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Why Startups Fail [Entire Talk]

Tom Eisenmann, ***Harvard Business School***

11-08-2021

URL: https://ecorner.stanford.edu/videos/why-startups-fail-entire-talk/

Tom Eisenmann is the Howard H. Stevenson Professor of Business Administration at the Harvard Business School; Peter O. Crisp Chair of Harvard Innovation Labs; and faculty co-chair of the HBS Rock Center for Entrepreneurship, the Harvard MS/MBA Program, and the Harvard College Technology Innovation Fellows Program. In this conversation with Stanford professor Tom Byers, he shares insights from his book "Why Startups Fail: A New Roadmap for Entrepreneurial Success" (Currency, March 2021), which analyzes common patterns that sink both early- and late-stage startups, and also proposes a road map for deciding when to pull the plug and how to fail better.

Transcript

Announcer Who you are defines how you build.. 00:00:08,549 - Thanks so much, Tom Eisenmann for being here today.. 00:00:10,470 My name is Tom Byers, so it is the Tom and Tom webinar show for this Entrepreneurial Thought Leaders seminar series episode.. It's the first of three, this particular term.. And I'm looking forward to spending the next 50 minutes or so with my good friend, Tom Eisenmann from, maybe I'll call it the Stanford of the East, the Harvard Business School, which needs no introduction as far as the university.. I teach here at Stanford University in the department of Management, Science and Engineering.. And I've been teaching entrepreneurship here for quite a few years about the same number of years as our guest today.. And I've always been such a big admirer.. I wanna get it right though with his proper titles, because they are significant.. Tom Eisenmann is the Howard H..

Stevenson Professor of Business and Administration at the Harvard Business School.. The Peter O.. Crisp chair of Harvard Innovation Labs, which is a terrific accelerator on campus, and a faculty co-chair of the HBS Rock Center for Entrepreneurship, which is our counterpart here at STVP.. But there's more, he's just come from opening the Harvard Ms.. MBA program for this year, which is he's the faculty director of.. And it turns out he's the faculty director of Harvard College Technology Innovation Fellows program, which has a parallel here as well.. So it's so cool.. But the reason particularly excited is that he has a book out that is just super, and we've got to get into that in just a moment, but did I get that correctly? All of that, did I get all your titles, right, or I don't miss anything, Tom? - No, Tom, thank you so much.. 00:02:04,480 I know we've got some Mayfield fellows listening.. I'm proud of the Harvard College Tech fellows..

It only took us 25 years to copy what you're doing.. And we've done that a few times, I'm happy to say it, stay in your slipstream on a lot of these things.. - Well, we've set some big, hairy, audacious goals 00:02:22,164 as Jim Collins used to say for the next 45 minutes.. There'll be time for questions from our audience later on, but I have a few.. And we're gonna range in a variety of topics.. What's really interesting about our audience today, Tom, is that we have everybody from folks just getting introduced that you can actually learn entrepreneurship, and of all ages to our colleagues around the world who teach entrepreneurship, which we've learned you can.. And so there's been a gap though, and this is what makes me so excited about your book and I'm gonna hold it up, 'cause I get to do this.. "Why Startups Fail, A New Roadmap for Entrepreneurial Success." Which I really think is a Seminole event.. And for those of us who teach entrepreneurship and we're- I'm gonna do my best to let you speak mostly during this.. And I think we'll convince most people who have a chance to listen to this episode eventually because it is really, it's really something else..

But let's start at the very beginning.. Why do you wanna potentially be labeled the professor of failure? Why does studying failure mean so much? - Yeah, it has scared off a few founders 00:03:40,580 who might otherwise be looking for advice.. So, I mean, there's two ways to answer this, which is why should an aspiring entrepreneur learn about failure? And the fact is, the drivers of failure aren't simply the photo negatives of the drivers of success.. There's- It's complicated, right? To succeed as an entrepreneur you probably have to grow, but boy, if you wanna find a leading cause of startup failure, it's growing too fast.. So studying failure is important, but personally why I started, goes back to a team that I worked with, they were students of mine and a year after graduation launched a venture, I was an investor, after they graduated, I had a lot of confidence in the team.. And they raised a million dollar seed round, wanted to raise a million and a half, that was part of the failure story.. And got the business going, validated demand with the very best lean startup techniques we can teach them..

And sure enough, after they launched, the demand was there and repeat purchases were there.. Took them longer than they expected to get the operations under control.. So they were burning through cash and while they were making progress, they weren't making enough progress and shut down after a year..

