Reasons Behind The Failure of Startups

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Abstract

Researchers have actively worked on studies for failure rates and causes among startups as 90% of startups fail within five years of establishment. It is essential to understand the underlying causes behind the failures. The purpose of the study was to determine the cause of failure and support existing and aspiring startups to create policies and adopt approaches to sustain their business in competitive market conditions. The paper aimed to discern the factors that contribute to startups' failure and assessed several reasons according to internal, external, and behavioral factors. These factors have highlighted challenges including financial, regulatory, personality-related, available capital, market need, experienced and professional teams, and other entrepreneurial challenges. This documentary research was based on the qualitative secondary data analysis A three-dimensional framework was proposed to be used to understand how internal factors can be optimized, external factors can be controlled, and behavioral factors can be controlled to save startups from failing. Moreover, the research also seeks to point out the factors that helped the success of several startups across the world.

Keywords: startup failure, causes of startup failure, reasons for startup failure, reasons to exit, startups

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1. Introduction

1.1 Research Background

Startups or entrepreneurial ventures are some of the most popular businesses all across the globe. These include companies started by now famous individuals like Elon Musk, Steve Jobs, and Mark Zuckerberg (Rudden, 2021). According to Baldridge and Curry (2021), startups are novel business ventures that are established for manufacturing a particular product or service. They are responsible for introducing these to the market and making them an unparalleled option for consumers. These companies are born from innovation and ideas to combat shortfalls of the pre-existing products of the same niche. They can also come up with their own product range or services that will benefit other industries or customers. Their revolutionary outlook has earned them the tag of being “disruptors". A few popular names in the startup domain include Amazon, Facebook, Google, Apple, and Netflix. Together these big guns are called ‘FAANG’. However, these are not all, businesses like Beyond Meat, WeWork, Peloton, etc. also fall under the startup category (Baldridge and Curry, 2021)

Startups that have higher market values are termed as ‘Unicorns’, which highlights their ambiguity. As per the statistics, America and China are home to the most numbers of Unicorns. Among these, the amount of American unicorns is twice more than their Chinese counterparts. However, the startups in China are two times more valuable than the American startups. By 2021 April, Ant Group, a Chinese tech firm, emerged as the startup with the highest market value. While in America, the Latin American region stands out as a hotspot for startups. Nations like India and South Korea also cover a percentage of global startup ventures (Rudden, 2021).

Furthermore, approximately 7.1% of startups worldwide have their roots in the Fintech sector. Healthcare & Life Science (6.8%), AI (5%), Gaming (4.7%), etc. follow the former at the respective percentage. This domain categorization data may not be entirely precise, however, one can easily decipher that contemporary startups are leaning more towards the digital or internet technology-based concepts (Minaev, 2021).

Exit is the process of a unicorn getting acquired by another organization or turning into a public firm. In such cases, the startup is not called a unicorn anymore. From 2014, there has been a gradual increase in the exits of North American unicorns. However, this is not the case with unicorns of other demographics. For example, in 2018, the number of exits grew in the Asia-Pacific area, but slowly fell in the following years. Regardless of the dissimilarities in the data, both the North American and Asia-Pacific regions have experienced extensive exit values in the last 15 years (Rudden, 2021). However, by 2020, the world had 475 unicorns whose total estimated value was around $1.394 trillion. (Fedorychak, 2021)

1.2 Research Problem

There are different perspectives when it comes to assessing the success of startups. While some of these are based on facts, several others are mere exaggerations.
Simultaneously, many are of the perception that opting for a startup is simple or doing business is an effortless job. However, this is a proven myth or fabricated concept (Minaev, 2021). Each day, novel startup ideas are born and established all over the world. However, the success of a startup is built over numerous failed attempts (Rudden, 2021).

According to some studies, nine out of every 10 startups do not succeed. It is noted that every year around 20% of startup ventures collapse, while 30% shut down in the first 2 years of their start. These numbers increase 50% when we talk about startups closing in their initial 5 years and 70% in 10 years (Minaev, 2021).

