Lessons from Entrepreneurial Failure

OVERVIEW

The majority of startups fail. Common patterns for failure of early-stage startups include getting the opportunity right but having the wrong resources to exploit the opportunity; having the right resources but the wrong opportunity; and having the right product and resources for early adopters but not for a larger pool of customers. For each of these patterns, there are actions that entrepreneurs can take to try to address the reasons for failure and improve the chances of success.

5 KEY TAKEAWAYS

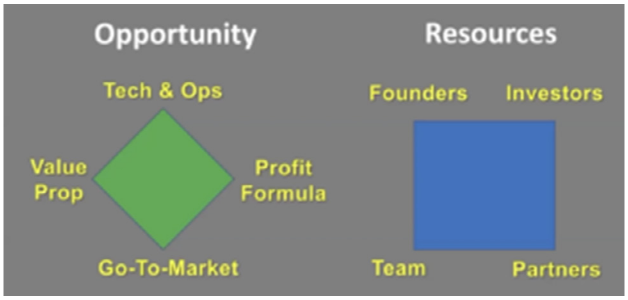
1. Entrepreneurial failure is not well understood.

While approximately two thirds of startups fail, there has been little study of the precise reasons why most startups fail. Statements such as, "they ran out of cash," or use of the jockey/horse metaphor, are overly simplistic and not helpful.

2. How HBS teaches entrepreneurship is a helpful framework for thinking about failures.

HBS's definition of entrepreneurship (per Howard Stevenson) is: Pursuing novel opportunity while lacking resources.

The Diamond & Square Framework, shown here, focuses on opportunity and resources.



- **Opportunity:** The four elements are the customer value proposition, the technology and operations to deliver the product/service, going to market to acquire customers, and the profit formula for making money.
- **Resources:** The four elements are the founders, the rest of the team, outside investors, and strategic partners.

Pro tip: The Diamond & Square Framework provides entrepreneurs a helpful tool for assessing their opportunity and resources; it is also useful in conducting postmortems on failures.

3. Early-stage failures follow three common patterns.

Tom Eisenmann's research led him to identify three common patterns for failure of startups.

Pattern #1: Good Idea, Bad Bedfellows
Right opportunity, wrong resources to exploit the opportunity

Example: Quincy—Stylish, affordable, better fitting professional apparel for young women. The founders did textbook-perfect MVP testing that proved they had found a compelling value proposition. The initial launch went well and sales were strong. Customer lifetime value was high and customer acquisition costs were low. Everything about the opportunity was positive.

But the founders lacked domain expertise and there was conflict among the co-CEOs. The investors didn't add value, weren't supportive, imposed extreme pressure to grow, and failed to provide bridge funding. Employees had an attitude of "not my job" and the manufacturing partners provided indifferent services based on low volume.

To avoid this outcome the founders could have better understood the apparel production process; found advisors and investors with more domain expertise; looked for investors other than traditional VCs, including apparel factories; and recruited for both skill and attitude.

Pattern #2: False Start
Wrong opportunity, despite right resources

Example: Triangulate—This founder raised $750k for a dating site matching people using online behavioral data. The company had a strong team, a supportive VC, and a good partnership with Facebook.

But, despite multiple pivots, the company was unable to find a value proposition, a go-to-market strategy, or a profit formula that worked. The founder didn't do enough proper MVP testing of the concept and fell into the trap of building before thoroughly understanding the market and the customer. The company adopted the lean startup mantra of launch early, fail fast, and iterate. This company would have fared better by doing more and deeper customer research before building and launching.

Pattern #3: False Positive

Right product but wrong customers; early adopters didn't represent the mainstream

Example: Baroo—The idea was to offer dog walking and pet care service through luxury apartment buildings. Instead of contractors, the company hired employees, aiming for loyalty and productivity. The founder's original plan was to raise $1.2M from patient angels, prove the concept in one market, and use profits to slowly expand, avoiding venture capital and hypergrowth expectations.

The first target was a new building in Boston's trendy South End. Among tenants, 60% had pets and 70% used Baroo. The company had landed a big whale. Inspired by this immediate success, the founder abandoned her plans, raised venture capital, and expanded to other cities.

It turns out, the experience of that first new building in Boston was not representative and the opportunity didn't work. Tenants in existing buildings already had dog walkers/pet services, which made acquiring customers harder and slower. The profit formula didn't work and the company—while expanding rapidly—was bleeding money. There were also issues on the resources side: employee turnover was higher and productivity was lower than expected, the patient investors were no longer patient, and the angels didn't have the resources to provide additional capital.

This false positive came from focusing too much on success with the first building, whose behavior was different from elsewhere. The company would have increased its chances of success by researching both early adopter and mainstream customers.

4. Data exists to predict which elements are likely to produce value for a startup.

Eisenmann surveyed founders/CEOs at 470 startups and asked whether the company's valuation had increased or decreased since receiving seed capital. Using this data, it is possible to see predictors of low valuations, including:

- Raising < 75% of the funding amount targeted
- Frequent, intense conflicts with investors
- Lack of industry experience, clarity on roles, and structured HR processes
- Zero months of research and no MVP testing

5. There can be good failures.

At times, failure can result from factors that couldn't be predicted or were out of the team's control. In the mid-2000s, clean tech companies were predicated on fossil fuel prices going up. Then, fracking happened and prices went down. It is hard to blame a management team for reasonable assumptions that didn't pan out. Good failures can also occur when a company fails but when there is knowledge gained or spillover effects that benefit society in some way.

A good failure can also occur when a founder or team can see the inevitable outcome and decides to pull the plug to preserve cash, relationships, and reputations. The founders can learn, heal, and rebound.

Finally, a well-designed experiment that refutes a hypothesis about an opportunity—one that does so with rigor and without wasting time or resources—is a good failure.

ADDITIONAL RESOURCES

- "Why Startups Fail: A New Roadmap for Entrepreneurial Success" by Tom Eisenmann

Tom Eisenmann is the Howard H. Stevenson Professor of Business Administration at the Harvard Business School, Peter O. Crisp faculty chair of the Harvard Innovation Labs, faculty co-chair of the HBS Rock Center for Entrepreneurship, and faculty co-chair of the Harvard MS/MBA: Engineering Sciences Program. Eisenmann teaches the MBA elective course Entrepreneurial Failure and the MS/MBA core courses, Technology Venture Immersion and Launch Lab. In recent years, Eisenmann has served as chair of Harvard's MBA Elective Curriculum—the second year of the MBA Program—and as course head of The Entrepreneurial Manager, taught to all 900 first-year MBA students. With colleagues, he has designed and delivered fourteen MBA electives focused on entrepreneurship, including PM101, Launching Tech Ventures, Scaling Tech Ventures, and Entrepreneurial Sales & Marketing.

Eisenmann received his Doctorate in Business Administration ('98), MBA ('83), and BA ('79) from Harvard University. Prior to entering the HBS Doctoral Program, Eisenmann spent 11 years as a management consultant at McKinsey & Company, where he was co-head of the media and entertainment practice.