



Entrepreneurship

Why Start-ups Fail

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ENTREPRENEURSHIP

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It's not
always
the
horse
or the
jockey.



PHOTOGRAPHER
KALLE GUSTAFSSON



Most start-ups don't succeed:

More than two-thirds of them never deliver a positive return to investors. But *why* do so many end disappointingly? That question hit me with full force several years ago when I realized I couldn't answer it.

That was unnerving. For the past 24 years, I've been a professor at Harvard Business School, where I've led the team teaching *The Entrepreneurial Manager*, a required course for all our MBAs. At HBS I've also drawn on my research, my experiences as an angel investor, and my work on start-up boards to help create 14 electives on every aspect of launching a new venture. But could I truly teach students how to build winning start-ups if I wasn't sure why so many were failing?

I became determined to get to the bottom of the question. I interviewed or surveyed hundreds of founders and investors, read scores of first- and third-person published accounts of entrepreneurial setbacks, and wrote and taught more than 20 case studies about unsuccessful ventures. The result of my research is a book, *Why Startups Fail*, in which I

identify recurring patterns that explain why a large number of start-ups come to nothing.

My findings go against the pat assumptions of many venture capital investors. If you ask them why start-ups fall short, you will most likely hear about “horses” (that is, the opportunities start-ups are targeting) and “jockeys” (the founders). Both are important, but if forced to choose, most VCs would favor an able founder over an attractive opportunity. Consequently, when asked to explain why a promising new venture eventually stumbled, most are inclined to cite the inadequacies of its founders—in particular, their lack of grit, industry acumen, or leadership ability.

Putting the blame on the founders oversimplifies a complex situation. It's also an example of what psychologists call the *fundamental attribution error*—the tendency for observers, when explaining outcomes, to emphasize the main actors' disposition and for the main actors to cite situational factors not under their control—for example, in the case of a failed start-up, a rival's irrational moves.

Putting scapegoating aside, I identified six patterns of failure, which I describe fully in my book. In this article I've chosen to focus on two of them in greater detail, for two reasons: First, they're the most common *avoidable* reasons why start-ups go wrong. I'm not interested in clearly doomed ventures with no chance of success or even promising start-ups that were felled by unexpected external forces such as the Covid-19 pandemic. Rather, I've focused on ventures that initially showed promise but subsequently crashed to earth because of errors that could have been averted. Second, the two patterns are the most applicable to people launching new ventures within larger companies, government agencies, and nonprofits, which makes them especially relevant to HBR readers. Below, I'll explain each pattern more fully, illustrate it with a case study, explain when it's most likely to occur, and suggest ways to steer clear of it. (To learn more about the other common reasons for failure, see the sidebar “Four Other Patterns That Doom Start-ups.”)

Good Idea, Bad Bedfellows

As I've noted, VCs look for founders with the right stuff: resilience, passion, experience leading start-up teams, and so forth. But even when such rare talent captains a new venture,



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there are other parties whose contributions are crucial to it. A broad set of stakeholders, including employees, strategic partners, and investors, all can play a role in a venture's downfall.

Indeed, a great jockey isn't even necessary for start-up success. Other members of the senior management team can compensate for a founder's shortcomings, and seasoned investors and advisers can likewise provide guidance and useful connections. A new venture pursuing an amazing opportunity will typically attract such contributors—even if its founder doesn't walk on water. But if its idea is merely good, a start-up may not become a talent magnet.

Consider the case of Quincy Apparel. In May 2011 two former students of mine, Alexandra Nelson and Christina Wallace, came to me for feedback on their start-up concept. I admired both of them and was impressed with their idea, which identified an unmet customer need: Young professional women had a hard time finding affordable and stylish work apparel that fit them well. Nelson and Wallace, who were close friends, devised a novel solution: a sizing scheme that allowed customers to specify four separate garment measurements (such as waist-to-hip ratio and bra size)—akin to the approach used for tailoring men's suits.