And I could point to a lot of things that went wrong, but I couldn't pinpoint the cause or the causes of failure.. And that was a little disconcerning here, I was a supposed expert on entrepreneurship and in our field, depending on what you, how you define a startup, and how you define failure, two thirds, three quarters, 90% of startups fail.. And so it's a really important phenomenon, and I was a failure at explaining failure.. So this goes back eight years and sort of set out to read everything anybody had ever written about startup failure, practitioners and academics, and interview lots and lots of failed founders and the investors who backed them and do the survey work and write the cases that form the backbone of this book.. So it only took eight years to pull it all together.. Things move a little more slowly in academia than they do in startup land.. - Well, I'm so glad you did.. 00:05:52,530 So, let's do some definitions here.. How do you define startup failure? - So startup failure in the book, 00:06:01,500 the shorthand definition is, early investors did not, or never will make money.. And that's important the early investors, right? Somebody can come in late with a liquidation preference..

A lot of folks listening will know what that means, is basically liquidation preference means, you get your money back before anybody else that invested earlier gets money.. And so if you're at the bottom of a liquidation stack, the way we express it, you're the last in line, series A, C, D, and common.. And so if the early investors didn't make money, the common didn't make money, which means the entrepreneurs didn't make any money.. And that's a failure of some sorts.. We might ask, well, why the investors and not the founders? The reality is by the time you get to series D, so four big rounds of financing and, maybe we're five years or seven years in, only 40% of venture capital backed startups at series D still are run by a founder CEO.. So you can't only take the founders preferences and priorities as the measure of whether the things worked or not.. We could ask questions, and I know STVP is super interested in ethics from the perspective of society at large.. We have startups that are financially successful, but we all wish they would disappear.. They pollute the exacerbate income inequality.. They have addictive products in a bad way..

And we have some financially unsuccessful startups that actually contribute to society, in the sense they show other entrepreneurs what not to do, which is important.. And they train a whole cadre of managers and employees to go off and do new things, better things.. So the answer is, it's complicated, but if you want shorthand, early investors didn't make money.. - And that seems reasonable.. 00:07:54,240 And that's what you studied.. So let's go through some of the findings in the way you organize them.. I believe if I got this right, there's three route patterns or reasons that you extrapolated from the data and from the amazing amount of field work on what went wrong at early stage ventures.. And then there's another three patterns for later stage or what I think you call them at scale.. - Yeah, exactly.. 00:08:31,220 You know, the folks here who've studied design, or work as designers know that you always start with a lot more options..

So the first draft of the book had 50 patterns.. It was gonna be basically two page chapters.. And it turns out if you keep combining and sort of looking for commonality, you can join all the way down to be six.. So the early stage patterns, these are companies that are still searching for product market fit.. One of them is I call it good idea, bad bedfellows.. And this is the startup I mentioned that was the catalyst for this work.. And they had a good idea.. And they had actually validated it through lean startup, MVP style testing.. But they never got the bedfellows in the sense it's, investors and a lot of entrepreneurs will talk about jockey and horse.. And the jockey meaning the founders, and the horse being the concept..

The point is bigger than that.. It's not just the founders who have to be ready to lead, but also the rest of the team has to be well-equipped, their investors who wanna add value, you want them to add value beyond just the money.. There's often strategic partners, 'cause the startup can't do it all, they borrow other people's capability.. And so there are some startups, unfortunately, that have a good idea, but they just never managed to marshal the full set of resources you need to pull it off.. That's the bad bedfellows pattern.. The second pattern, and this is probably the number one killer of early stage startups I call false starts.. So as we do this conversation, we're in the middle of the Olympics.. So we're familiar with false starts and swimming, and track and field.. You jumped the gun in an effort to get an edge and lots of entrepreneurs do exactly that.. They basically start building and selling their thing 'cause that's what entrepreneurs do, right? Bias for action, passion burning bright, sort of a conviction they found the right problem-solution pair..

And what they've done is they've skipped a whole bunch of upfront research, what your colleague Steve Blank would call the customer discovery phase, where you basically exploring the problem, figuring out if you've found a problem worth solving.. And then they've skipped the phase of generating lots of potential solutions, which is what a designer is user experience designer would do, and narrowing that a big set of solutions down to the most promising one through prototype testing and getting user feedback and so forth.. And so this is not work that needs to take a year.. You can probably do this stuff in four weeks and for many entrepreneurs, but in the interest of saving those four weeks, these folks have plunged straight in, and essentially the odds of the first version of the product, when you do that, it's been hit the mark are low.. And might take you four months to build it, figure out how to sell it, see that it's not working and figure out what to do next.. So, in order to save four weeks and just get going, you've wasted four months.. And if you've only got a year's worth of money in the bank, like my founders, I mentioned at the beginning, that's really boosts your failure odds.. So that's the second one.. Third one is a false positive.. And again, we've been through a lot of COVID recently..