This clearly implies that more than half of the startups are unable to make it through. And over two-thirds of them cannot repay the investors (Harvard Business Review, 2021). Additionally, it is proven that 40% of startup ideas can get returns. While 30% keep losing their finance, and the last 30% close down (Mansfield, 2019)

1.3 Objectives of the Study

Most budding entrepreneurs take their steps back after reviewing the high failure rates. This has also demotivated the stakeholders from making investments in ideas that may not deliver them optimal returns on their investments (Chalak, 2019).

This study aims to illustrate the accurate figures on startup failure, their causes, present startup ecosystem, features of a constructive startup ecosystem, support requirement, and providing solutions for the pre-existing gaps in the system.

The main aim of our research is to discern the factors that contribute to startups failure. The result provides a comprehensive glance over the common errors made by beginner entrepreneurs during the initial stages of startup development.

1.4 Scope of the Study

The material of this paper has been drawn out after researching with concerned research articles, journals, books, websites, reports, magazines, etc. All the concerned material has undergone deep study along with reviewing procedures encompassing various databases like Ebsco and Emerald. Google Scholar was also used to get relevant material. Recent literature is the main factor concerned for the discussion, finding, and material of this paper.

1.5 Research Significance

The study highlights the key factors that fail the startups. The results of this paper will help future entrepreneurs to understand the practical issues faced in the market. These factors affect the success and failure of businesses. The information will make them strong for making business concerning decisions in an effective way along with preventing the risks and negative factors related to the failure. Successful startups will help in solidifying the economy with diversification, increasing employment, and reducing poverty.

Along with it, the study provides suggestions that can help the government in making efficient policy-making along with providing augmentation for the small number of information sources that lead to the failure of startups.

2. Literature Review

A smoother growth of the economy relies on an increasing number of startups budding into major enterprises. This will increase the employment rates in entrepreneurial ventures. However, the road to establishing a successful startup comes with its own unique set of challenges. It is observed that only a few entrepreneurs have what it takes to overcome all these obstacles and emerge successfully. Normally, it is observed that the startup survival rate is very less, which implies that most startups have to face lots of hardships before shutting down. For the US market, around 90% of startups fail to survive the initial 5 years (Patel, 2015). This is very much similar to the Indian startups (Businessline, 2018). This situation is similar to most other countries. The closing down of a startup does not only affect the entrepreneur but also the firm they founded. However, the after-effects of unsuccessful startups transcend from the brand and affect the economy or employment. The failed journeys of such entrepreneurs become an example for aspiring entrepreneurs, to keep growing while avoiding making the same mistakes. It is suggested that the founders should have the autonomy to innovate according to their needs and maintain minimal failure expenses (Bala Subrahmanya, 2017). Furthermore, knowing entrepreneurial learning is important for any potential entrepreneur. It can help them lead their business to success and will also support the ecosystem (Startup Genome Report, 2017).

2.1 Failed Startup

Any thriving startup will have adequate finances to back its operations up. On the contrary, a failing startup will not be able to get adequate revenue. In most cases, such firms experience a lack of suitable long-term objectives and cash flow-based problems. This generally results in interruption of their operations. On a larger scale, lowering the startup failure rates will ensure that entrepreneurs and firms have proper backing to make their brand successful. While on a smaller scale, detecting and recognizing the reasons behind failures can assist in developing a failure-proof mechanism. It will significantly reduce the socio-economic expenses for failures. While the lessons learned, or Epiphanies, will educate potential entrepreneurs (Kalyanasundaram, 2018 and Singh et al, 2015).

2.2 Reasons for the failure

CBInsights (2021) has mentioned the list of common reasons behind the failed startups.