Following the lean start-up method, Nelson and Wallace then validated customer demand using a textbook-perfect minimum viable product, or MVP—that is, the simplest possible offering that yields reliable customer feedback. They held six trunk shows at which women could try on sample outfits and place orders. Of the 200 women who attended, 25% made purchases. Buoyed by these results, the cofounders quit their consulting jobs, raised \$950,000 in venture capital, recruited a team, and launched Quincy Apparel.

They employed a direct-to-consumer business model, selling online rather than through brick-and-mortar stores. At this point I became an early angel investor in the company.

Initial orders were strong, as were reorders: An impressive 39% of customers who bought items from Quincy's first seasonal collection made repeat purchases. However, robust demand required heavy investment in inventory. Meanwhile, production problems caused garments to fit poorly on some customers, resulting in higher-than-expected returns. Processing returns and correcting production problems put pressure on margins, rapidly depleting Quincy's cash reserves. After Quincy tried and failed to raise more capital, the team trimmed the product line, aiming to simplify operations and realize efficiencies. However, the business lacked enough funding to prove out the pivot, and Quincy was forced to shut down less than a year after its launch.

So why did Quincy fail?

Quincy's founders had a good idea. The venture's value proposition was appealing to target customers, and the business had a sound formula for earning a profit—at least over the long term, after shaking out the bugs in production. The team had credible projections that customers in priority segments, who'd accounted for more than half of Quincy's sales, would each have a lifetime value of over \$1,000—well in excess of the \$100 average cost to acquire a new customer. (Quincy's out-of-pocket marketing costs were kept low by social-network-fueled word of mouth and enthusiastic media coverage.)

Were Wallace and Nelson simply poor jockeys? Temperamentally, their fit with the founder role was good. They were sharp and resourceful and had complementary strengths.

IDEA IN BRIEF

THE LIGHT BULB

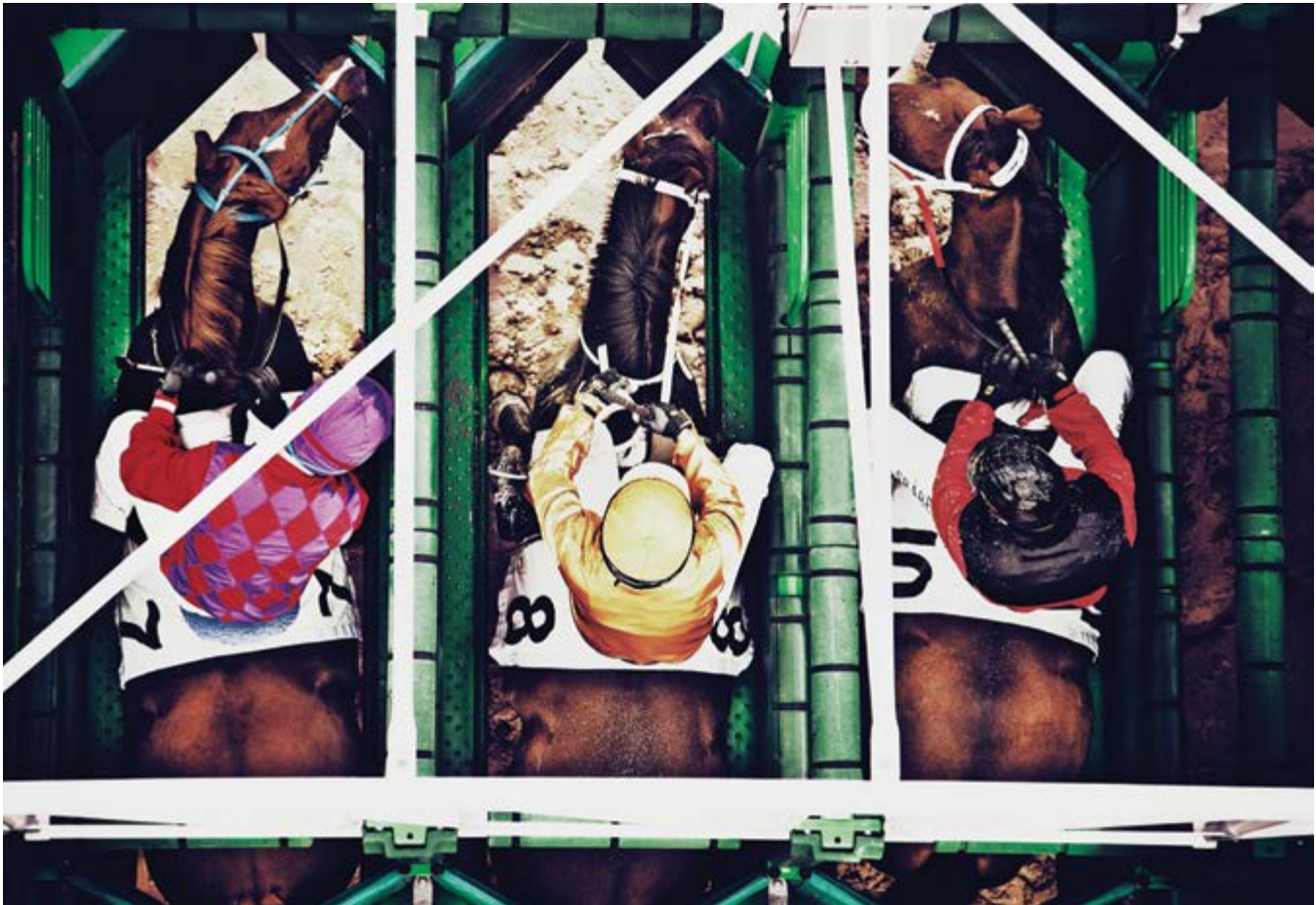
Most start-ups don't succeed. A foremost expert on entrepreneurship realized he didn't understand why.