So everybody knows about false positives and false negatives.. And for an entrepreneur, that's a signal that your concept is right on target.. And it's an invitation to step on the gas.. And it often comes from the enthusiasm of your early adopters.. Every entrepreneur needs early adopters to get going.. And what's true is the early adopters needs are often different than the needs of the mainstream customers.. You see this with, a Dropbox would be a good example.. Drew Houston, when he launched the business, talked about building a product that would be simple enough that his mother could use it to store her recipes.. His early adopters were software engineers who had incredibly sophisticated needs for sharing across many devices, collaborating big files, et cetera, et cetera.. And they wanted features that Drew left out of the product..

And he did that very deliberately.. It's not the only way to go, but he was very aware of the difference between the mainstream and the early adopters.. Other entrepreneurs in their zeal to serve, you wanna keep the early adopters happy.. So they'll build a product that ends up being over-engineered for the mainstream.. So, those are the three early stage patterns.. - Let's pause right there 00:13:01,283 and just take a little deeper dive because, it's phenomenal how much of an impact that lean startup methods have had, well, as it on teaching entrepreneurship.. And we've been lucky to have Steve Blank start that course and spread it 10 years ago.. You also had Eric Reese, who is also one of the, I guess if there was such a thing of founders of the lean startup methods with Steve, and he spent time with you.. So it's, I was on a call with Steve Blank earlier today, and we were part of a meeting at Stanford.. We're very lucky he has been associated with us all these years, with this happening, but I wanna dive into a couple of the things you just talked about and how people embracing those methods..

Kennan can improve from what you learned from this statistically significant data set that you have from failure? - Yeah, so I mean, 00:14:11,820 the survey work that basically shows things like if you pivot too often, or not often enough, that's gonna boost your failure odds.. So there's no surprise there.. The big surprise was the false start.. 'Cause we know what lean startup done well looks like.. And certainly Steve has been teaching it and lots of people have been writing about it, we've been teaching it.. And what's true is a lot of entrepreneurs think they are following lean logic because they are building fast, they're building in an agile method, they're getting their product to market fast and they're getting a lot of feedback on it.. The problem is they've skipped the whole upfront phase, the phase that Steve calls, Steve Blank calls customer discovery.. And they've jumped right to what Eric Reese in particular is the build measure learn part of lean startup.. And you can sort of understand some of the psychological motivations here.. Entrepreneurs have a bias for action..

That's how they identify.. Basically people who make things happen.. What could be more natural than starting to build the thing? A lot of entrepreneurs are engineers.. Engineers love to build things.. So, what could be more natural than starting to build? And a lot of entrepreneurs are overconfident.. So they're sure they've got, they can see around corners, they know the problem they wanna work on, they got a vision of the solution, so let's start building it.. And, I teach a lot of MBAs who are not technical, but what do they hear? They hear that you have to have great product to succeed.. How do you get great product? You get an engineering team.. How do you get an engineering team? You take those MBA networking skills and you go off and you find a co-founder or where you sort of scraped together enough money to outsource the thing, however you're gonna do it.. Once those engineers are on board, you have to keep you busy..

And how do you keep busy? They start building.. So there all these pressures, and if you think about the full lean startup process, the MVP testing is actually the last stage of the process.. I mean, you should really only do that after you've done a big round of customer discovery.. The British Design Council has this double diamond design and the designs, the diamonds are side by side, our problem definition and solution development, and the diamonds go out, divergent thinking, so you expand your understanding of the problem space, lots of customer segments, lots of needs you might sell.. And then you narrow in through proper user experience research techniques.. And then the same thing with the solution.. Generate a lot of solutions and then narrow them down, and it's only after you've done that narrowing, you start MVP testing.. So these entrepreneurs skip a whole bunch of stuff.. They think they're running lean and they are in a sense, but they they've skipped a lot of steps for very understandable, but ultimately deadly reasons.. - Thanks for that..

