

New Venture Failure Survey

This is a survey about failure. I have been working on a framework that tries to learn from new venture failure for the past 3 years. The need for the framework and the myths arose when I realized it was difficult for me to retain an objective point of view when my ventures were dying or in trouble. Instead of using just in time diagnostics or trouble shooting which made things worse, it would have helped if there was a list of common diseases, symptoms and cures that I could refer to figure out what had gone wrong and what I need to do to fix it. The accompanying write up gives a very brief introduction to the framework and then follows up with some simple questions. The objective of this survey is to validate the framework and generate as many real life examples as possible from survey participants.

Instructions:

- 1) Please read the four page write up on a framework for top ten myths behind new venture failure carefully
- 2) Please take as much space and time as you need to answer venture specific and framework specific questions. On average you may need 15 – 20 minutes to read the framework and another 30 minutes to answer questions
- 3) When quoting an example, please indicate the type of failure (Type I, Type II, Type III, details discussed in the attached writeup), if material from the example should not be used in a published or distributed form of an article using on the above mentioned framework and this survey. If this is the case, please indicate if the instance could be used if names, locations and references are changed.
- 4) Please return the survey to the jawwad@avicena.com within 4 weeks of receiving it. If you need any clarification or have questions about the intent and usage of this information, please feel free to email Jawwad at the email address above or give him a call on +9221 4802037
- 5) I value and appreciate the time you are taking out to answer these questions. I hope they will help me better understand failure and allow me to share these lessons with entrepreneurs, founders and students who will put them to good use.
- 6) Since this is still an unpublished exercise, I would request that the material is **not cited or quoted** without prior permission from the author

Introduction

Ideas for a new venture start with a moment of blinding insight. Some start as accidents or unintentional mistakes, others take years of wandering effort to gel the real concept into shape. Regardless of the cause, for most new ventures, the flash of inspiration is followed by a down hill journey that fades into insignificance. It is a rare venture that realizes the full potential of its original vision.

Why is that? Unlike parenthood, there is no paternal instinct that guides us in nurturing and growing young businesses. Beyond the missing paternal instinct, there is an observable pattern of repeated fatalistic behavior that indicates failure is neither documented nor well understood.

What follows are the ten most common variations of high stakes Russian roulette that I have witnessed or played over the last twelve years. The problems are not endemic to the startup world. Large organizations and corporate ventures also suffer from similar issues. Its just that in startup mode every resource is critical, every second essential. The inherent leverage amplifies impact of the simplest mistakes.

The ten myths

Before we hit the myths, let's take a step back and define types of failure.

- a) **Type I a.k.a. the no commitment date** is a failure with no significant financial cost. You come up with an idea, you throw a little money at it, test the waters, do not get the right response, pull the plug and step out as soon as you get your feet wet. Your total investment is limited to a few weeks (4-12 weeks) of your time and less than 5% of your net worth.
- b) **Type II a.k.a. the fair priced joyride** is a failure with some financial cost. Moving forward with the above theme, after testing the waters you actually go for a swim, find the current too strong, get stung by a jelly fish, pull a muscle, get a cramp and almost drown before heading back to the shore. Time frames could run into years, personal losses claim a substantial portion of your and your friends and families net worth and recovery from this misadventure is spread over multiple years. Called the fair priced joy ride because you knew what you were getting into, you had your fun and your chance, took your shot and missed. Charge it to the experience account
- c) **Type III a.k.a. tail spin** is failure with fairly significant financial cost. You go for a swim and are never seen again. Type III failures generally results in complete financial wipeouts and tremendous personal emotional strain. Personal recovery from such failures is very rare and requires serious intervention by friends, family and well wishers.

Serial entrepreneurs follow a very interesting pattern. They will keep on playing the game till life deals them success or a tailspin. Social and economic systems that make it easier to recover from tailspins have a thriving and growing entrepreneurial community. Failure viewed as a badge of courage and not taboo, protective bankruptcy laws, liberal write off and loss recognition provisions, a healthy appetite and understanding for risk, all help. Social and

economic systems that don't miss out on the economic boost entrepreneurial steroids provide

1.1 The curse of technology

– The mythical value driver

Not many people understand how IT creates and delivers value. Very few have mastered that art of restraining technology projects to remain a static and achievable target versus the runaway train they normally become. To this mix add business and technology teams speaking in different languages, working from different sets of expectations and not willing to bridge the gulf between them. With this list of complex conditions, shouldn't technology investments earn economic rents rather than just accounting profits?ⁱ

We think notⁱⁱ. Technology is not a competitive advantage. Yet businesses overemphasize the contribution technology makes in business or product success. Anytime we see a business plan for a venture that emphasizes technology or a technology related factor as a value driver and or a competitive advantage, we know the management team has not done their homework and taken the easy way out. Not understanding the technology factor leads to understating the commitment, the cost, the timelines and the effort required to rein in the technology demon – its impact on deadlines, deliveries, customer perception and an organization's future.