THE AUTOPSY

An examination of start-up failures revealed two common mistakes by founders: failing to engage the right stakeholders, and rushing into an opportunity without testing the waters first.

THE REMEDY

Founders should take conventional entrepreneurial advice with a grain of salt, because it often backfires. They also should find the right investors and management team and avoid giving short shrift to customer interviews and research.



Wallace, who was responsible for marketing and fundraising, had a big vision and the charisma to sell it. Nelson, who led operations, was deliberate and disciplined. However, the founder team wobbled in two important ways. First, unwilling to strain their close friendship, Wallace and Nelson shared decision-making authority equally with respect to strategy, product design, and other key choices. This slowed their responses when action was required. Second, neither founder had experience with clothing design and manufacturing.

Apparel production entails many specialized tasks, such as fabric sourcing, pattern making, and quality control. To compensate for their lack of industry know-how, the founders hired a few apparel company veterans, assuming

that they'd fill multiple functions—as jack-of-all-trades team members do in most early-stage start-ups. However, accustomed to the high levels of specialization in mature apparel companies, Quincy's employees weren't flexible about tackling tasks outside their areas of expertise.

Quincy outsourced manufacturing to third-party factories, which was not unusual in the industry. But the factories were slow to meet production commitments for entrepreneurs who had no industry reputation, required unusual garment sizing, and placed small orders. This meant shipping delays for Quincy.

Investors also played a role in Quincy's demise. The founders had aimed to raise \$1.5 million but managed to

Trunk Archive



Many entrepreneurs who claim to embrace the lean start-up canon actually adopt only part of it, neglecting to research customer needs.

secure only \$950,000. That was enough to fund operations for two seasonal collections. Before launching, the founders had correctly assumed that at least three seasons would be needed to fine-tune operations. Quincy had some traction after two seasons but not enough to lure new backers, and the venture capital firms that had provided most of its money were too small to commit more funds. Furthermore, the founders were disappointed with the guidance they got from those VCs, who pressured them to grow at full tilt—like the technology start-ups the investors were more familiar with. Doing so forced Quincy to build inventory, burning through cash before it had resolved its production problems.

In summary, Quincy had a good idea but *bad bedfellows*: Besides the founders, a range of resource providers were culpable in the venture's collapse, including team members, manufacturing partners, and investors.