00:16:57,100 And I that's a- Those are stewed observations on how to improve the odds of success, I know being a educator like yourself, all of the stuff that we teach and work on in our active learning and experiential classrooms, both, physical again someday, as well as online, we're just working on increasing the odds for success.. I mean, there's no one prescription.. So I also liked the style of your book, that it doesn't say do this and you'll be guaranteed not to fail.. So this is in the spirit of just adding additional probability of success to what is a great contribution to education with the whole lean startup thing the last 10 years.. All right, so let's go back to the behaviors.. Those are, we've been concentrating the last few minutes on early stage, the launching stage.. Now let's talk about when it's time to hopefully get into scaling.. What did you find there? - Well, again, it's kind of shocking.. 00:18:12,560 If say two out of three early stage startups, venture capital backed startups fail in the sense that they don't, yield a positive return for the investors, you'd think that the failure rate would be lower for folks who get past the early stage, make it to say series C and beyond, but it's still one in three odds of not making money for your investors.. Sometimes that's 'cause the investors get in a bidding war for your shares, they get excited about the momentum that got you to series C..

But it turns out there's just an awful lot of things that can go wrong as you start to scale up.. And I think that probably the biggest killer of late stage startups is what I call a speed trap.. So, picture the policeman with a radar gun at the side of the road, and saying your startup's going too fast.. And the speed trap will often start when a company has a lot of early momentum.. So the product is working, people are buying it, they're spreading the word.. And that attracts the attention of investors, they pour a lot of money into the startup, hoping to basically ride the rocket ship and expecting that the team will sustain the momentum.. There's some dynamics then.. So as you try to keep growing almost by definition, you're expanding in a direction toward customers that are less interested in your product than the last round, right? The first people on board are the people that really want what you've got.. And as you move beyond that, they're gonna be people that are well, a little less interested.. So you're gonna have to cut the price..

You may have to add features, you may have to market much harder, so the customers become worth less and they cost more to acquire.. So you get this squeeze on profits, or for the folks who've studied long-term value of a customer, LTV to CAC customer acquisition costs.. Now you want that ratio to be over one and preferably over three or some number like that.. And so you get an LTV, CAC squeeze, you're very growth attracts competitors, the rivals come out of the woodwork, big established companies sort of wake up to somebody doing something interesting in their space.. Meantime you're growing, and if you've got the kind of business where humans have to do things, it might be lucky and it's pure software, so that scales a little more easily.. But a lot of businesses direct to consumers say you got people packing boxes, manufacturing things, answering the phones to handle customer service.. All those people have to be brought on board and they come on board a company that has no systems, no processes, no nothing.. So all that stuff has to be put in place.. It has to be put in place by entrepreneurs who are probably suspicious of bureaucracy, rightly so, and are probably resistant to putting in too much in the way of structure.. You get cultural friction and tension between the old guard, the people that were present at the creation and the new guard..

Who are these new people? They're specialists, Sam and Jack of all trades generalist.. The new comers say that person down the aisle has $5 million worth of stock options and I don't, but I seem to be working just as hard as they do.. So you get fiefdoms between the functions and cross cultural, cross functional conflict.. And so there's a lot of things that can start to go wrong.. And when it goes really bad, but pressure, pressure, pressure for growth, and the growth is harder to come by.. That's where you can hit an ethical, slippery slope, and see people across the line, misrepresenting their progress, or just sort of cutting corners in ways that are dangerous for customers or illegal.. And so that's the speed trap.. And you can sustain it for a while, sort of people can look the other way and assume you can fix it, but eventually you realize that it's growing, but it's not growing profitably and it probably never will.. And at that point, the investors skitter away and you can't find new ones and the thing can crash pretty quickly and leave this giant steaming greater in the landscape.. When a late-stage startup fails, we notice..

It's hundreds, maybe even thousands of jobs and hundreds of millions of dollars.. When an early stage startup fails, it's heartbreaking for a few people and their friends and family, but the late stage hurts.. - Yeah.. 00:22:39,190 So I'd like to talk about one of those patterns that cascading miracles and elaborate on that.. And particularly in the book, you talked about Better Place.. I want to, I'm using my silver now- I'm when I'm not shooting arrows at you, I'd shoot a bullet on this one professor Eisenmann, please let's chat about Better Place.. 'Cause we had some of our Mayfield work study program fellows work there when it was in its heyday.. I think it was headquartered here.. Yeah, so I remember gonna the offices and it was, oh, wow, I mean it, so let's just use that because frankly, the label you gave this pattern, cascading miracles, I think is just the best label.. It's gonna stick in....

