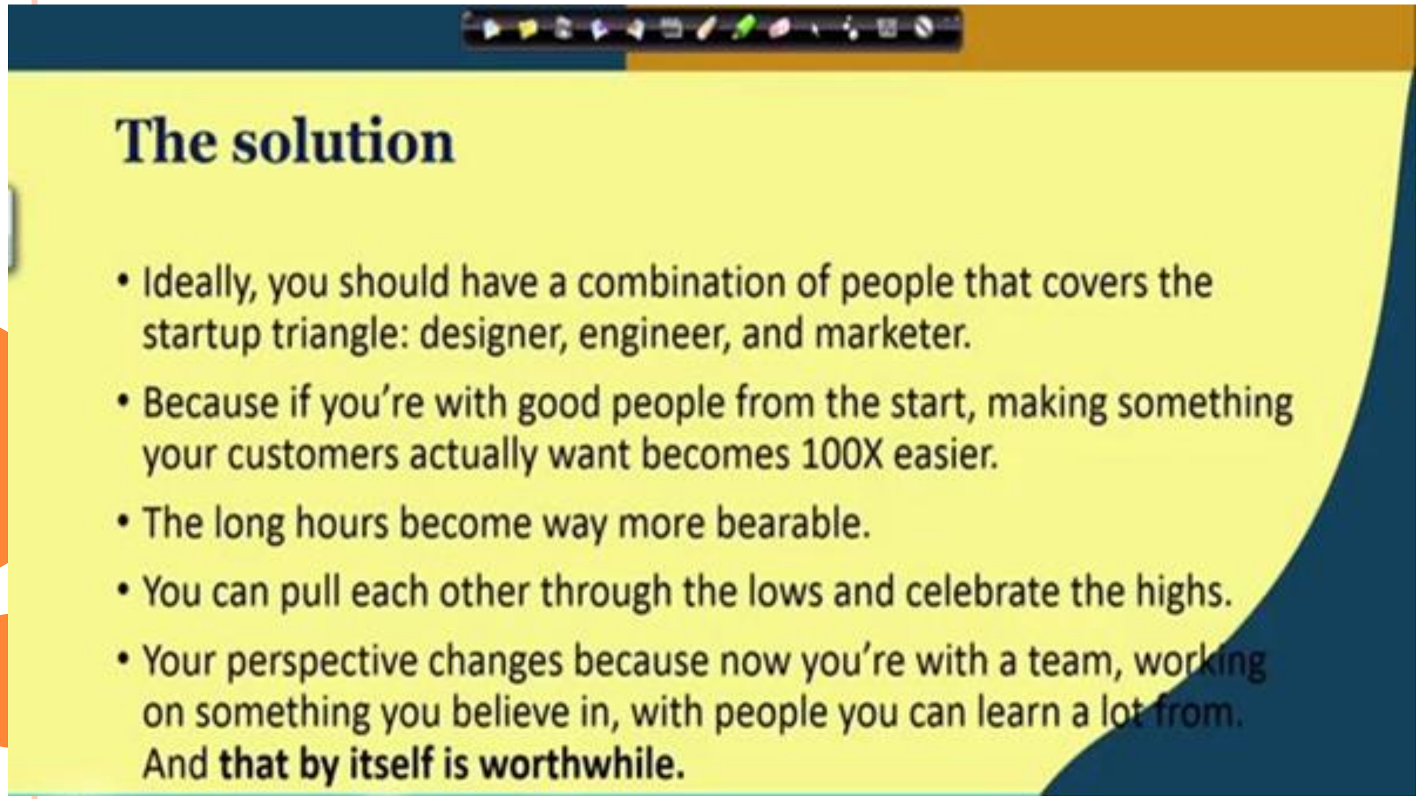

Why Startups Fail

Premature scaling

- "Premature scaling is putting the cart before the proverbial horse. The more a company grows, the further away from profitability it becomes." -Michael A. Jackson
- The problem
- This one is tricky, because it seems you're doing everything right. You're scaling, you're hiring, you're funded, you're growing.
- However, if they are not in order the impact is huge. According to the Startup Genome Project, up to 70% of startups scale up too early. They say that it affects performance of up to 90% of failed startups.
- Premature scaling basically means too much, too soon.

