More than 100 million startups are founded every year (that’s about three every second), but 92 per cent of them will fail within three years—and the crazy thing is that this is largely preventable.

Just think about that for a second. In any other area of your business or personal life, if 92 times out of 100 a course of action didn’t work, you’d think of doing something quite different. Yet in the startup world these high failure rates are accepted with a shrug, because ‘that’s how it is’. Why?

This book aims to challenge that acceptance. Failure shouldn’t be the natural way of things.

We need to study startup failure more closely to understand why it happens. That’s what struck me when I started investing in startups. If we can better understand why and how startups fail, then we can increase the chances of their success. By learning from others’ mistakes, we can ensure we don’t repeat them. If we can move the needle to decrease the failure rate by just a small amount, it will have a huge impact—both to the founders who put their heart and soul into their startups and to the investors who back them.
Paul Graham, the respected venture capitalist and co-founder of Y Combinator, distinguishes between startups that are *default dead* (if they maintain their current trajectory on sales, growth rates, expenses, they will run out of cash) and those that are *default alive*. The reality is that most startups, especially in the early stages, are default dead. Many founders don’t even ask this question, or they ask it way too late. Graham goes on to describe the ‘fatal pinch’, where a startup is default dead, unable to raise the cash to survive, essentially the ‘walking dead’. The founders are deluded into thinking they can raise more cash, but they are essentially in a death spiral. Raising capital is by no means easy or certain, and even for those who do manage it, fundraising success does not equate to future success. Especially if the company is default dead.

Default alive, on the other hand, means a startup is at or heading to break-even and can survive and thrive on its available cash. These businesses have a viable future, and can move on from thinking about fundraising to thinking about growth and new prospects. I want to help founders think about the default state of their startup, and to consider why and how it could fail.

**THE CULT OF FAILURE**

Failure is a word you hear a lot in the startup community. The term *fail fast* is associated with the lean startup movement, which is very well articulated by Eric Ries in his book *The Lean Startup*. However, I believe the term is much overused in the startup community and indeed misunderstood by many founders and their teams.

Behind the *lean startup* is the concept of iteration. The idea is that if a new product proves to be unsuccessful, the business should let it fail fast, after which the product can be iterated based on customer testing and feedback. You develop a *minimum viable product* (in which you invest the least expense needed to make it workable), and you test it with customers. You iterate and improve it, then repeat the cycle.
It is a sensible approach, but it is often misunderstood by founders. What Ries is talking about in *The Lean Startup* is a robust approach to product development and a way of validating product/market fit. Let’s get some customer feedback, then we’ll test, iterate, test, iterate, and we’ll go through that product cycle. The challenge is that founders often misconstrue the fail fast idea by applying it at the company level.

Ries doesn’t mean that your startup should fail. He is talking about iteration and customer feedback loops at a product level. The startup community gravitates towards these catchphrases and sound bites that don’t mean much outside their proper context. Your startup still needs a plan.

I’m all for developing a learning culture inside a startup and truly practising the ideas behind the lean startup, but I want to define the difference between good failure and bad failure.

**SELF-HARM: GOOD FAILURE VS BAD FAILURE**

Most founders think about failure as an ‘external’ event — something that happens to you, causing you to fail. More often failure is an ‘internal’ event. It’s about self-harm: you are doing something or not doing something that causes you to fail. Sadly, most startups fail from the inside.

The insight here is recognising that it’s not about karma or fate. Most startups are disruptive to some extent: it is they who are delivering external competitive pressure to traditional businesses, not the other way around. Most startups are not disrupted by someone else — they implode. And guess what? That’s great news, because it means you can develop a plan and take action yourself to avoid failure.

Later I will discuss the 10 main reasons why startups fail. Every single one of those reasons can be prevented. There is a belief that startups defy gravity. We have this twisted idea that startups are somehow
special, but the truth is this: a startup is no more special than any small business. If I intended to start a small business such as a bakery or a café it would be reasonable to be asked, ‘Do you have a sales plan? Do you have a marketing plan? Have you thought about where you’re going to locate it and the demographics of your customers?’ Many startup founders, however, think they don’t need a plan. They are just going to ‘fail fast’. No shit. The startup myth perpetuates the view that gravity does not apply to them. In fact, they need all the planning and execution that any small business needs.

PLACE YOUR BETS: THE VENTURE CAPITALIST APPROACH TO FAILURE

Venture capitalists (VCs) understand very well the risks associated with investing in technology startups and have developed a simple but effective approach to managing that risk. The conventional VC approach to risk mitigation is to invest in a broad portfolio of startups. VCs traditionally came from finance backgrounds. Before and during the internet bubble, they funded startups with little understanding of the companies or business models they were investing in. They knew there were high failure rates, and their approach was ‘let’s just lay a lot of bets’.