- I stole it from John Malone, 00:23:32,295 who was the entrepreneur who built the biggest cable TV system operator in the country.. And he got it from a mentor of his.. So the notion, I'll explain cascading miracles in a minute.. but we should probably say a little bit about Better Place.. So Better Place had, and you've get a feel for the cascading miracles pattern if you understand this company.. So Better Place, Shai Agassi was the entrepreneur, had the concept that to save the world, literally climate change, we needed electric cars everywhere.. And the only way you could have them is if you could reliably recharge them when they were out on the road.. So he wanted to deploy a network of charging stations everywhere, everywhere, including stations where a car would drive in, a robot would pull out the depleted battery and pop in a fully charged battery.. All in five minutes, same amount of time would take to gas up.. And they deployed this network in Israel and Denmark, raised $900 million..

And it was just too much, too much in every dimension.. Too big a behavioral change for the customer, so let's step back and think what has to go right.. And now our audience will see what we mean by cascading miracle.. So think of an equation where you're gonna multiply a bunch of things together, and if any of the things, any of the elements are at zero, the whole expression goes to zero.. So a bunch of long shot probabilities, or difficult probabilities, uncertainties that this company faced.. You needed behavioral change on the product consumers.. This was 2008 before, the only electric car out there was the Tesla Roadster, $110,000, a little sports car.. And you need a government subsidies for that obviously, which hadn't happened yet.. You needed the big car companies to design their cars, to have the swappable batteries, big deal, big deal to get Ford and Volvo and all these companies to change their car designs imagine.. You needed to find places to put all these charging stations and battery swapping stations..

You needed to raise literally billions of dollars to deploy this thing.. And you needed to have a team that could actually keep the wheels on as you were building and executing all this stuff.. So you needed a bunch of things to go right, and you would need a cascade of miracles if all of them were gonna go right.. And they got, they did get some things right.. People did adopt electric cars eventually, there were government subsidies, they got one OEM, Nissan Renault to design a car that had the swappable battery.. But it just turned out that deploying the recharging station turned out to be much more expensive than they originally projected and demand was growing, they only ultimately sold 1500 cars in the two countries.. So with a long way from world domination.. So yeah, cascading miracles and the pattern.. So sometimes Tom, they work.. I mean, Tesla was a case of cascading miracles, Space X certainly was..

If we go back, you and I are old enough to remember when Federal Express was launched in the early 70's, it was the biggest venture capital launch in history at the time, and people thought it was insane, to fly a package from Buffalo to Cleveland, through Nashville, Tennessee.. - But if you look into those stories, 00:26:59,432 maybe I've been just to cascading just in time miracles.. I mean, just the ones you mentioned that there were, there were some moments for Tesla that really came to a head that they were staring at a different outcome.. - Yeah, and Federal Express nearly bankrupt many times.. 00:27:22,292 So yeah, they're tough.. They tend to be run by, or led by truly charismatic founders who can spin up, we use the expression, reality distortion field about Steve Jobs and some other entrepreneurs.. These are the best at it.. And Shai Agassi was that, he could mesmerize an audience just by sort of spinning a vision of a better world as a better place with his network deployed.. But there can be a line between charisma and cult leadership.. And sometimes the reality distortion field folds back on itself and the charismatic founder can't see that the universe is saying, this is too early, or this is too big, or this is not gonna work..

And then it becomes a tricky problem for the board of directors, sort of, how do you reel the person in and convince them that it's time to pivot, find something that can be done.. - Well, thanks for taking us through the six behaviors.. 00:28:24,810 And I find this moment truly ironic.. Remind me, when did you start teaching at HBS? What year? - 1997.. 00:28:36,570 - Yes, mine was 1995, full time.. 00:28:39,103 And so I realized, and remembered that we were the same pedigree or vintage.. Maybe that's how to put it.. But the reason I got to get this job, and I know you feel the same way, this is not a job, this is such a joy to what you and I do.. And I wanna talk a little bit about education later on.. But the reason that happened is, because I was part of a cascading miracle situation that did not happen..

And that was building a lot of software, gonna be the Microsoft in terms of Microsoft's applications.. The broadest set of applications for pen and finger based computing.. - Were you on Go Computing? 00:29:22,170 - No, we're on top of Go, 00:29:24,310 meaning the applications that ran on there.. It's called Slate, and we had one of your grads, the fellow, my co-founder was the person who invented the Spreadsheet, in your classroom.. You know who I'm talking about, Dan Bricklin.. - Yeah, of course.. 00:29:43,860 - And so we had amazing 70 of the finest software people 00:29:48,670 at the time, including the person who invented Spreadsheets to begin with long before that.. But we were the cascading miracles, meaning you're sitting on top of an ecosystem that had everything had to go right.. And it went right, but not in 1993.. - It took 20 years..

