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Why Start-ups Fail: Cases, Challenges, and Solutions

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ABSTRACT

This study revealed the top three characters of failed start-ups by analyzing five cases from unfulfilled market to team disharmony. This paper proposed three purposes. First, to analyze the primary factors why most start-ups do not succeed. Second, to identify the challenges faced by the leaders in establishing the start-ups. Last, to create solutions in minimizing the failure risk. This research collected data by observing and reviewing several academic works of literature. It presented five case studies. A SHELL methodology was employed to identify the start-ups' failures. Findings reveal the main failure factors, such as lack of funding and products or services that do not meet market needs. This paper presents different solutions for early start-ups to minimize risks, as follow (1) focus on delivering value for cash, (2) aligning skills with the product or service you intend to sell, (3) keeping a stream of income, (4) surrounding yourself with mentors, and (5) avoid unnecessary expenses.

Keywords: *Start-up, Shell Methodology, Failure Factors.*

1. INTRODUCTION

Start-up is a temporary status or term for an organization whose vital objective is to launch a new business model or open up a new market. Most of the start-ups fail, especially in the present pandemic situation. In Indonesia, stores are forced to close, and many workers are unable to continue their work. Indonesia is the 6th country in the world with the most start-up amounts, circa 1.939 digital start-ups. However, the data also presented a high number of failed start-ups [1]. In the Philippines, this difficult time also affected the market and product. Nine out of ten start-ups are flopped [2]. Several factors contribute to the failure of a start-up business, including lack of market investigation, business plan issues, less financing, nonstrategic location, internet absence, and marketing and expanding way too early. Competition is also one of the biggest challenges for the survival of start-up businesses. The fact is that initiating business is risky, which means the businessman should seize a strong business plan and risks management [3]. The first failure of start-ups usually appears on day 120 [2].

Planning and research are crucial in establishing a start-up. It ensures the business idea is feasible, the price is competitive, and there is an adequate return on investment. Start-ups require a carefully thought-out business plan that has to be realistic and erudite projections for the future. Businesses that fail to seek professional advice may find their financial troubles worsening. If a business lacks capital and a contingency plan, it will be unable to develop. Having a quality team of people to work alongside is paramount to the success of the business. Recruiting requires careful consideration to ensure each employee brings up a new skill to the business. Utilizing all marketing channels, such as professional websites and social media, will drive the business forward. Insurance is a common oversight, but so many businesses can be crippled. By protecting the business with the correct insurance, it can avoid failure [4].

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2. MATERIAL AND METHODS

The datasets were collected by observing and reviewing several academic works of literature and five cases of start-ups were picked. The research identified start-ups failure by using the SHELL methodology, a well-known approach that has been adopted for over 40 years in the aviation sector for describing accident causes. The research modified the methodology to suit the objective of the study. The SHELL model is provided in Figure 1.

3. RESULTS AND DISCUSSION

3.1. Cases

3.1.1. Case 1 – Videology

Scott Ferber created Videology in 2007. The objective of Videology was to find promoters to put their advertisements on to the digital platforms to attain their target consumer. It also provided the video’s efficiency rate tools. It held total funding of $201 million. Videology’s idea was too futuristic for its time, with the result being that the industry was not proficient in applying the ideas. Videology, in turn, was not capable of adjusting to the condition and ended up failing. Another problem that has arisen is the advertising policy of Google and Facebook, which disallowed foreign companies to buy advertisements. All of it had to be obtained from Google [5].

3.1.2. Case 2 – Exec

Exec is an online cleaning service. Its main job was house cleaning, but the employees would do any task at a rate of $25 per hour. Exec gained $3.3 million initially and managed their finance: the main cost for software engineers, 30% for overhead costs, and $25 per hour, 80% for the team member on duty, and the remaining for the company. The fault was that the company offered refunds toward employees' mistakes, and it rapidly consumed the profits. In addition, too high costs on software engineers. Exec should get software development costs at a reasonable price [5].

