Stanford eCorner

Bad Endings, Good Endings

Tom Eisenmann, *Harvard Business School*

11-08-2021

URL: https://ecorner.stanford.edu/clips/bad-endings-good-endings/

As he studied the various causes of startup failure, Harvard Business School professor Tom Eisenmann found a pattern of unfortunate missteps that were often repeated as ventures neared failure — mistakes that disadvantaged employees and alienated investors without saving the company in question. He suggests that there are better ways to fail, which can support customers and exiting employees, and also preserve relationships with investors.

Transcript

- What's the most troubling thing 00:00:03,939 you tend to see startups do as they start to fail? - Yeah.. You know, 00:00:11,310 it's almost choreographed, the set of moves a startup goes through when it starts to struggle.. You try some pivots, and that doesn't lead to bad behavior.. You try to get a bridge loan from your existing investors.. First off, you try to raise money from new investors and they say, you know, this ain't going to go.. So then after that doesn't work, you go to your existing investors and say, please bridge us, give us money for anybody, don't know what it is, enough money to get over this bridge to the point where we can sort things out.. And boy, do you see some nasty dynamics between investors who are willing to do it, and those who don't want to do it, but also don't want to be diluted, because basically anybody who steps in when they're in trouble is, it will be what's called a cram down.. You know, where whose ever going to put the fresh money in is going to take a big, big chunk of equity at the dilution expense of everybody else, and you can get these nasty board fights and the poor CEO, the founders, are caught in the middle of this.. So, there's nastiness there.. Then, when that either works or doesn't, you start to try to sell the company and boy, do you see some messy, nasty behavior there..

A lot of it on the part of the acquiring entities, they're kicking the tires.. Who wouldn't? The entrepreneur gets excited because they get all sorts of expression of interests.. You know, every competitor in the space wants to look at our company.. Well, guess what? They want to sort of meet your employees.. They want to see how much you're paying them.. They wanna learn more about your products and that, they're all gonna look and they're gonna string you along.. And so you get people who know that they've got, the clock is ticking, your cash is running out, and they know how much cash you have.. So, you get some really awful behavior around mergers and acquisitions, and the acqui-hires, which, I think, again, it's the thing we lionize on the east coast and Silicon Valley.. It's a great exit approach for lots of teams.. Well guess what, not everybody goes, right? That acquiring entity is doing a tryout, and they're going to interview all your people, and some of them get to come, and many of them don't, and it's painful..

And you know, a team that's been working together really hard, to sort of see that some of them don't make the cut, is nasty.. You know, founders themselves can do bad things.. Transparency's really tricky at this stage, when you're in trouble, because if you're very open with your team about it, or your investors, you can scare them off.. And some employees may leave and that'll just hasten the downward spiral.. And so, you know, you're ethical, you're torn up about how open and honest to be about what's going on and whether to misrepresent or at least, you know, be quiet.. And so the founder has to make some tough choices.. The last sort of tough choice a founder has to make is whether to sort of toss the keys on the table and basically say: Hey, board, you know, I am obviously not gonna make any money from this thing, and I've got a lot of life ahead of me, I have better things to do.. You drive.. And boy, if you want to sort of destroy permanently your relationships with venture capitalists, try that move.. - Yeah..

00:03:13,670 - So, yeah, it's just pain 00:03:17,290 and nastiness at a lot of the stages there.. - I'd like to flip the coin though, 00:03:22,620 and talk about what I've found that the last part of the book is truly extraordinary, and talking about how to fail, but how to fail with integrity, with your character in place.. So, let's talk about that, because I took, that to me is a key takeaway of what you've- I keep saying the book, but the book is just a manifestation of these lessons or patterns you saw, but also I really liked the last part of book.. Can you talk about that? The importance of integrity and character at the- - Yeah, for sure.. 00:04:03,260 The goal for a founder, if they're going to fail, I mean, you want to do your best not to, but if you're going to, ought to be to fail well, and there are really two dimensions to that.. Failing gracefully means that everybody who's owed money, and I don't mean your investors, but your vendors, your employees, the tax authorities, everybody gets repaid.. Your customers get moved to a good place.. If your product isn't going to be available, you move them to some competitor who can do for them what you've been doing.. And you're open with everybody about what happened, you help your employees find new work.. With your investors, it's so easy for the founder to, basically at this stage, a lot of founders will be embarrassed, they'll feel disgraced, and they go silent, you know, and they don't reach out for help and they don't update people on what's going on..

So your investors are actually, you lost their money.. They knew that.. Anybody who invests in startup knows that that's a part of the game, but you do owe them an explanation, and a thank you.. So, that's all failing gracefully, and then post-the failure, it takes some time to wind the thing down.. And basically the experience is an entrepreneur is going to be surging with all sorts of emotion.. Sadness, anger, grief, rage at, you know, the co-founder who dropped the ball or lost attention and all this stuff.. And it takes time for those emotions to settle down, and the best way for a founder to do that is to sort of alternate between distractions and find a hobby, do some exercise, something different, side project, and rumination.. Sort of reflecting on what happened.. And eventually the founder will find a space, hopefully, where they've learned from the experience, and unfortunately, a lot of founders don't.. There are one to two extremes..

Many founders will continue to blame everybody else and the universe for what happened, and not their own failings or faults or mistakes.. And they've learned nothing.. They've probably going to go found or try to found again, and they'll make exactly the same mistakes over again.. At the other extreme, you have people that take too much responsibility.. And so you want to avoid those extremes.. The people that take too much responsibility will never be founders again, and some of them shouldn't be, but most of them will probably be perfectly fine to get back on the horse and do it again.. And it's a shame for society if they don't try.. So, if you fail gracefully with transparency, and if you can explain to people what happened, what your role was, what you did wrong, what you'll do differently next time, you're actually pretty well positioned to bounce back.. And what we see in the research is that more than half of failed founders go back and found again.. And the ones who really learned from the experience and failed well I think are particularly well-positioned to do it..

They have preserved relationships, and reputations...