1.2 Big projects and big sales deals

– The price of credibility

Is there any correlation between targeting large customers, executing large orders and new venture failure? We believe so. New ventures, without exception, lack the depth to survive closure or execution of large assignments and contracts. Without sufficient depth, such ventures make bad short term calls on pricing, delivery terms, hiring, concessions and service level agreements that put them on track for eventual failure. Success is built on a collection of small wins, not big hits.

1.3 The perfect product

– The allure of Perfection

The effort spent in perfecting product offerings when customers are willing to work with imperfect solutions. Common phenomenon in technology companies where generations of the same product go through the never ending product development → testing → product development cycle without giving thought to customer interaction and the opportunity cost of perfection. There is a minimal acceptable feature set customers are willing to work with. Failed ventures climb higher on the perfection curve than their successful peers, ignoring financially viable product development strategies that get to revenue generation quicker and faster.

ⁱ Economic rents indicate the existence of a competitive advantage. Just because technology is difficult to get right or because everyone does technology badly does not imply that it bestows such advantages on its users.

ⁱⁱ See "IT doesn't matter" (HBR May 2003, Carr, Nicholas) and "What is Strategy" (HBR, Porter, Michael). In the latter Porter argues that Operational Excellence (one form of which is technology execution) is no longer a competitive advantage. Carr updates the debate in his controversial piece and suggests that technology is now part of the infrastructure dimension, hence common, ubiquitous and no longer a competitive advantage

1.4 Heroes

– The Hamlet syndromeⁱⁱⁱ

When was the last time you were part of an organization that had found the “rain maker” who would save your soul, your startup, your investment and your clients and bring some sense of sanity to your life? When was the last time such “rain makers” delivered on the promise linked with their arrival. Heroes are “very human” resource expected to solve insolvable problems.

Why do heroes fail? They don’t know where to begin, they wait too long, they carry too much excess baggage, they do too little, they compromise too much and they often fail to notice subtle transitions that change the power structure around them. Heroes also fail because organizations and institutions succeed only when they grow beyond personalities and individuals; by definition, Heroes accentuate reliance on one man armies.

1.5 Solving the wrong problem

– Prescription glasses

Great products for wrong markets! Great solutions searching for appreciative and paying customers! Great ideas going nowhere! Welcome to the graveyard of brilliance that missed its mark. There is more to the question than surviving till you get it right. First, in problem spaces involving new ventures, there will always be false optimal solutions – solutions that give the appearance of arrival at your intended destination, when the target objective is still miles away. Second, successful product development is iterative product development that uses fine tuning as well as dramatic remedial surgery with an even hand. Failed ventures spend too much capital on false optimals and use single iteration product development models.

1.6 Leadership

– Gods and generals

All else being equal, can a good general win a lost war? When a team loses confidence in its leadership, is there no where else but to go down? Leadership is about holding your own and your team together in good times as well as bad. Charm, motivation, wit, strategy, wisdom, fairness, discipline, inspiration, loyalty, ambition, sacrifice and execution – combined in right measure and parts leadership delivers on all its challenges. However when leadership sells itself short, is not up to the measure required of it or betrays the trust in which it is held, ventures fail. Sun Tzu presents an interesting and objective framework for assessing leadership potential. The capacity to exercise moral influence (lead and inspire), the ability to observe external factors (feedback loop with the environment), the strength to command and the intelligence to choose the right doctrine for the problem at hand¹. Leadership that fails the Sun Tzu test also fails its following

1.7 Faith, commitment and the inability to fail – Who will cast the first stone

How difficult is it to walk away? It boils down to the battle of two mindsets: The practical view that emphasizes failing quickly & the emotional view that appeals to faith and invested effort to salvage anything if at all possible. Which one should you listen to?

There is only one reason for a business to exist. To make money for its owners and investors. If on a forward looking basis, it fails to achieve that goal, there is no reason left to

ⁱⁱⁱ In Search of the Perfect Prince, (excerpt from the book Power Plays by John Whitney), Columbia Business School, Columbia University, NYC.

justify its continued survival. Faith and commitment are relevant when the underlying business model is viable, where numbers add up and profitability is attainable. When these conditions are not true, faith and commitment are misplaced. These conditions or test results are not static; a business model may be viable on day one but no longer be relevant or realistic two weeks down the road. New and previously unknown information is generated as ventures reach significant milestones. It is better to ask simple questions again about capital, products, customers, economics and teams to grade ideas and plans as milestones go by than to rely on just the initial analysis, no analysis or the sin of all sins – irrational exuberance.

1.8 Capital and Partners

– The equity paradox

Businesses need operating capital to run, risk capital to make bets, signaling capital to form relationships² and intellectual capital to protect margins. For new ventures the bets are bigger and the relationship more uncertain hence the need for additional risk and signaling capital. While thinking through the financial planning and capital budgeting process, ventures that fail, makes no separate provision for risk and signaling capital. Left to fend with just operating capital these startup run into trouble when bets go wrong or when clients are hesitant to sign contracts with a vendor with no reserves to fall back on. The thing is you don't really miss capital till you need it. The more you need it the more expensive and elusive it gets. If you have been not been smart enough to get your fill when it was abundant and cheap, the distraction and cost of raising capital can burn your business down.