3.1.3. Case 3 – Jawbone

Jawbone is one of the highest failed start-ups. It produced electronic gadgets, such as headsets, fitness trackers, and so on. It gathered $930 million in venture capital and started glory in 2016 when it stopped selling fitness trackers. The overfunding led the company to the abysm. It caused inconsistency between the appearance and the actual values. In addition, products of Jawbone are lack product-market fit [5].

3.1.4. Case 4 – Lytro

Lytro was a technology company that developed light field imaging technology and gained $215.8 million in funding. Unfortunately, the technology never suited the photographers' needs. So Lytro swapped to virtual reality and repeated the same mistakes, which was a lack of

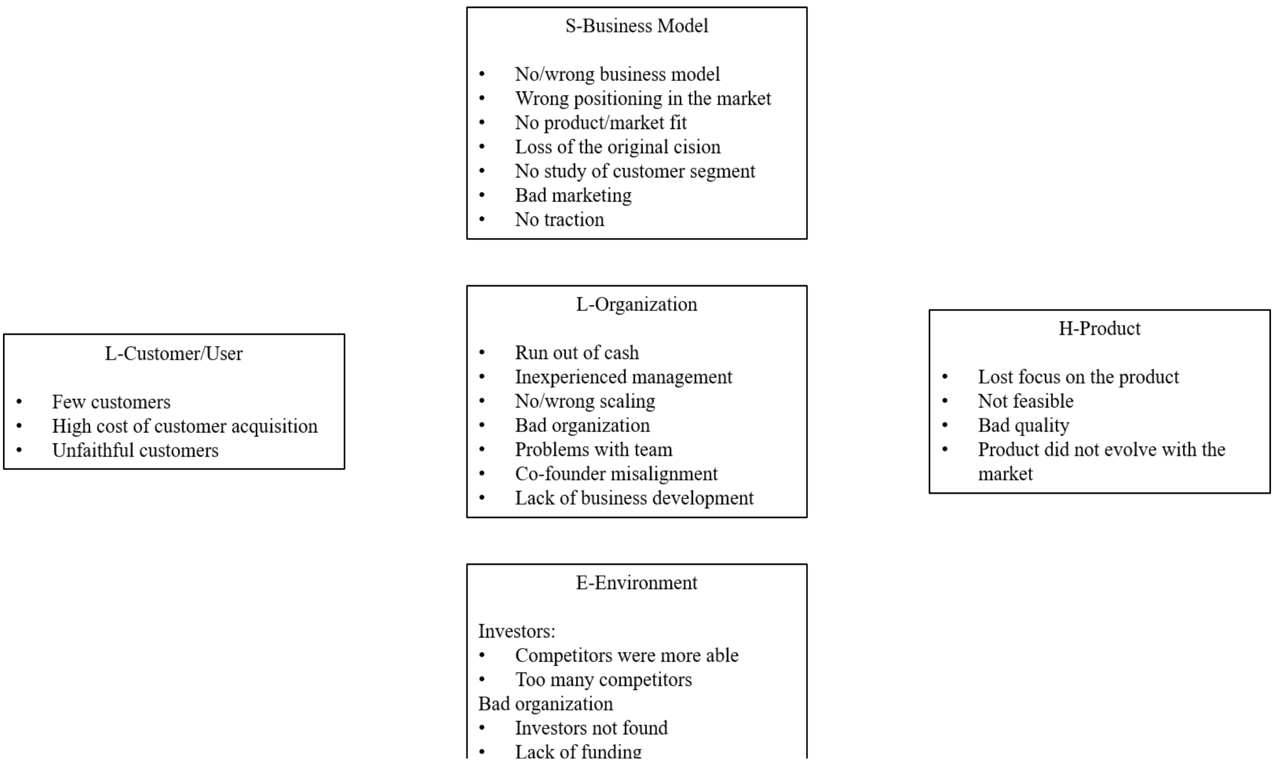

Figure 1 The model of SHELL

product-market fit. The primary reason for its downfall was the lack of good quality product need recognition [5].