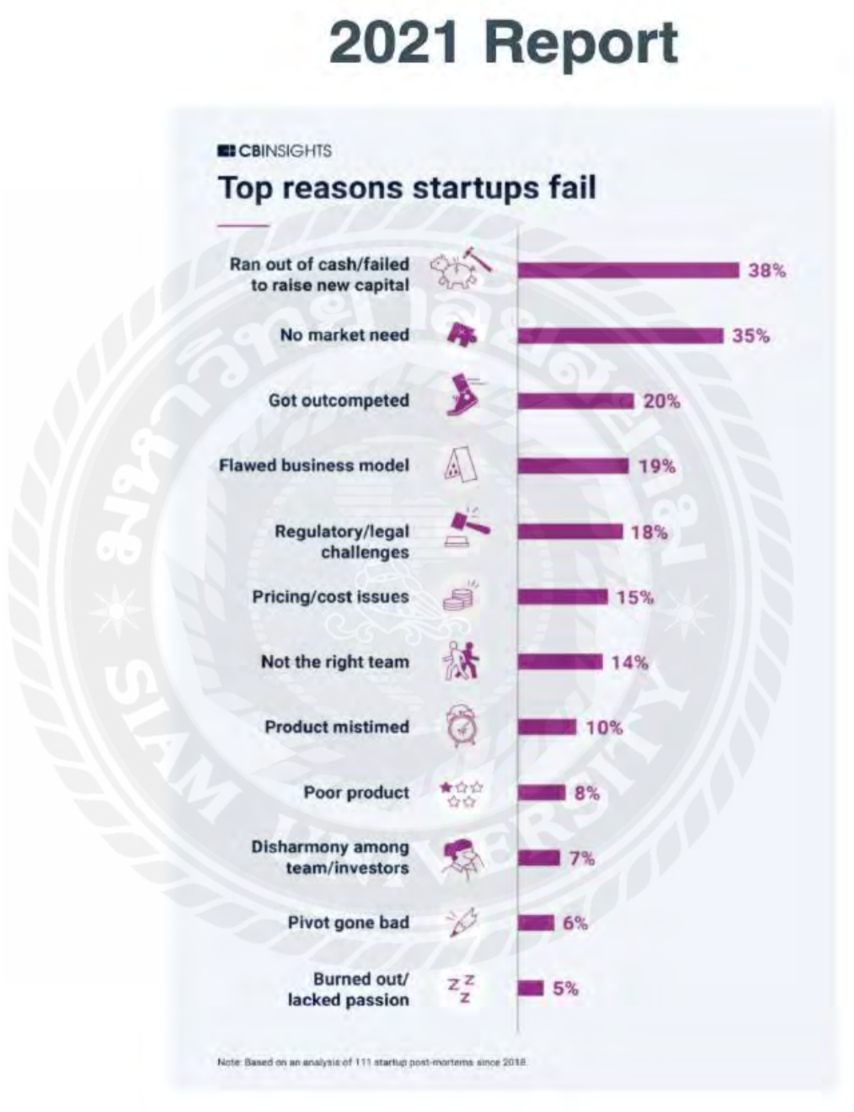

Fig. 1 Top reasons for failure

According to Mancha et al. (2019), there were 7 common mistakes observed upon analyzing 16 novel startup platforms. These were: 1. The inability of delivering flawless Digital Experience; 2. Lack of a Vibrant Ecosystem; 3. Failure of making the best of Capitalization Opportunities; 4. The ineptitude of identifying and balancing strategic opens on the main Pivot Points; 5. Incapable of harnessing the power of Physical and Digital asset blend; 6. Lack of timely Innovation; 7. Failure of complying by Emergent Strategies. Few other crucial components of platform failures are Business Model, Platform, and Process Innovation (Fu et al., 2017). Based on an article, published in the Harvard Business Review, 5 main elements can affect the failure: Network Effects, Entrepreneurs' Hubris, formation of improper Strategy, Product Timing, and failure in gaining the consumer's trust. Yoffie et al. (2019) has also categorized some of the common errors in startup failure. These 4 groups are 1. Late Startup Decision; 2. The inability of establishing trustworthy relationships with consumers or stakeholders, 3. Misalignment towards one niche market, 4. Early Redundancy of Competitors. Some older studies on reasons that cause startup failures have very differing views.