Could this outcome have been avoided? Perhaps. The founders' lack of fashion industry experience was at the root of many problems. It took time for Wallace and Nelson to master the complexities of apparel design and production. Without industry connections, they couldn't leverage their professional networks to recruit team members or count on past relationships with factory managers to ensure prompt delivery. And without an industry track record, they had difficulty finding investors willing to bet on first-time founders.

An ideal solution would have been to bring in another cofounder with apparel industry experience. Nelson and Wallace tried to do this, without success. They did have some advisers who could offer guidance—but adding more would have helped. In a postmortem analysis, Quincy's founders also concluded that they could have sidestepped operational problems by outsourcing their entire design and production process to a single factory partner. Likewise, rather than raising funds from venture capital firms, they could have sought financial backing from a clothing factory. A factory with an equity stake in Quincy would have expedited its orders and worked harder to correct production problems. Also, the factory owners would have known how to pace the growth of a new apparel line, in contrast to Quincy's VCs, who pressured the team for hypergrowth.

Quincy's troubles shed some light on the attributes that may make start-ups vulnerable to this particular failure pattern. Entrepreneurs' lack of industry experience will be

especially problematic when large, lumpy resource commitments are required, as they are in apparel manufacturing: Quincy's founders had to design a multistep product process from scratch, and revising such a process is disruptive once it's in place. Another factor was ever-shifting fashion trends; the founders had to commit to garment designs and then build inventory for an entire collection many months before it went on sale.

With such challenges, learning by doing can result in expensive mistakes. Compounding the pressure, investors prefer to mete out capital one chunk at a time, waiting to see if the business can stay on the rails. If the start-up stumbles or stalls, follow-on financing may not be forthcoming from existing investors, and potential new investors will be scared off. Pivoting to a better solution isn't feasible when it requires large amounts of capital along with weeks or months to see if new approaches are working. In that situation entrepreneurs have no room for big errors, but a lack of industry experience makes missteps all the more likely.

False Starts

I have long been an apostle of the lean start-up approach. But as I dug deeper into case studies of failure, I concluded that its practices were falling short of their promise. Many entrepreneurs who claim to embrace the lean start-up canon actually adopt only part of it. Specifically, they launch MVPs and iterate on them after getting feedback. By putting an MVP out there and testing how customers respond, founders are supposed to avoid squandering time and money building and marketing a product that no one wants.

Yet by neglecting to research customer needs *before* commencing their engineering efforts, entrepreneurs end up wasting valuable time and capital on MVPs that are likely to miss their mark. These are *false starts*. The entrepreneurs are like sprinters who jump the gun: They're too eager to get a product out there. The rhetoric of the lean start-up movement—for example, “launch early and often” and “fail fast”—actually encourages this “ready, fire, aim” behavior.

The online dating start-up Triangulate experienced this syndrome in 2010. Its founder, Sunil Nagaraj, had originally intended to build a matching engine—software that Triangulate would license to existing dating sites such as eHarmony



and Match. The engine would automatically extract consumers' profile data—with their permission—from social networks and media sites such as Facebook, Twitter, Spotify, and Netflix. The engine would then use algorithms to pair up users whose tastes and habits suggested that they might be romantically compatible. But VCs wouldn't back the plan. They told Nagaraj, "Come back after you've signed a licensing deal."

To prove to potential licensees that the matching engine worked, Nagaraj decided to use it to power Triangulate's own dating site, a Facebook app that would also leverage the rich user data available to Facebook's platform partners. VCs now showed interest: Nagaraj raised \$750,000 and launched a dating site called Wings. The site was free to use and earned revenue from small payments made by users who sent digital gifts or messages. Wings soon became Triangulate's main event; the licensing plan went on the back burner.

