“Failure and invention are inseparable twins.”

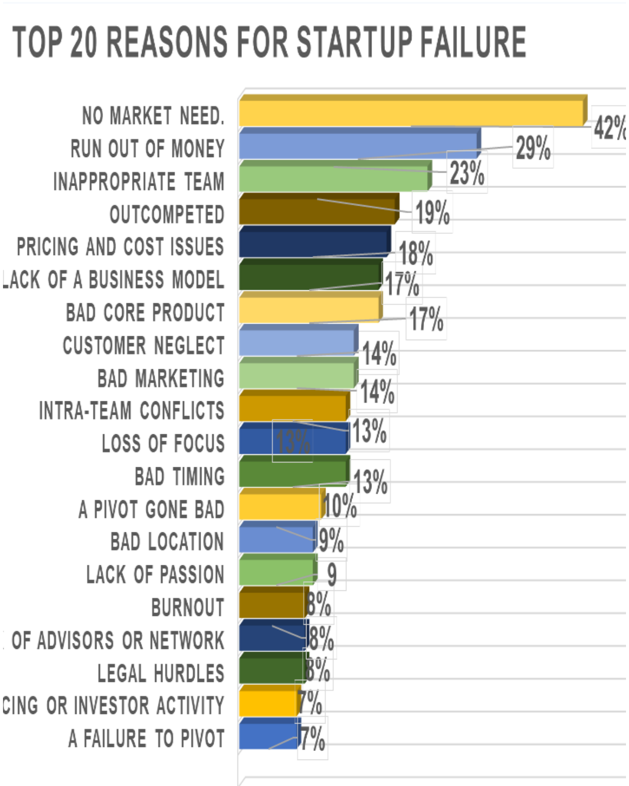
Five-minute read # 4 - Why do Startups fail? Some New Perspectives

Word of the Day: The ‘value proposition’ is a bundle of benefits that a venture offers to its customers, making their product or service preferable compared to those of competitors.

“ Nothing fails like success” - Arnold Toynbee

John C Maxwell - “Fail early, fail often, but always fail forward.” Success is not about avoiding failure. Success is achieved through learning from failures. If one achieves success without failing, chances are s/he is overly lucky. Every successful story has many failures preceding the success. Achieving success becomes more manageable if you can fail early, meaning that if failure has to happen, let it happen early so that you can save time and resources for the next attempt. Endlessly pursuing an idea is like flogging a dead horse. Fail often and learn from each failure to gain maturity. When reminded of his failures, Thomas Alva Edison famously said, “I have not failed. I’ve just found 10,000 ways that won’t work.” But the most important part of failure is to fail forward. Maxwell explains that one must learn from failure and move forward with that knowledge not to repeat the same mistake. If you stop trying again with more conviction, you really fail. On the flip side, if you are overly passionate about your idea and do not accept the reality that it would not take you anywhere, you are destined to fail forever (many refer to the TATA Nano car project in this regard). Always fail forward, not to fail for good.

Charlie Munger once said, figuratively - “All I Want to Know Is Where I’m Going to Die so I’ll Never Go There.” That puts today’s topic in the proper perspective. If we know why startups fail, we will avoid making the same mistakes and be successful. Data collated by cbinsights.com by analyzing the post-mortems of 101 failed ventures bring to light the true causes of their failure. The most significant revelation of this data is that one can avert most of these causes through appropriate pre-emptive actions. For example, 42% of the startup failures occurred because they produced and tried to sell things that nobody wanted to buy. Ideally, startups must onboard customers early on and get the idea and products validated by potential users before sinking in a lot of resources and time. The second most failures occurred due to running out of money. A more in-depth analysis of the companies failing due to this reason would reveal that majority of them neglected financial prudence. Many of them mismanaged finances, while others failed to approach investors in time primarily because they did not make a meaningful cash flow projection to know when they would run out of money. Most of these failures could have been averted by being frugal, disciplined, and planning in advance. We shall discuss some relevant real cases in the class later. Placed below is the summary of the findings by cbinsight.com for your ready reference.



Data of 2014 Source: cbinsights	Data of 2021 based on 390 filed startup post mortem Source: cbinsights

Current Example – Running Out of Cash:

With development expenses exceeding US $ 1B, and order book position of US$ 11B and partnerse such as Airbus and Lockheed Martin, the supersonic jet maker Aerion declared in May 2021"We have run out of time and have unfortunately not been able to secure funding for the company… I will never be able to forgive myself for not taking action sooner." The Aerion AS2 12-passenger aircraft aimed for Mach 1.6 with a supersonic natural laminar flow wing for a minimum projected range of 4,750 nm (8,800 km). The company went bust for not being able to raise funds in time. This type of mistakes happen because of lack of data on projected cash flow.