00:30:06,090 (laughing) - Yeah.. 00:30:09,660 So tell me about the origins in the classroom.. Where you taught a course, right? You taught a course on failure.. And so what, when did the light bulb go off, or the epiphany go off that, well, I should really dive into this, really do the research, really do the book.. So it's not so much about a book, it is about this period of time that you went through and said.... - Yeah, exactly.. 00:30:32,850 You know, I knew that the course, when I made the commitment to write the book, I knew a course and sort of testing the ideas with smart students and bringing entrepreneurs into the class, failed founders into the classroom would sharpen the ideas.. And boy, was that the case.. I had tried teaching failure, when the intro entrepreneurship course at Harvard Business School.. The students in the end of semester feedback always said, you tell us the two out of three startups fail, but then you show us all these winners and like what's going on here? And so we would put in a couple of failures and then the reaction would be thank you, rear view mirror..

Oh, isn't it kind of obvious why that one failed? Like, well, did you see the smart people that built it and the smart people who invested in it? It wasn't obvious at the time.. So I knew to actually to teach this stuff, I was gonna have to sort of reinvent the approach in the classroom.. And we, Harvard Business School had a lot of case methods.. So this course and setting failures particularly well suited to the case method.. But the way I got around the rear view mirror was to bring the founder in, literally from the first minute.. Most of my colleagues save, if a founder's visiting, they save them for the last 20 minutes and the class will run a discussion for an hour.. And then you bring the founder in to comment on the discussion and update things and so forth.. I've brought them in from minute one.. And boy, the students would look at that person and say, wow, this is a sharp individual, they're inspiring, they clearly thought this through.. And that diffused the whole notion that it's obvious why these things fail..

And so the second thing I worried about at the time when I launched the course was that it'd be depressing, but even more so, that it would turn off a whole bunch of Harvard Business School students from ever launching anything.. Half of our graduates over the course of the first 20 years launch a business.. So it's a pretty entrepreneurial place.. And I worried about the article coming out five years from now, suddenly entrepreneurship has rolled off the edge, and who's responsible for that? It's this failure course.. - Man, you killed entrepreneurship education.. 00:32:29,155 - Exactly.. 00:32:32,056 And so at the end of the course each year, I ask the students has the course changed the way you think about being an entrepreneur in the next five years after graduation? And 40% on average say, yeah, I'm actually more likely.. And it's, yeah, I've seen the pain, I've seen it right up close, you put it in my face.. I think I can handle it.. But more importantly, I've seen this founder that you brought in and what he or she's doing now really impressive..

So they bounce back and every one of them said that, even though it failed, it was worth the ride.. They're proud of what they did, they learned a lot.. So those folks, another 20% say, no, thanks.. Like you showed me the pain, you showed me the personal, what it does to families, just how hard it hurts, and I don't think I wanna go through that.. And then 40, the remaining 40% basically say, I was always gonna be an entrepreneur I'm still gonna do it.. And if they self-select those aspiring entrepreneurs, in the courses like mine.. But what you've shown me is that raising venture capital isn't the only way to build a tech venture.. And that's important.. You know what I mean, the business schools in particular, I think it's probably true where you teach, we lionize venture capital and our students tend to think it's the only way, if you're gonna build a startup, it's the only way to do it.. And a lot of these founders in the course come in and they say, look, I was eyes wide open, I knew what I was signing up for, the VC is gonna pressure you for lots of growth, they need everything in the portfolio to have the potential, to be a 10 times 20 times return..

And of course only a handful or a small fraction are gonna be.. But I didn't realize what that meant for the way I would run the business and the sort of pressures it would put on me.. And I'm not gonna do it again.. So we started to think because of the course about, how can we bring better understanding of other financing approaches into our classroom? - Thanks for the sharing of that experience.. 00:34:27,880 So building on that though, I wanna go, of all the things, I'm gonna go a little negative side here, 'cause it got triggered by your comment about how painful it can be.. And earlier, I know you share our interest in elevating ethical behavior, especially for our students that are gonna be entrepreneurs and innovators.. So what's the most troubling thing you tend to see startups do as they start to fail? - Yeah, it's almost choreographed, 00:35:08,360 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, this thing, ain't gonna go..