Wings automatically populated a user's profile by connecting to Facebook and other online services. It also encouraged users to invite their friends to the site as "wingmen" who could vouch for them—and provide a viral boost to the site's growth. Less than a year after launching Wings, however, Nagaraj's team abandoned both the matching engine and the wingman concept. Users found more value in recommended matches that were based on potential partners' physical attractiveness, proximity, and responsiveness to messages—criteria routinely employed by existing dating sites. The wingman role, meanwhile, was not delivering hoped-for virality and made the site cumbersome to navigate. Furthermore, many users were uncomfortable making their dating life an open book to their friends.

A year after launch, Wings' user base was growing, but user engagement was much lower than expected. As a result, revenue per user fell far short of Nagaraj's original projections. Also, with limited virality, the cost of acquiring a new user was much higher than his forecast. With an unsustainable business model, Nagaraj and his team had to pivot once again—this time, with cash balances running low. They launched a new dating site, DateBuzz, that allowed users to vote on elements of other users' profiles—before seeing their photos. This addressed one of the biggest pain points in online dating: the impact of photos on messaging. On a typical dating site, physically attractive individuals get

FOUR OTHER PATTERNS THAT DOOM START-UPS

False positives. Early-stage entrepreneurs often misinterpret signals about market demand. Beguiled by an enthusiastic response from initial adopters, they expand rapidly. But if mainstream customers have needs that differ from those of the first customers, the start-up may have to reengineer its product and reeducate the market. Those efforts can be costly and consume scarce capital, boosting the odds of failure.

Speed traps. In this pattern a venture discovers an attractive opportunity and initially grows rapidly. That lures investors who pay a high price for equity and push for more expansion. The start-up eventually saturates its original target market, so growth then requires broadening its customer base to new segments. Its next wave of customers, however, don't find its value proposition nearly as compelling as the first adopters did. To keep growing, the firm must spend heavily on customer acquisition. Meanwhile, the start-up's rapid growth attracts rivals that cut prices and pour money into promotions. At some point new customers begin to cost more to acquire than they're worth. As the venture burns through cash, investors become reluctant to commit more capital.

Help wanted. Start-ups that experience this pattern manage to sustain product-market fit while adding legions of new customers, but they stumble because of shortfalls in funding or their senior management team or both. Sometimes an entire industry suddenly falls out of favor with venture capitalists, as cleantech did in the late 2000s. If a funding dry spell begins just as a fast-growing start-up is trying to raise a new round, the venture may not survive. Start-ups that are scaling up also need senior executives with deep functional expertise who can manage bigger pools of employees in engineering, marketing, finance, and operations. Delays in hiring those executives or the recruitment of the wrong people can lead to strategic drift, spiraling costs, and a dysfunctional culture.

Cascading miracles. Entrepreneurs who pursue an incredibly ambitious vision face multiple challenges, such as persuading a critical mass of customers to fundamentally change their behavior; mastering new technologies; partnering with powerful corporations that have prospered from the status quo; securing regulatory relief or other government support; and raising vast amounts of capital. Each challenge is a "do or die" proposition: Missing the mark on any will doom the venture. Assuming there's a 50% chance of a good outcome for any given challenge, the probability of getting five out of five good outcomes is the same as the odds of picking the winning number in roulette: 3%.



Entrepreneurs should conduct a competitive analysis, including user testing of existing solutions, to understand the strengths and shortcomings of rival products.

too many messages, and other users get too few. DateBuzz redistributed attention in ways that boosted user satisfaction. Less-attractive individuals were contacted more often, and attractive users still got plenty of queries.

Despite this innovation, DateBuzz—like Wings—had to spend far more than it could afford to acquire each new user. Lacking confidence that a network effect would kick in and reduce customer acquisition costs before cash balances were exhausted, Nagaraj shut down Triangulate and returned \$120,000 to investors.

So why did Triangulate fail?

The problem was clearly not with the jockey or his bedfellows. Nagaraj had raised funds from a topflight VC and had recruited a very able team—one that could rapidly process user feedback and in response iterate in a creative and nimble manner. Weak founders rarely attract strong teams and smart money. This was not a case of “right opportunity, wrong resources,” as with Quincy’s failure. Rather, Triangulate’s demise followed the opposite pattern: “wrong opportunity, right resources.”