2.3 Financial Challenges

In a few findings, fiscal challenges are regarded as one of the major causes of startup failures. According to Atsan (2016), these obstacles are the internal aspects of the firm. Additionally, receiving the fitting price is important for a platform (Yoffie et al. 2019). To survive, a startup platform must reform its pricing strategies to maximize the inclusive value of the platform (Reillier & Reillier, 2017).

2.4 Regulatory Challenges

These are also sometimes referred to as Legal Problems. These are generally more influential for modern startups. In case a startup is unable to deliver product/ service quality and optimal safety, then they are putting their existing and potential consumers at stake. In addition, making faulty or fake assurances will surely have detrimental effects on the business functioning. This can pose another problem for startups since they are operating on limited resources (Choudhary, n.d).

Furthermore, media-based startups employ non-exclusive products to obtain user information to deliver tailored services. However, the lack of conformity with appropriate safety procedures makes them vulnerable to legal accusations. They may get sued for using personal data. Khajeheian (2020) advocates that spreading obscene content, like abuse/ fraud/violence, pornographic, pirated content, etc. has led many startups towards lawsuits. Some, against the producers, were put forth by anonymous individuals or organizations. Thus, startups that encouraged media-based entrepreneurship became the founding layer of the entrepreneurial economy. However, they still have to adapt new requisites to strengthen their business, society, and other firms.

2.5 Personality-centric Challenges

Excessive pride and overconfidence are some ineffective attributes that can lead to failures (Yoffie et al. 2019). When employed with accurate financial data, human traits can assist in predicting failures. Based on research done by Khelil (2016), the personality attributes of an entrepreneur shape the success or failure of a startup. They are also linked with the emotive or psychological characteristics of entrepreneurship. Every platform depends on the leading entrepreneur's capability to capitalize on the available opportunities on digital platforms (Dal Zotto & Omidi, 2020). Both Omidi and Dal Zotto agree that an entrepreneur should always consider the amendments in the work nature and consumer behaviour.

Apart from these three reasons, several other causes vary from situation to situation. The startup platforms bring up numerous investigations that are important for identifying suitable opportunities. Moreover, the fast evolution of the sector has introduced newer problems and analysis organizations. Additionally, maintaining healthy customer relationships is significant as well. This includes interactive (through social media platforms) or direct (from producer to buyer) (Crespo et al., 2020).

The political and governmental authorities are actively taking steps towards increasing their command over public opinion by accessing the social media domain (Dal Zotto & Omidi, 2020). The mentioned data helps in understanding that the failure of a startup is not because of the low chances of succeeding. Rather, it is because of errors and improper management done by the individual who aspires to become an entrepreneur. If the startup idea is properly planned and well-thought, then it can succeed with the entrepreneur making the best use of available opportunities. They also need to target their functioning to serve the customers and work according to the consumer demand. Additionally, one must also devise team-based models to enhance management. Lastly, their faith in their success also plays a crucial role in determining the prosperity of the business. This is because the success of a business idea does not only rely on resource availability, but also the skills, expertise, and knowledge of the leader. Upon performing a thorough analysis, it is observed that effective planning, innovation, growing, planning, and precise timing can help the startups in emerging as a unicorn in the industry (Kasimov, 2017).

2.6 Lack of Money or investors

As mentioned above, finance unavailability or insufficiency is a common and major issue with startups (Mikle, 2020). It is always among the top 3 problems as discovered by multiple studies performed previously. However, there are different aspects to this challenge. One is issues with finding the right investor in time. According to some founders, startup businesses are unpredictable and have caused investors to lose lots of their money. They have also failed to achieve their short-term goals, giving the potential investors more evidence that no startup can show exponential growth. Furthermore, the absence of relevant business models, for the investors on such issues, has led to inadequate awareness among the stakeholders. Over time, the scarcity of understanding has created a gap between investors and startups (Bednár & Tarišková, 2017).