The premise was if 92 out of 100 startups fail, then put down 100 bets and the eight successes need to pay off big enough to make up for the failures (and they did). In a world of unicorns, the eight paid off at rates that were so high that it made the 92 failures insignificant — except to their founders.

It was a reasonable strategy from the VC point of view. Let’s just lay out a whole lot of bets, assume that 92 of them are going to fail, and make sure the eight are unicorns.
Today VCs are far more sophisticated. They are more involved with the companies they invest in (many of them are former entrepreneurs and startup founders), and far more interested in examining the reasons for failure and mitigating them. If you look at the problem from a venture capital perspective, there’s an absolute economic reason to improve the success rate of startups — investor return. More success equals more money for everyone.

That said, a lot of investing behaviour, particularly at the early stage, is still very much influenced by what I call the slot-machine effect.

**THE SLOT-MACHINE EFFECT**

Human behaviour is a funny thing, especially when it comes to payoffs. Everyone knows that you can’t win at the slot machines, that they are wired and programmed for you to lose — casinos were not built by the winners. Everyone knows the statistics, but people play them anyway. Imagine 100 people playing slot machines; 92 of them pull the handle, and 92 lose their money. Then eight people sitting near them pull the handle and make a billion dollars. Human behaviour doesn’t look at that in a rational, statistical way.

It’s the same reason people play the lottery. Even though people know the chances of winning are minuscule, the jackpots are so enormous that they create a reality distortion field. People don’t think rationally about the losses.

When people see an Uber, a Facebook, an Instagram or an Atlassian — all high-profile startups — they put them on a pedestal. There’s a lot of cultural storytelling about those businesses, which has created a powerful mythology. In fact these companies are rare exceptions to the rule, yet humans have this inbuilt emotional belief that says, ‘If I want it badly enough, I’m going to be one of the exceptions.’
I listen to three or four startup pitches almost every week. Most people who pitch to me haven’t addressed the core, foundational issues around avoiding startup failure. They don’t have a business model. They don’t have a value proposition for a product or service that customers will pay for. It’s astounding.

I meet prospective founders all the time who say (and believe), ‘I’ve got an excellent idea — it’s going to be the next Facebook.’ That’s easier said than done. There’s a big journey between a brilliant idea and Facebook. Too many founders don’t recognise that or they minimise in their minds how challenging the necessary execution around an idea is.

**UNICORN TEARS: THE REAL IMPACT OF FAILURE**

It’s easy to think about the financial impact of failure. Millions of dollars of investors’ money is flushed away every time a startup goes under. Billions of dollars are wasted every year. As a founder myself, I have also seen the results of failure on another level — the personal impact. I’ve seen founders whose marriages have broken up, founders who suffer from depression, founders who have turned to alcohol or drugs, or have even become suicidal. This is the dark side of startups that no one wants to talk about. We love to focus on the glamour and the unicorns, but not on the unicorn tears.

Startup failures take a huge personal toll on founders. They have taken a risk, put themselves out there, worked themselves to the bone, then the business goes under, usually in a very public way. They must go home and tell their partner that they don’t know how they’re going to make the mortgage payments or the school fees. They have lost their job, and the rest of their team have lost their jobs too.

This is the reason I wrote this book, and it’s something I am hugely passionate about. By addressing the preventable failure of startups,
and the impact this failure has on founders, I want to help you to avoid the unicorn tears.

We should be concerned with investors losing their money, it has a huge impact on the economy. But we should also be concerned with founder waste. For our society to progress we need innovators and risk-takers. We need startup founders. Too many of those innovators are wasted, chewed up and spat out, never to return to the startup ecosystem. Some may say this is Darwinism at work, that only the strong survive. Yet most founders simply aren’t equipped with the skills they need to be successful, and we are only now starting to explore and understand why startups fail and how to prevent that. I want those founders, having learned from their mistakes, to come back and build bigger and better startups.

CASE STUDY: MY ‘CLIPP’ AROUND THE EAR

Several years ago I made an investment in an early-stage startup called Clipp. It is a business operating in the mobile payments space, solving the problem of bar tab management. To use Clipp you go to a bar, open a bar tab using the mobile app, order drinks and pay automatically. It is a very smooth, Uber-like experience.

When I met the company founders I was excited. It was one of the few startups I saw that year to do something new. They had built a functional version of the product, and it was working ‘in the wild.’ The technology was unbelievably well built and the software developers in the business were amazing. I was one of a group of investors who seed-funded the business, representing approximately 27 per cent of the equity and taking a seat on the board.

(continued)
In retrospect, if I look at the reasons for startup failure that I will discuss in detail in these pages, I think this business ticked almost every box. In my view there were founder issues and funding issues, and the business model turned out to have major challenges.

