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Reasons for Failure in High-Potential Startups

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Noam Wasserman, of Harvard Business School, explains how he came to focus on trying to understand why high potential startups commonly fail. According to Wasserman, while a certain percentage of these ventures succumb to issues of product or market fit, the vast majority meet their end due to people problems.

Transcript

So I am going to start out with a happy topic, that topic being failure, entrepreneurial failure in particular. This is something that we all hear about, something that is an amorphous fact of life, that we just have to take as a given, that a very high percentage of startups are going to fail. And so in between all of the wringing of the hands, all of the dreading that this might be the future of what we are heading towards, I happened to run into an article that was written 25 years ago. From what I understand it's actually the only other HBS professor who has come to ETL and has visited and talked about his research. This was not what he would have talked about. This is what - it was not at all a focus of his at the time, but it was a professor named Bill Solomon. And Bill was going in, back then, to try to go and explore inside a black box. That black box being venture capital. What are venture capitalists do? What does their job entail? Going into all of the different dimensions of it, how do they go and get deal flow? How do they go and assess investments? How do they do due diligence? How do they negotiate term sheets? Once they have negotiated and made the investment, what do they do when they come onboard? And so Bill was understanding all of these different dimensions of venture capital and what do venture capitalists do. Fortunately, along the way he also thought to ask them what was a very small part of his paper, but was a critical question for me, that when I saw this one line and this one data point within his paper, it hit me like a ton of bricks that this is where I should then devote the last dozen years of my life.

So a high-impact one line and one data point. What he went and asked them about was about the parts of their portfolio that we would never hear about. The parts of their portfolio that they would never issue press releases bragging about how they had done, that they would not be posting them these days on their websites. That happens to be the parts of their portfolio that failed. Tell us about the startups that you thought were so high potential that you invested in them, but then they ended up on the dustbin of history. What are the reasons that they failed? And Bill went in with his ideas and same kind of things that I would have gone in with, of thinking about what that list would look like. What are the leading reasons for failure of these high-potential startups? And what he found was, lo and behold, about 35% of the reasons for failure were those things that we would have thought about, what today we would call product/market fit problems or issues within functions as you are trying to develop your product and then once you have it developed as you are trying to go tackle the customers, get them to pay, support them, all of these other functional reasons, those were indeed a little bit more than a third of all of the reasons for failure. There was, though, one predominant reason for why these high-potential ventures had failed. That potential failure reason was 65%. They were the people problems.

The interpersonal tensions between the founders as things are getting off the ground, or the tensions between them and the hires who were brought in to complement them, or the other people who were getting involved as you are trying to build your high-potential venture, you are trying to pursue that opportunity and bringing all of these other pieces on board.