Capital, irrespective of its shape or form, is not free. With capital, come partners; with partners come questions of allocation of ownership and equity. The allocation occurs on the basis of contribution of implied capital – ideas, services, network, relationships or cash. When implied capital is not contributed – ideas that are held back, services that are not delivered, networks that are locked away, relationships that breakdown or cash infusions too late, partnership and ventures run falter and die.

1.9 Expectations management

– The undersold dimension

Customers, family, employees, investors – It is important to ensure that these four stakeholders are on the same page with respect to the amount of pain, the likelihood of failure and the chances of success. But then you have to remember that nothing is static or stable in the startup world (the only constant is change). The expectation that needs to be set is that expectations will be reset as the game changes. Link this to the fact that there are no short cuts, no free lunches, no inefficiencies and a statistically insignificant chance that you will actually come out ahead in the long run^{iv}. Without this mindset a new venture turns

^{iv} When you add the net effort invested in a new venture and compare that with the end return as an owner or employee, more than 88% - 94% of venture capital funded startups lose out in the long run. It is only 6%-12% of funded startup employees who break even or earn a positive return (Source Venture One, Venture Source, Vinod Khosla @ KPCB Venture Partners). If you broaden the pool and include all startups that apply for venture capital funding, your chances of making real money in the long run are less than 1 in 1000 (validation?? also point out that the for a small venture/franchise, stakes are much lower and the survival rate is much higher on the non-VC route?). Statistically and monetarily speaking you are better off with a regular pay check. This implies that for rational adults who understand probabilities, working for a new venture is at best a lifestyle choice or a speculative gamble. In either case the high comes from being a “startup guy or gal” or rolling the dice. For irrational adults or adults not comfortable with probabilities, it's an uninformed decision based on

into a never ending, inconclusive shouting match of ‘you-never-said-this-would-happen’ kind. The same mindset also plays a big role in retaining and motivating talent when options fall under water, contracts fall through, customers walk away and the annual bonus pool disappears.

1.10 Diversification

- Any which way you can

Should you really care about what brings revenues into the company? Why is diversification a four letter word? Primarily because diversification comes in many distracting forms. From owners doing free lance consulting on the side to pay bills, to vendors getting into incremental services to close contracts, new ventures get into areas that take them further away from the focused path they were expected to follow. As Geoffroy Moore puts it, to succeed you must first understand the difference between core and context and then focus on the core³.

Model that work are those that starts with products and stays on track till they hit sustainable growth. Product → Revenue → Profits → Growth → Sustainable Growth. When diversification is used to generate revenues earlier, the model distorts to Revenue → Growth → Product → Profits → Sustainable Growth or other variations that push the product further down the road. The game is not about revenues. It is about succeeding in the line of business you have chosen and making a viable venture out of it. To do that you have to get to Product and Profitability before you run out of capital. Diversification takes you further away from that path.

incomplete information analogous to buying a lemon from a used car dealership. Underlying motivators and personality types aside, you still need to set expectations for the group at large

Individual specific questions

- 1) Participant Name:
- 2) Title:
- 3) Organization:
- 4) Email address:
- 5) Phone number:
- 6) Mailing address:
- 7) Number of startups or new ventures that you have worked for as an employee, consultant, owner, investor, vendor, etc:
- 8) Total years of professional work experience:
- 9) Informal Job/Function/Skill set classification:

Venture / Example specific questions

- 1) Over your professional life have you been associated with a venture that you feel failed to achieve its original vision and potential? If you can think of multiple ventures, please indicate the number of failures.
- 2) If yes, can you share some background information about where the venture was based geographically, its target market, business model, revenues, years of existence, ownership and date of failure.

- 7) What was your role in the venture in question? If not directly employed how did you find out about what went wrong?

Framework specific questions

- 1) If you had access to the framework defined above (top ten myths that kill), how would you have used this information at the venture in question?
- 2) With respect to the “myths” in question, are there any “myths” that you strongly agree or disagree with. Are there any “myths” that you would like to add or remove from the list?
- 3) Please assume that the order in which these myths have been presented represent the importance, frequency or contribution of these myths in new venture failures. Do you agree with this order? Would you prefer to re-order some of the myths in importance? Why?
- 4) Does the framework help in thinking about failure? Are there any gaps or weaknesses in the framework that you would like to fill in? Is the framework mere common sense or more than that?

5) Please rank the framework on the following criteria

- a) Readability
- b) Clarity of thought
- c) Applicability
- d) Approach and appeal

¹ Sun Tzu, Art of War, Author, Publisher, Location, Date

² Integrated Risk Management, Prakash Shimpi, TexRe, New York, 2001

³ Living on the Fault Lines, Geoffory Moore, Publisher, City, Year