No Market Need

Many startups offer products or services that customers do not want. The data show that the reason for the failure of the maximum number of startups is "no market need." Many of these companies have great technologies, use many possible cutting-edge tools, put a lot of marketing efforts, have access to adequate funding and expert advisors. They lacked a business model alleviating pain in a sufficiently large market to scale the business. Founders of many ventures failing after raising a lot of funds acknowledged this fact. Many technocrats spend years perfecting technologies that they consider the best and assume that the market will have all the reasons to buy their products or services. They wrongly presume that they know the market.

The mantra to correct this mistake is to adopt the strategy of validated learning. Founders should make a minimum viable product with features that demonstrate the key value proposition, get them evaluated by customers, refine them based on feedback, and reevaluate until they are satisfied.

Team Incompatibility: One significant and frequent cause of failure is team incompatibility, disharmony, incongruence, disunity. The team must have the same passion, share the same vision, and work collectively and synchronously on the same mission. Though data show a small percentage of startups failing because of team inappropriateness, a more in-depth look at all failed companies will reveal elements of team incompatibility leading to a great deal of stress and finally pushing toward failure. Though there is no time-tested formula, strangers do not make a good team. A team of 2 to 3 (maximum four) members appears to work far better than a one-member team or teams of more than four members. A team should have members with complementary skills to fill all the knowledge gaps. Some experience in a startup in any capacity or as a profit-center head in an established company may be of great help. Persons with moral or ethical laxity must be avoided no matter what value they bring.

The 'founders' dilemma' leads to many failures. It is the unwillingness of founders to recognize their lack of skill in business process management and refusing to relinquish management control to professionals (Noam Wasserman). Starting a business is one thing; managing growth is another. It requires an entirely different set of skills that people learn through experience. Early success tends to make some founders complacent. They need to understand that success is not a goal or a destination that one may wrongly think to have achieved; success is a process or a journey that continues as long as the venture lives. You lose focus and fall over a precipice.

A wonderful Story to the Contrary: Bill Gates appointed Satya Nadella as the CEO of Microsoft in 2014 when it faced tough competition in the market and was going on the downhill. His masterstroke was shifting focus from operating system to Azure, the more lucrative cloud computing platform. He understood what the market was demanding and departed from what the company was doing best at that time. He interacted with employees, many of them one-on-one, to get a grip on the kind of talent the company has and the possibilities by them. Motivated them to adopt a collaborative culture to leverage diverse expertise instead of a know-it-all mentality that builds silos. The results are that the market value of Microsoft has gone up to US$2.20 trillion in 2021 from US$0.38 trillion in 2014. The primary takeaway is that a company must understand what the customers are crying for instead of what best you can offer. Nadella's approach to employees is an excellent example of good leadership. Good leaders identify and exploit the best out of all team members to create great values equally for the companies and the employees.

Many startups fail at growth phase, most of them well-funded, fail because they are unprepared to manage growth though they are already on growth path. The growth phase

In September 2019, augmented reality startup Daqri shut down after burning through more than $250M in funding and failing to raise a new round from investors:

demands actions that are quite different than those at early stage. The founders have to ensure necessary infrastructure, hire adequate people to handle increasing number of customers, increased volume of products, arrange required funds, make connection with suppliers and distributors, hire the right talents in time, ensure customer satisfaction and gather data to proactively understand the market. With increasing new employees comes more complex human relation management, particularly among a diverse groups of employees.

There are many stories of entrepreneurs failing many times over but finally becoming hugely successful. One common observations in many studies is that persistence is a great virtue and those who fail are more likely to be successful in their subsequent attempts.

Pepper Tap

The company was delivering groceries in two hours. Raised US$ 51.2 M, but failed because of bad business model (zero inventory, high customer acquisition cost, untenable discount – at times, 70%) and folded in 2016. **Zepto** run the same business model, promises to deliver in ten minutes, and have gained valuation of more than $500 M in about six months. Difference? Execution. Read the business model of both the companies to learn the difference of the two business models.

Most of the successful entrepreneurs believe that the progress you are likely to make is worth the pain of failures because you will learn from every failure to not commit the same ever again.

References

Failing Forward - John C. Maxwell, HarperCollins Focus, 2007.

Fail Fast, Fail Often: How Losing Can Help You - Ryan Babineaux & John Krumboltz, Penguin, 2013

https://www.cbinsights.com/research/startup-failure-reasons-top/

The Founder’s Dilemma by Noam Wasserman, HBP, 2008