A clue about the cause of Triangulate’s failure lies in its three big pivots in less than two years. On one hand, pivots are foundational for lean start-ups. With each iteration, Nagaraj’s team had heeded the “fail fast” mantra. The team also followed the principle of launching early and often—putting a real product into the hands of real customers as fast as possible.

But there’s more to the lean start-up approach than those practices. Before entrepreneurs begin to build a product, lean start-up guru Steve Blank insists, they must complete a phase called “customer discovery”—a round of interviews with prospective customers. (See “Why the Lean Start-up Changes Everything,” HBR, May 2013.) Those interviews probe for strong, unmet customer needs—problems worth pursuing. In Nagaraj’s postmortem analysis of Triangulate’s failure, he acknowledged skipping this crucial step. He and his team failed to conduct up-front research to validate the demand for a matching engine or the appeal of the wingman concept. Nor did they conduct MVP tests akin to Quincy’s trunk shows. Instead they rushed to launch Wings as a fully functional product.

By giving short shrift to customer discovery and MVPs, Triangulate’s team fell victim to a false start—and turned the

“fail fast” mantra into a self-fulfilling prophecy. If the team members had spoken to customers at the outset or tested a true MVP, they could have designed their first product in ways that conformed more closely to market needs. By failing with their first product, they wasted a feedback cycle, and time is an early-stage entrepreneur’s most precious resource. With the clock ticking, one wasted cycle means one less opportunity to pivot before money runs out.

Why do founders like Nagaraj skip up-front customer research? Entrepreneurs have a bias for action; they’re eager to get started. And engineers love to build things. So entrepreneurs who are engineers—like Nagaraj and his teammates—often jump into creating the first version of their product as fast as they can. Furthermore, at the risk of stereotyping, I’d offer that many engineers are simply too introverted to follow Blank’s advice and get out of the building to learn from prospective customers.

Founders without technical training also fall victim to false starts. They hear repeatedly that having a great product is crucial, so they bring engineers on board as soon as they can. Then, feeling pressure to keep those expensive engineers busy, they rush their product into development.

The good news is that false starts can easily be avoided by following a structured, three-step product design process.

1

Problem definition. Before commencing engineering work, entrepreneurs should conduct rigorous interviews with potential customers—at which they resist the temptation to pitch their solutions. Feedback on possible solutions will come later; instead the focus should be on defining customers’ problems. Also, it’s important to interview both likely early adopters and “mainstream” prospects who may be inclined to purchase later. Success will hinge on attracting both groups, whose needs may differ. If their needs do vary, entrepreneurs will have to take the differences into account when formulating a product road map.

In addition, entrepreneurs should conduct a competitive analysis, including user testing of existing solutions, to understand the strengths and shortcomings of rival products. Likewise, surveys can help start-up teams measure customer behaviors and attitudes—helpful data when segmenting and sizing the potential market.



The behaviors that conventional wisdom holds make a great entrepreneur can paradoxically increase the risk of failure.

2

Solution development. Once entrepreneurs have identified priority customer segments and gained a deep understanding of their unmet needs, the team's next step should be brainstorming a range of solutions. The team should prototype several concepts and get feedback on them through one-on-one sessions with potential customers. Most teams start with crude prototypes, reject some and iterate, and then refine the ones that seem promising, gradually producing “higher fidelity” versions that more closely resemble the future product in functionality and look and feel. Prototype iteration and testing continue until a dominant design emerges.

3

Solution validation. To evaluate demand for the favored solution, the team then runs a series of MVP tests. Unlike the prototype review sessions during step 2—conducted across the table with a single reviewer—an MVP test puts an actual product in the hands of real customers in a real-world setting to see how they respond. To avoid waste, the best MVPs have the lowest fidelity needed to get reliable input—that is, they provide no more “looks like” polish and “works like” functionality than are strictly necessary. Early MVP tests may take things further, assessing demand for a planned product through a Kickstarter campaign or by soliciting letters of intent to purchase from business-to-business customers.