Another financial problem aspect for startups is acquiring the right financial support and resources for shaping the business idea. This is very crucial in the phase when the business is unable to generate adequate income. Therefore, to maintain the fund inflow, most startups get financed from external providers like state support, venture capital, crowdfunding, development capital, or friends/ family. Zagorsek (2016) recognized and enlisted a few positive effects of employing a higher cost strategy. Moreover, in over one-third of startups, it was observed that they have not planned and specified the exact amount of funds required for introducing the product. They also have made errors in their investment schedule. Simultaneously, these startups failed to reach their sales level to open another revenue stream for their business. The absence of proper financial sources exposes the business to another set of problems that include: spending on operation costs, compensating for the capital expenses, funding the business expansion, and various other expenditures.

2.7 Lack of need

While this was not mentioned in any of the above-listed studies, the lack of consumer interest in the product/service offered by the startup is also a leading problem (Mikle, 2020). The founders explain this issue as the insufficiency of real market testing. Most of these researchers have reached out to the buyers and questioned them about common issues they face and presented suitable solutions. The analyzes in the preliminary stages were quite favourable. Although, when the product was launched in the market, potential consumers, who were initially interested in investing in such a commodity, did not purchase the item. Another problem that arises here was that the founders suspect that the product launch timing was not suitable. This could mean either the brand was late in introducing this item or the market is not prepared for hosting such products (Sharma, 2019).

2.8 Absence of the right team

A startup must have an experienced, talented, and qualified workforce to drive the attention of suitable investors. It also decides the success or failure of a business (Giardino et. al, 2014). To cope up with this challenge, most startups have to make adjustments or replace their business model multiple times. However, the right implementation of such approaches can only be done if a firm has an appropriate team. Some of the common problems under this category included not having a seasoned group of people. Additionally, in most situations, individuals with strong personalities or incompatible attributes can cause many conflicts. This has also been observed in candidates that seemed potentially competent during their initial stages but emerged as more unskilled in the later time. Lastly, appointing inept individuals as team leaders will generate improper performance from the team. Under this, either the leaders did not deliver proper demarcation of work or they were unable to interact/ communicate with their team (Bednár & Tarišková, 2017).

2.9 Entrepreneurial issues

Most studies conducted on the success/ failure of startup businesses specify more than one factor that led to the particular result. This ensured that increasingly more and more studies opted for a multi-dimensional approach to responding to such issues (Khelil, 2016). Human competencies are generally employed for other tasks alongside financial data to predict the failure or chances of survival and development of the business as a result. The researchers suggested that the failure of a venture was connected with the environmental data, business resources, personality attributes of the entrepreneur, emotive/ psychological components of being in the entrepreneurial sector. Furthermore, in this finding, failure was provided with a larger meaning. It was not only related to the withdrawal from a company, mainly because of economic aspects, but also with the under-performing skills and approach of the entrepreneur (Cantamessa et al., 2018). Hammer and Khalil (2014) state that the personality attributes of an entrepreneur were explored in-depth using a combination of strategic preferences and management problems.

Based on the research and review, a key research gap has been identified. The literature covers an overview of start-ups' failure, however, there is a critical research gap and the need to study the reasons comprehensively, prevails (Kalyanasundaram et al., 2020). There is no comprehensive research that mentioned how the internal and external reasons are linked with the behavioural reasons of the failure. Moreover, there is a lack of comprehensive study that covers all the dimensions of failure in startups. And there is a lack of dedicated work on exploring the reasons behind the failed startups.

3. Research Methodology

The documentary study has taken a research approach of qualitative secondary data analysis. It has combined literature and data from several reputed and internationally published journals and organizations. Secondary research has gained immense popularity in the last few decades following the ease of data collection and effective analysis (Long-Sutehall et al, 2010). In the social sciences research, documentary sources are not ideally harnessed as researchers aim to conduct individual documentary research, however, this study has incorporated the documentary sources to integrate social and historical value to the research. Secondary qualitative research methodology enables the implementation of a broad narrative by including specific studies relevant to the concerned research topic. As per Scott & Marshall, 2015, documentary research can be defined as research that uses various documents to meet the requirements of the source. They can be journals, diaries, newspapers and all the other documents. The documentary research design compliments the topics relevant to content analysis as well as other methodologies.