Why Startups Fail

The solution

- This comes down to a couple of stages with different focus.
- First: problem-solution fit. a) find a problem that is big enough, b) for enough people and c) where they will pay you to solve their problem in whatever way.
- Second: product-market fit. Creating an in-demand product that services a large enough market for your startup to grow. This means you test, validate and determine the core features, and use product feedback to build next version.
- Third: channel fit. The third phase is about lowering acquisition costs and increasing revenue so you can reach profit. This means you optimize your conversion funnel and find ways to retain more customers.
- Once you know that your cost to acquire a user will be lower than their lifetime value, you can step on the gas and scale up.

Why Startups Fail

Lack of focus

"Lack of direction, not lack of time, is the problem. We all have twenty-four hour days."-Zig Ziglar

If you find yourself doing one of the following things without knowing they're going to move the needle, STOP!

- "Coffees," whether that's with potential partners, investors or acquirers.
- Networking. Seriously...
- Recruiting a board of advisors
- Doing partnerships without proof of extra revenue
- Spending time on PR and social media before knowing you've got the right product for the right customer.

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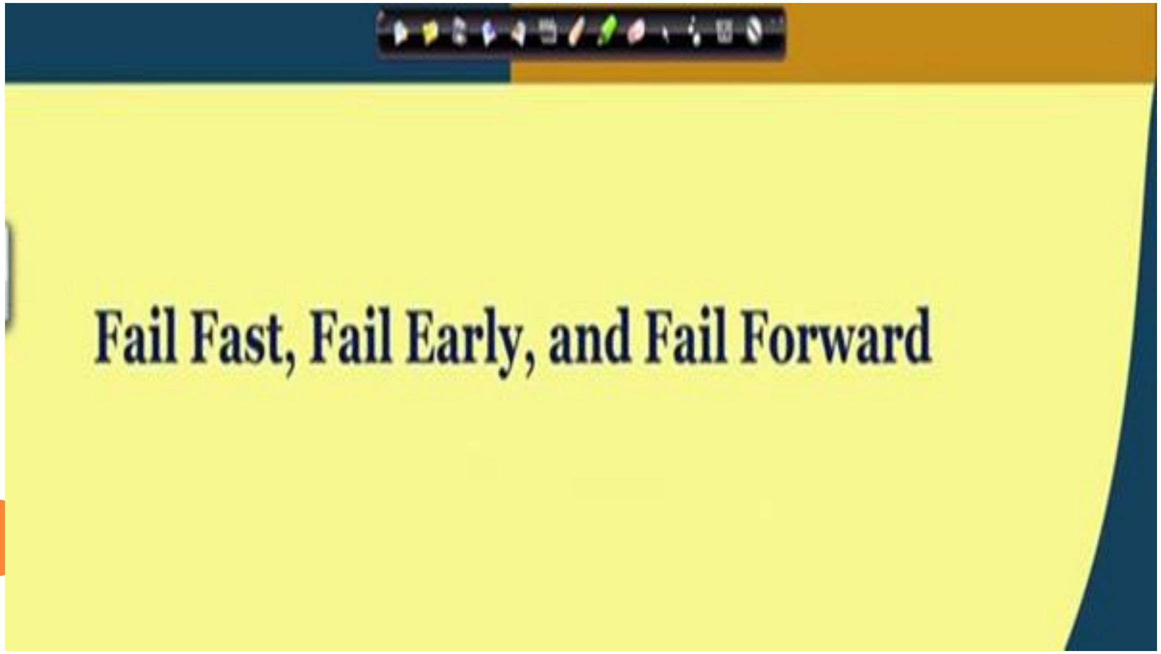

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Here Are Some Excerpts from 'The 21 Irrefutable Law Of Leadership' – John C. Maxwell

- Successful people learn to do what does not come naturally. Nothing worth achieving comes easily. The only way to fail forward and achieve your dreams is to cultivate tenacity and persistence.
- Success is in the journey, the continual process. And no matter how hard you work, you will not create the perfect plan or execute it without error. You will never get to the point that you no longer make mistakes, that you no longer fail.
- The fellow who never makes a mistake takes his orders from one who does. Wake up and realize this: Failure is simply a price we pay to achieve success.