Success with the product design process may require a shift in the founders' mindset. At a venture's outset many entrepreneurs have a preconceived notion of the customer problems they'll address and the solutions. They may fervently believe they're on the right path. But during the product design process, they should avoid being too emotionally attached to a specific problem-solution pairing. Entrepreneurs should stay open to the possibility that the process will uncover more-pressing problems or better solutions.

Maintaining Balance

Of course, there is no way for founders to know which deadly trap they may face as they launch. Familiarizing oneself with these two dominant failure patterns can help. But so too can understanding why they afflict start-ups so frequently.

Part of the answer is that the behaviors that conventional wisdom holds make a great entrepreneur can paradoxically increase the risk of encountering these failure patterns. It's important for an entrepreneur to maintain balance. Guidance based on conventional wisdom is good—most of the time—but it shouldn't be followed blindly. Consider the following advice given to many first-time founders and how it can backfire:

Just do it! Great entrepreneurs make things happen and move fast to capture opportunity. But a bias for action can tempt an entrepreneur to truncate exploration and leap too soon into building and selling a product, as I've explained. When that happens, founders may find themselves locked prematurely into a flawed solution.

Be persistent! Entrepreneurs encounter setbacks over and over. True entrepreneurs dust themselves off and go back at it; they must be determined and resilient. However, if persistence turns into stubbornness, founders may have difficulty recognizing a false start for what it is. They likewise may be reluctant to pivot when it should be clear that their solution isn't working. Delaying a pivot eats up scarce capital, shortening a venture's runway.

Bring passion! A burning desire to have a world-changing impact can power entrepreneurs through the most daunting challenges. It can also attract employees, investors, and partners who'll help make their dreams a reality. But in the extreme, passion can translate into overconfidence—and a penchant to skip critical up-front research. Likewise, passion can blind entrepreneurs to the fact that their product isn't meeting customer needs.

Bootstrap! Because resources are limited, entrepreneurs must conserve them by being frugal and figuring out clever ways to make do with less. True enough, but if a start-up cannot consistently deliver on its value proposition because its team lacks crucial skills, its founders must decide whether to hire employees with those skills. If those candidates demand high compensation, a scrappy, frugal founder might say, “We'll just have to do without them”—and risk being stuck with bad bedfellows.

Grow! Rapid growth attracts investors and talent and gives a team a great morale boost. This may tempt founders to curtail customer research and prematurely launch their product. Also, fast growth can put heavy




demands on team members and partners. If a team has bad bedfellows, growth may exacerbate quality problems and depress profit margins.

IT'S FASHIONABLE IN start-up circles to speak glibly about failure as a badge of honor or a rite of passage—just another phase of an entrepreneur's journey. Perhaps doing so is a coping mechanism, or perhaps failure's ubiquity inures those in the business world to its true human and economic costs. I've counseled dozens of entrepreneurs as they shut down their ventures. Raw emotions are always on display: anger, guilt, sadness, shame, and resentment. In some cases the founders were in denial; others just seemed depressed. Who could blame them, after having had their dreams dashed and their self-confidence shattered? In my work I try to help people come to terms with failure, but I can tell you that at ground zero, there's no way to avoid the fact that it hurts. It also can destroy relationships. When they founded Quincy Apparel, Nelson and Wallace vowed not to let conflict over the business threaten their close friendship. But after clashing over how to wind the company down, they weren't

on speaking terms for two years. (Their relationship has since been repaired.)

Failure also takes a toll on the economy and society. A doomed venture ties up resources that could be put to better use. And it acts as a deterrent to would-be entrepreneurs who are more risk-averse, have financial obligations that make it hard to forgo a paycheck, or face barriers when raising capital—which is to say, many women and minorities. To be sure, failure will (and should) always be a reality for many entrepreneurs. Doing something new with limited resources is inherently risky. But by recognizing that many failures are avoidable and follow the same trajectory, we can reduce their number and frequency. The payoff will be a more productive, more diverse, and less bruising entrepreneurial economy. ©

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