3.1.5. Case 5 – Hoop

The Hoop was a successful start-up launched in 2016 by a group of thoughtful parents. They developed a platform to link local events and families, such as dancing class, creative workshops, etc. The Hoop was a success until it ran into hardships in 2020. It was affected in severe by the pandemic because during quarantine periods, family activities became hugely obsolete. In order to survive, Hoop introduced a new offer which was kids' online activities. Unluckily, it did not cover the losses until the app closed for good [6].

The five representative start-ups reveal that the primary failure of start-ups is lack or over of funding and not fulfilling the market needs. This study listed the top three founder reasons of failed companies [7] as depicted in Figure 2.

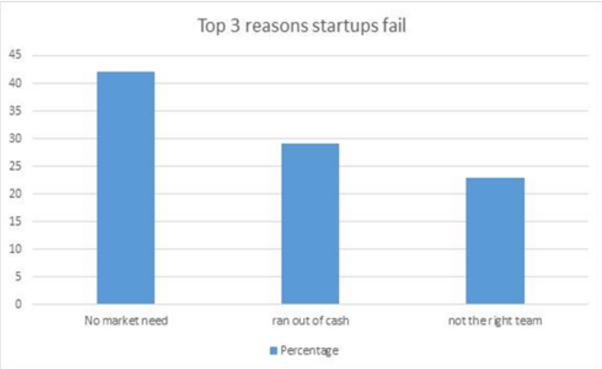

Figure 2 The top 3 reasons why start-ups fail

The graph shows that some factors why start-ups fail are no market need (42%), running out of cash (29%), and not the right team (23%). Moreover, the other reasons are lack of customer focus, a poor product, lousy timing, or poor marketing. Start-ups based on the industry that fail [8] are presented in Figure 3.

3.1.6. The SHELL Model

The SHELL Models explain five categories of start-ups failure:

1) Software - Business model: Some companies employ the wrong business model and do not suit the market
2) Hardware - Product: Poor and not an agile quality product
3) Environment: Lack of initiate funding and competition to get venture capital
4) Liveware - Customer/User: Few customers need the product
5) L - Organization: Bad organization, running out of cash, problems with the team, and co-founder misalignment.

A start-up needs a well-organized task, roles, and rules for each member. The start-up life cycle is essential to identify and analyze the different reasons why start-up businesses fail. The cycles are:

1) Emergence
   It focuses on establishing a Proof of Concept (POC) usually financed independently. Furthermore, it focuses on marketing to set the market goal and earn income. A suitable marketing tool will be the highest investment [9] and lead to early income realization.
2) Survival and Stability
   The business moves to capture new targets while keeping the existing ones. Moreover, the financial requirements will be higher because of the operations [10]. Hence, it focuses on finding new funding sources.
3) Success and Accelerated Growth
   The product is mature, and the income stream is well established. It focuses on exploring the international market and accelerates growth [11].

The challenges faced by entrepreneurs vary in magnitude depending on the start-up's cycles. Given the different stages in the life cycle of start-ups, it is relevant to assess the reasons that cause start-ups to fail. The most fundamental is the characteristic of the entrepreneurs themselves [12].