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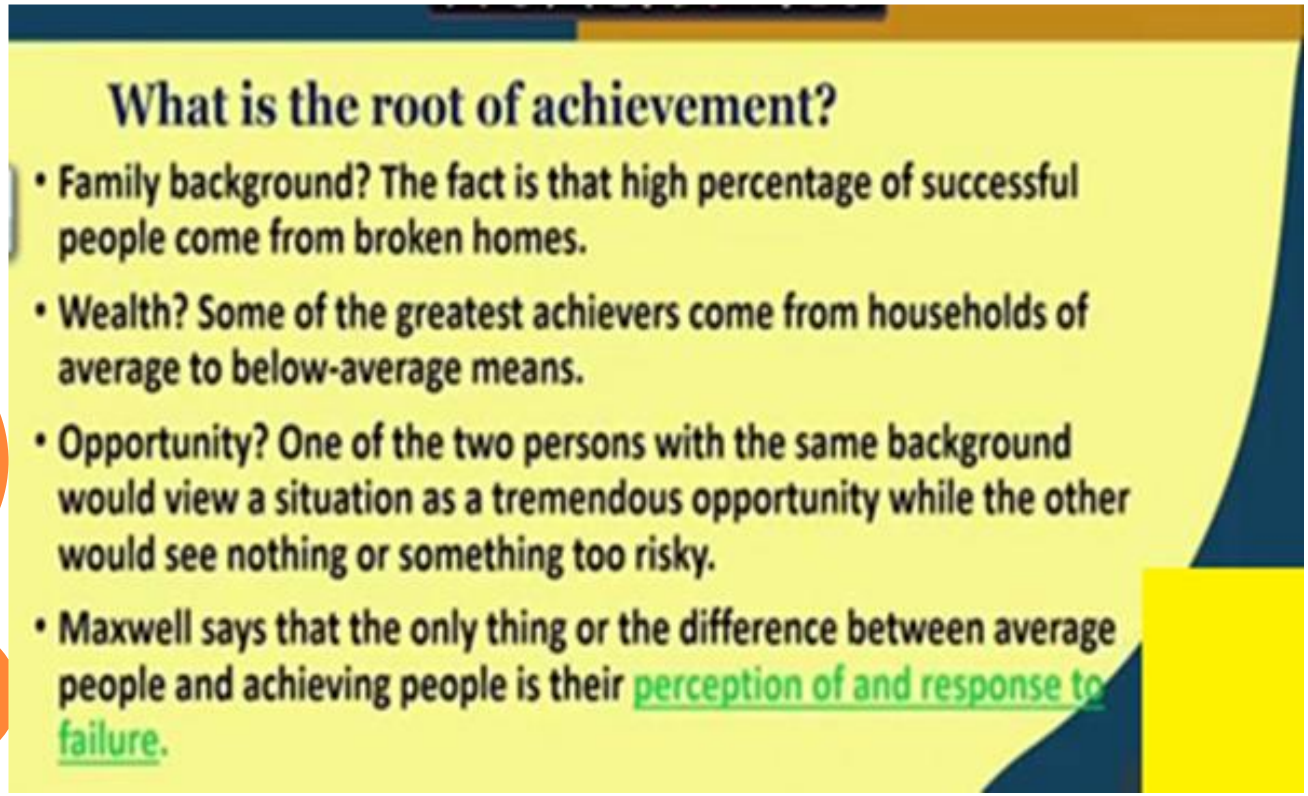

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Some Last Words

- Understand why startups fail.
- Prepare strategies to avoid the most obvious causes of failure.
- There will still be chances of failure. So do research whenever things go the way you did not expect.
- Restart with refinements or pivot with new idea.
- It is almost certain that failure is almost inescapable. But one's response to failure differentiates successful ones from the failed ones.
- Learning from failure is the best way to move forward. Failure is actually great investment provided you learn from it.
- Accept that failure is waiting there to happen and save your resources for restarting.

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