There were a lot of arguments. From an investor perspective, I would say that the founders were difficult to coach in the way I would have hoped. By this I mean lots of people with experience were trying to help the founders of the company, but that help wasn’t well received. The founding team argued among themselves too. They were all really nice people personally, but I feel that the dynamic between them, and ultimately with us as investors, deteriorated — to the detriment of the company.

From a funding perspective, we probably gave them too much money in a single tranche. And we didn’t link the funding to key operational milestones. More importantly, even though it was a sexy product, in my view the business model had serious challenges. It just wasn’t possible to make enough money using the business model we had. The model had made that business default dead. It came close to running out of funding (the fatal pinch) and another strategic investor took on our investment. The initial seed investors lost a reasonable amount of money.

Clipp was one of my earliest investments. I made a lot of mistakes. That said, the experience was a major inspiration for this book. After my investment in and subsequent exit from Clipp, I reflected a lot on why the business didn’t achieve its full potential, and what I could have done differently. Many of the lessons outlined in this book come from what I learned from that investment. It was then that I began to look more deeply into why startups fail and the various levers that you can pull to prevent it.
In the aftermath there were a lot of questions. Could we have foreseen the founder dynamic? Could we have done more due diligence around identifying the risks? Could we have put more effort into validating the business model before we made our investment? Could we have helped the founders validate their business model? How could we have partnered with the founders more effectively around some of the issues — their cash burn rate, for example — so the business was more successful? It was a business with so much promise — more than I’d seen in a long time. Sadly that promise was just not realised, largely because of preventable, internally driven issues.

It’s easy to underestimate the huge personal impact of these failures, when you have investors breathing down your neck and unhappy customers, and the embarrassment of telling your friends and family, ‘Hey my business isn’t going well — it may go under.’

The problems weigh heavily on you when things aren’t going well, so it wasn’t a good experience for those founders. But investors can move on and make another investment. It’s not the same for those who put their blood, sweat and tears into the business.

LIGHT AT THE END OF THE TUNNEL

By now you are probably thinking, ‘Why would I ever want to get into this startup game? It sounds horrible.’ Ask any founder and they will tell you how hard the journey is — but also how rewarding. Creating something from an idea, and turning it into a successful company, is hugely satisfying — if you have the capacity and capability to take on that challenge. I want to introduce you
to a methodical approach to developing yourself as a founder and building a startup that works.

You will face many challenges as a startup founder. Hiring is important, but this isn’t a book about talent management. Leadership is essential, but this isn’t a book about leadership. There are many dimensions to success in business. In this book I am looking at how you can avoid, prevent or mitigate mistakes that would have a high impact on your success or failure. I set out a structured methodology for how to develop your product from an idea to a fully launched company with the maximum chance of success, while making sure you as a founder survive the journey.

Startup success isn’t an art, let alone a black art. And it isn’t a matter of saying, let’s just roll the dice and hope it works. Taking a structured approach to managing startup risk gives you a critical competitive advantage. By reducing some of the risks, you’re going to jump ahead of other startups.

Since the internet bubble, technology startups have proliferated at an extraordinary rate (as mentioned earlier, three startups are founded every second). More than $50 billion is invested in venture capital every year. While that sounds like a lot of money, with more competition for a finite amount of money, startup capital is in fact becoming harder to find. In particular, seed funding (to get started) and ‘Series A’ funding (to grow) are becoming more difficult to access because investors know that a lot of startups are going to fail. By studying why failure occurs and how to mitigate those risks you improve your odds of being funded.

You need to be able to have an informed conversation with potential investors: ‘We know most startups fail, but here’s why they do, and here’s what we’re doing to eliminate those failure points.’ With this informed approach, investors are going to take you more seriously. Thinking more deeply about failure before it occurs means you’re going to be more prepared when issues arise, and this will set you apart from the many founders who don’t even understand that their startup is default dead.
Myth: Startups are glamorous

Do you know a startup founder? If you don’t, I want you to go out and find one. Once you have found one (the hoodie is often a giveaway), ask them about their experience as a startup founder. You will hear words such as exciting, stressful, fun, challenging and enlightening. What you won’t hear is glamorous. If you expect founding a startup to be glamorous, then you should put this book down and go back to your corporate job. Startups aren’t for you.

ARE YOU STARING FAILURE IN THE FACE?

Before you begin your startup journey it’s worth asking yourself some important questions. Here are 10 questions you should think about.