So then after that doesn't work, you go to your existing investors and say, please bridge us, give us money for anybody, I 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 wanna do it, but also don't wanna be diluted.. 'Cause basically anybody who steps in when they're in trouble, it will be what's called a cramdown, where who's ever gonna put the fresh money in is gonna take a big, big chunk of equity at the expense, 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.. You 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 'cause they get all sorts of expression of interests.. Every competitor in the space wants to look at our company..

Well, guess what they wanna sort of meet your employees, they wanna see how much you're paying them, they wanna learn more about your products and that.. And 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 Aqua 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 trial and they're gonna 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.. The 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 even scare them off, and some employees may leave and that'll just hasten the downward spiral..

And so, ethically you're torn up about how open and honest to be about what's going on and whether to misrepresent or at least 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, 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 wanna sort of destroy permanently your relationships with venture capitalists, try that move.. So, yeah, it's just pain and nastiness at a lot of the stages there.. - Well, 00:38:16,290 I'd like to flip the coin though 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 that to me is 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, so, can you talk about that? The importance of integrity and character at the.... - Yeah, for sure.. 00:38:58,260 The goal for a founder if they're gonna fail, I mean, you wanna do your best not to, but if you're gonna, oughta 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 gonna 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, 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 part of the game, but you do owe them an explanation.. And thank you..

So that's all failing gracefully, and then post the failure.. Take some time to wind the thing down.. And basically the experience is, an entrepreneur is gonna be surging with all sorts of emotion, sadness, anger, grief, rage at 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, find a hobby, do some exercise, something different, side project, and rumination, 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 or two extremes.. Many founders will continue to blame everybody else and the universe for what happened, not their own failings or faults or mistakes.. And they haven't learned nothing, they'll probably gonna go found or try to found again, and they'll make exactly the same mistakes over again.. At the other extreme are people that take too much responsibility.. And so you wanna avoid those extremes..

The people who take too much responsibility will never be founders again, and some of them shouldn't be.. But most of them would 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 preserved relationships and reputations.. - Yeah, as we like to say, graceful, 00:41:59,500 or I'm now adding the word gray, so I think that's a wonderful way to put it.. Tom graceful failure is okay.. Unethical behavior is not.. That sentence is simple..

So we've gotta, do you mind if we do a couple of questions that have been to us? - Yeah.. 00:42:22,890 - So let me read you this one.. 00:42:27,410 It came early on, but let me know if we covered it already, we'll discover it together.. As students and future founders, what is one important component most new founders overlook when starting a venture? What is the key initial step you would recommend to new founders? So maybe that's a kind of a challenge and how to summarize that first block of a conversation we had.. - Yeah, so, you know, a big surprise to me with the work was 00:42:55,090 how important industry domain expertise is for some startups, but not others.. The founders that have sort of, at the very beginning of the catalyst for the work, they were building an apparel company.. And it turns out that designing and manufacturing apparel is incredibly specialized steps, and you better understand how they all fit together and how people are gonna do that work.. And my founders had no such experience and that got them in a lot of trouble.. Food and beverage too.. I mean, I'm sure you must at Stanford see a lot of folks launching, have a wonderful idea for some new food or beverage product, takes a ton of experience..

How are you gonna get a co-packer? How are you gonna get the packaging to jump off the shelf? When do you pay slotting allowances? When do you expand from local and national? So know whether the business you're in requires that.. And there are many, to launch Instagram you didn't need to have worked in photo sharing, you know? So there are many startups that don't require it, but there's some that do.. And you need to know that.. The other thing to keep an eye out for, I mean, we talked about the false starts.. So that's just be aware that there's gonna be a lot of pressure on you to build prematurely.. And then, we didn't talk a lot about the false positive, but basically it's really tricky to spot the false positive.. Because you need the early adopters and you will love the early adopters, and you wanna be loyal to them and serve their needs, and an entrepreneur should do all those things, but you can take it too far.. And so the first time founder needs to be aware that mainstream customers may be different.. And if you can build a business happily around early adopters only, good for you, but you'll probably need the mainstream.. - Yeah, thank you..

00:44:31,287 I think this is related to what you said, but you may want to embellish it.. Another person posted that, founders are almost inherently strong headed and obviously believe they are right, and have a better idea.. Part of the way, why they're starting a company.. Knowing this, how can you convince them to follow your advice and avoid these pitfalls either before they start a company, or when they're in the thick of, or headed toward a catastrophic failure.. And this is really to another one.. How do you know of an entrepreneur is coachable and will listen when things go bad in early stage? So it looks like that's a theme of a number of these questions.. - Boy, the second one's easy on him.. 00:45:17,130 You've worked with literally thousands of students over the years, and it's pretty clear to me at least.. And I bet to you when somebody is listening, and particularly if it's repeated contacts, whether they have.. And you don't expect of course, an entrepreneur to do everything as an advisor that you tell them to do, that would be a big mistake, 'cause they're gonna get whipsawed by lots of different advice..