4. Findings

Startups have emerged as the top businesses worldwide and contribute a large part of the overall economy of the country. Some of the most popular businesses and ventures globally were born from startup ideas. These entrepreneurial firms are founded to deliver a particular type of service or product to consumers. However, regardless of their growing popularity, these businesses have to face significant hardships to get a firm grip over the market. Numerous challenges range from the disinterest of investors to making well-informed decisions. With the increasing number of startups, the importance of educating entrepreneurs about avoiding these obstacles has grown simultaneously. Over the years, many types of research and studies have been performed to find suitable solutions for the existing issues in startup operations. Furthermore, this has also helped in exposing the myth that running a business is easy or hassle-free. Most studies covered in the literature have mentioned that more than half of startup ventures are unable to keep up with the volatile market and have to opt for exit or closing the business.

This study aimed at examining about the risks that are associated with starting an entrepreneurial firm. After taking several other studies and documents into account, it can be observed that some of the most common challenges faced by a startup are either related to financial resources or the personal attributes of the leader of the business. However, these are not all, a few other problems include regulatory issues, the inability of monetizing the available opportunities, compliance failure, improper timing, inadequate utilization of the accessible digital and physical capital, and more.

To foster better understanding, a framework has been developed. The reasons for failures are categorized into two broad yet inclusive sections: Internal and External.

The internal factors include regulatory issues that come up because of lack of conformity, faulty products/services or any fake promises that make startups vulnerable to lawsuits (Khajeheian, 2020). Other internal factors include inefficiency in reading the market needs and insufficient market testing by the startups, lack of appropriate human resource or team (Sharma, 2019), entrepreneurial skills of strategic planning and decision making related to business model, market, competitors, products etc. (Cantamessa et al., 2018). On the contrary, external factors include the reasons that are from the external environment and beyond the control of a leader. This includes a lack of investors and funding (Bednár and Tarišková, 2017), corruption, and technological innovation (Justino, 2015). These factors trigger behaviour like emotional overreaction, impatience, overconfidence, etc. (Joseph, 2020) of the entrepreneur and they take decisions as per their personality which in return fail in the startup.

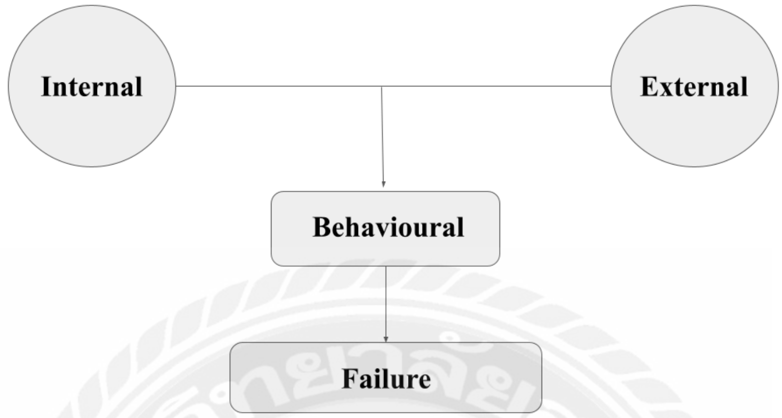

Fig.1. Three Dimensional Framework

These categories, Internal and External, are not interrelated and interdependent. Nevertheless, they generate a change in the business conduct and leader behaviour, which in turn leads to the success or failure of a business. In simple terms, the errors of the previous entrepreneurs and reliable studies help the novel entrepreneurial firms in understanding the recurring reasons behind the failure of startups. By knowing the potential problem areas and predicting issues, one can evade challenging situations while maintaining operational flow. Furthermore, it will also bring a change in their approach towards an obstacle, which can be both- positive or negative. If the individual can make positive modifications to their conduct, then there are high chances that they can make their startup venture successful. In contrast, if the changes are negative, then the entrepreneur might be increasing the adversity of the situation and lead their business to failure. Entrepreneurs need to understand that if they do not want their startups to fail, they need to leverage external factors, optimise internal factors and resources and control their behavioural characteristics.