1. What is your motivation for starting your business?
2. What proof do you have that customers want your product?
3. What proof do you have that customers will pay for your product?
4. How long have you known your co-founders? Do you need them?
5. Have you ever had an argument with your co-founders? Are you friends?
6. What unique skills do your co-founders bring? Could you just hire someone instead?
7. Have you built a startup before? What do you think it will be like?
8. How do you react to criticism? How do you deal with stress or pressure?

9. What kind of investors do you want?

10. What will you say to your investors if you lose all their money?

Having rational, honest conversations with all your stakeholders before you start is critical.

On a personal level, discussing your fears and expectations with friends and family will help. What support will you need from them? If you have a significant other, talk it through with them. Discuss the risks, time commitments and potential for stress. Address your fears and what support you may need.

Even more important is to have a frank discussion with your potential business partners and co-founders. Are you all aligned to the same values? Do you have a common motivation for starting the business? Will they run when the chips are down? What will you do if things go wrong? What will you do if things go right? What if someone wants to get out of the business and the others don’t? Do you even need your co-founders? Would it be easier just to hire the skills that one or all of them bring? Or do they bring unique skills that earn them an equity position? Set expectations up front.

Talk to your investors. Discuss the risks. A common mistake that founders make is to gloss over the ugly parts. Most investors can tell. The smart ones know the risky nature of investing in early-stage businesses. You gain far more credibility if you have realistic and honest conversations with your investors than if you try to sugarcoat it. Discuss your plans and how you intend to mitigate the potential risks. Consider what help you need from them. Involve them in the business. Use their networks and experience. You don’t have to do this alone, and when you engage them in the company they will feel far more comfortable about their investment in you and the business.
Lastly, talk to other founders. Build a solid network of people who are facing the same challenges as you and can act as a sounding board. Most startups face common problems. Tapping into the experience of others can fast-track your learning and give you insights into how to solve your current challenges.
Success starts with you. Here are some steps you can take to set yourself on the right path.

**STEP 1: QUESTION YOUR MOTIVES**

Why are you starting this business? What is your motivation? Are you scratching an itch? Money motivates some people; some people say, ‘It sounds cool’ or ‘I just want to be an entrepreneur’. Some people have a genuine passion for solving problems. There are a whole bunch of motivations behind startups and their founders. It’s important to understand yours.

Your business needs a solid foundation, and that foundation is you. If your motivation is weak, then you will likely give up when the chips are down or when you face heavy criticism. Getting this right means you will be well placed for the challenges ahead. You need to be prepared. There will be failures. There will be stress. You will work your arse off. Reflect on your motivation and commitment. Do you want this? Why? How badly?

**STEP 2: BECOME A STUDENT OF FAILURE**

I have a horrible fear of flying, but I love watching the TV show *Air Crash Investigation*. Knowing that air accidents are analysed in such detail to prevent future crashes makes me more comfortable when flying.

Beyond this book, there is a mountain of information in the public domain about startup failure, and you can learn a lot
from the autopsy. Go and read up on three high-profile startup failures and analyse them. What can you learn from them? Do any of the causes apply to your startup? Could the failure have been foreseen? What could they have done differently? Speak to founders who have failed in the past. Most founders I know are extremely open about their past mistakes.

STEP 3: FIND MENTORS

Entrepreneurs tell me that being a founder can be very lonely. Carrying the burden of responsibility for the success of the product, the team and the business can be a tough proposition. They have put their reputation on the line with investors and feel a huge weight on their shoulders. Not to mention the fear.

You don’t have to do this alone. One of the amazing things about startups today is that there is this large, vibrant community that wants to see everyone succeed. Experienced entrepreneurs have already faced the challenges you will face. Seek them out. Ask for their opinion and advice. I strongly recommend creating an advisory board, either formally or informally. These advisers will be an essential source of mental and emotional support.
RECAP

Startups are awesome! But they need the right preparation. Many fail that don’t have to. Startup failure is generally caused not by an external event, but by an internal one — they fail as a result of self-harm. Thoughtful study and analysis of the causes of failure will give your startup a critical competitive advantage and therefore a better chance of success.

Understanding that startup failure is common but not inevitable is the beginning of your journey to standing out from the crowd. When you have acknowledged, analysed and understood the risks and the failure modes, you will be more credible and knowledgeable when you speak with investors. Your evident competence will win you far more attention from venture capitalists and investors than first-timers who demonstrate less judgement.

Is your startup default dead or default alive? Call it early and act on it. By calling it now, your team will have a common language, and they will feel confident that your startup will be a greater success than others that appear to be just wandering in the wilderness. You will sleep better at night, and have less worry and anxiety, because you know you’re planning for and controlling those common failure points.

WHAT’S NEXT?

Startup failure can be attributed to three common root causes: founders, funding and flawed business models. In the next chapter I will outline the 10 main reasons why startups fail, and why your MBA won’t make you a successful startup founder.