So it is the entrepreneur's job to sort through what lots of conflicting views, but I don't find it hard to figure out who's coachable.. And I think that would be true for a lot of good investors.. They look for that and everybody listening, who's just, aspires to raise money, should know that entrepreneur, excuse me, investors are gonna be on the lookout for that.. Yeah.. The overconfidence thing is, it comes with the territory, right? We need entrepreneurs to be confident that they've got a winning formula.. If people were too sober-minded about the odds of success, no one would do this, and society wouldn't get amazing new products.. So it does work, and when it works, we get great stuff.. And even when it doesn't work, people learn things and sort of can bounce back and do other great stuff.. - Well, I'm gonna steal these last couple of minutes 00:46:32,180 to just finish down a question for you.. So it's wonderful to hang out with you, and think about the last 25 years of entrepreneurship education and just how far it's come..

And I'm including the teaching design, as well as teaching, taking novel stuff to market or to society.. Your job, it has been wonderful.. Why are you optimistic about the next 10 years in our field, that we, our occupation this notion that, yes, okay, we've proven, thanks to Harvard actually, because you were the pioneers long ago.. We've proven you can teach entrepreneurship and innovation, but what makes you optimistic about this coming decade for those of us who do teach? And that means for everybody in this room who to learn, because someday, maybe there'll be a teacher.. - Yeah, so the optimism comes from two things 00:47:25,860 and you're at the forefront of certainly one of them, and in many ways the other.. We're learning how important it is to pull ethics into the curriculum.. And ethics comes in two flavors.. It's sort of the moves that an entrepreneur makes, student view.. When do you fire your co-founder, ethically.. And then it's the ethics of the emerging technologies sort of privacy, and all that..

And they're related in some ways.. The entrepreneurship ethics, one day misrepresent your progress, at what point does it become Theranos.. And so I think when we figure out how to teach this and how to work it into our curriculum, the world will be a better place.. No doubt about it.. Entrepreneurs will be better equipped to think through these tricky choices they have to make.. The second thing that's got me excited, and Stanford's sort of, again, right in the thick of it, MIT certainly is, and I think Harvard is too, is tough tech.. People use different terms, MIT says stuff deck, and we love that hard tech, emerging tech, deep tech, frontier tech.. But everybody I think knows what I'm talking about.. This is space tech, it's autonomous vehicles.. It's a lot of clean tech technologies and they are bloody difficult, right? We know how to do software..

Basically, you usually can make the thing, but there's a lot of market uncertainty and lean startup turns out to be the perfect way to sort of sort through the market uncertainty.. and then you have make it, you got a winning business.. We know how to do biotech too.. There's actually often no market uncertainty if the drug works, and sort of solves the medical problem.. People are gonna adopt it, but there's enormous technical uncertainty.. And we've got a well oiled machine for putting money for the FDA testing and putting money in at the different phases and then selling the thing to big pharma, et cetera, et cetera.. What we don't yet have is a machine for turning out tough tech.. And tough tech's problem, because if you think about it, there's both market uncertainty, profound and market uncertainty, think better place and technical uncertainty.. And so the entrepreneurs who launched those businesses have to confront with very long development cycles, huge amounts of capital.. And we don't have an established way of funding these businesses..

And so I think as entrepreneur educators, we're gonna spend a lot of time at all these places, figuring out how to move those businesses forward and how to train entrepreneurs to run those businesses.. And that's important because these are the very businesses that are gonna make a huge impact on society if they work space tech, clean tech, Ag tech, we can go right down the list.. - Thank you for that, Tom.. 00:50:06,527 I'm gonna urge my colleagues, my teaching colleagues at Stanford to listen to these last three minutes.. (laughing) You just gave us a call to action.. And it's been terrific to serve on your advisory board for those 25 years too.. I'm out here, and I hope you'll keep me around, but most of all, thank you, thank you, thank you for sharing your wisdom and your thoughts about these topics today.. They're very important, and I know that this live audiences and the others will benefit greatly from.. - Thank you, Tom.. 00:50:38,883 And thanks to everybody at STVP for this opportunity..

(upbeat music)..