5. Recommendation and Discussion

As per the findings of the research, aspiring entrepreneurs must inculcate the factors or challenges of beginning a startup in their study or research. The study highlighted that financial resources are of utmost importance to pursue a stable startup, however, individual factors concerning leadership skills and other personal attributes are also critical. All aspiring entrepreneurs in the present times must be guided on strategic thinking and objectively dealing with these issues. Entrepreneurs who become successful or ideal leaders move with precise measures to get over their weaknesses. They take self-discipline very seriously. Their ideas along with the advice from the right group of people modify their attitudes and viewpoint (Joseph et al., 2021). Personality based transformations are important and should be taken into account while putting efforts into establishing a business. Running a successful business is not merely about a good idea but the execution of proper actions. The study explored that external factors like regulatory framework, capitalization of existing opportunities, execution of compliance requirements and other factors remain significant to favour the growth of a business. Though, the study also found that it is sometimes not possible to find the specific reason for business failure. However, it is privy to determine the right causes of failure through focusing on problem areas and accurately determining the existing loopholes in the operational framework of the business. Only after a wholesome effort in all the domains, businesses can be made productive and great output can be expected. Lack of money is one of the most common reasons for a start-up's failure. This factor along with bad execution can ruin the entire business plan. Still, entrepreneurs can recover from a loss. But the constant backfire will eventually lead to failed confidence of investors in a start-up.

The formation of a startup is based on multiple factors. The main foundational requirements are triangulation of behavioural characteristics, deployment of Intrinsyc factors effectively, and extensive utilization of external factors. However, on the failure of these triangular factors, The startup remains unsuccessful and challenges remain unanswered. This is an alarming situation for major failures of a startup. The limited resources for internal activities convince the entrepreneurs to spend the allocated amount wisely to obtain maximum returns. The uncertainties around the success of a start-up depend on the executed actions and planned actions for the future. The tough and resilient entrepreneurs express confidence, self-awareness, and the ability to learn continuously (Korber and McNaughton, 2018).

The entire process of establishing a business is emotionally demanding. The tough and lifelong lessons learned by the entrepreneurs affected their emotions deeply. The grief recovery is very demanding. The most common cause of failure is ignorance towards potential clients. Start-up employees must take proper care of the customers to cultivate good relations with them (Yohn, 2019).

Start-ups get noticed when they have an effective business plan. Not every start-up attracts investors such as Accel Partners' who invested in Facebook. Around 29% of cases lack money and resources. The right group of skilled people in the team brings great change to the overall success of a startup. New businesses without a good team end up failing badly (McCarthy, 2017). As per the findings of the research, some of the recommendations for upcoming businesses could,

- New entrepreneurs should focus on exploring the complexities of their business model. It will help them determine the problem areas and further implement a solution suited to sustain the business in the market.
- They also need to explore and study the market while analyzing the mistakes made by previous entrepreneurs to make sure they don't repeat their mistakes.
- Assessing and planning the behavioural approach within the market is necessary to overcome the issues related to internal challenges for a startup. It can be done by accurately supervising the conduct of the team and self.
- Diligent monitoring of changing trends in the external environment would also help entrepreneurs to deploy a dynamic approach and accordingly optimize their operations to leverage the competitive edge from the market.

Besides the great fortune that pushed the success of big tech giants such as Google and Facebook, there are multiple reasons why start-ups succeed so much. The selling point for every start-up is its product. A complete product that meets the demands of the consumer and doesn’t ignore their needs is optimum. The national government provide various subsidies to boost the startups with the hope of nurturing the ecosystem as the startups generate jobs, and contribute to the economy directly and indirectly. However, they become a burden if they fail. Hence, with subsidies, the government should conduct basic preliminary skill criteria for launching the startup. Moreover, they can tie up with the NGOs and conduct seminars and workshops that can help the prospective entrepreneurs understand how they can leverage external factors, optimise internal factors and control behavioral factors to save themselves from failure. For future reference, interested scholars can expand this study to understand if the underlying internal, external and behavioural factors are universal or these differ with sector and country. Moreover, it can also be expanded and key driving success factors can be added alongside to have a more exhaustive understanding.

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