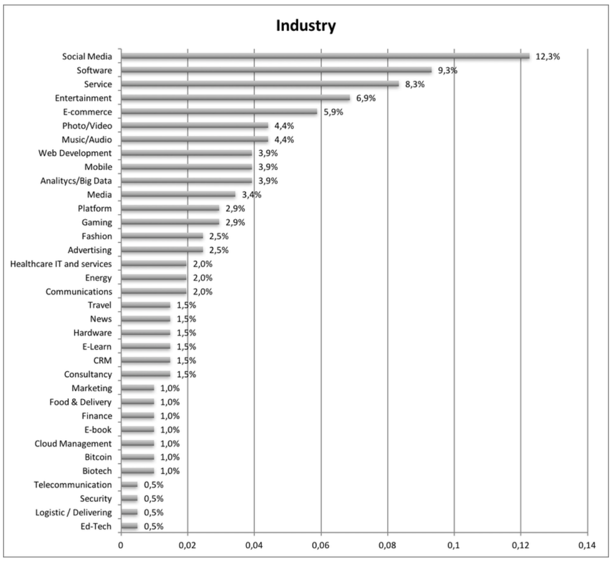

Figure 3. Start-ups failure by industry

3.2. Challenges

These are challenges faced by start-ups [13]:

1) Strength of business model
   The business model is the basis for the formation of a business. The strength of a business model determines the success and failure of a start-up. Existing businesses should continue to review their business models regularly to respond to changing trends and challenges in the future.
2) Securing funding

To secure the funding, the start-up needs to research the most appropriate funding route for the business, the funding venture, and tailor the promotion to them.

3) Financial planning
A common mistake that start-ups make is poor financial planning. Underestimating start-up costs and ongoing expenses, mispricing a product/service can paralyze a start-up. Understand the realities of costs in detail about all the expenses from the start. Then look at the pricing structure to make sure it will cover costs and make a profit.
4) People and talent
The people within the start-up will significantly influence the success or failure of the business. Open collaboration and communication with the team is the key to the success of a start-up.
5) Competition
Competition can be the biggest challenge for a start-up, but it also can be a massive advantage if the business can innovate and differentiate itself from the competitors. Competition stimulates creativity, innovation, and good quality product.
6) Leadership
Becoming a leader requires vision and making sure the team is headed in the same direction. Leadership is not a solo performance but a partnership between a leader and a team. Leadership is about working to implement innovative strategies to solve problems, make a productive work environment.
7) Market demand
The lack of demand for products or services is one of the challenges faced by start-ups. Researching the demand for the problem is trying to solve is key to avoiding this problem. A start-up needs to make sure there is an audience for the product/service and a way to drive revenue from its delivery, penetrate the market and achieve measurable growth.
8) Planning
Having a plan helps start-up makes better decisions and prevents them from making quick decisions. A good business plan not only helps entrepreneurs focus on the specific steps needed to make a business idea successful but also helps them achieve both short-term and long-term goals.
9) Scaling the business
Moving from a small operation to a business scale is often a critical point for many start-ups. It is important to improve distribution, customer service, and other critical business functions to drive growth.
10) Mentors and top-level guidance
A start-up may need help making the right business decisions or focusing on the right areas of the strategy to scale the business. Reaching out to a business mentor can provide valuable insight and support. A start-up can also access knowledge in other ways, such as podcasts, articles, and books written by business experts.

3.3. Solutions

Entrepreneurship and risk go hand in hand. Most entrepreneurs believe the gamble is worth the compromise if it means controlling their destinies, setting their schedules, and changing people's lives. In minimizing the risks, particularly in the early stages, businesses should (1) focus on delivering value for cash, (2) aligning skills with the product or service you intend to sell, (3) keep a stream of income, (4) surrounding yourself with mentors, and (5) avoid unnecessary expenses. Right this moment, people are ready to pay for solving their problems. An entrepreneur could identify the marketing channel to promote the business by monetizing skill quickly and conveying the value proposition to the ideal customer. Entrepreneurs are constantly tempted to explore shiny ideas with growth potential. Most of the time, those ideas require additional skills which are necessary for the business. Also, venturing into a familiar business can be tested, iterated, and pivoted quickly without incurring expenses. Ensuring that the business will generate continuous income by defining a target for the monthly business revenue that will provide enough security. Also, a good mentor can help avoid mistakes, choose the right path and accelerate progress toward the goals. Always ask for help when needed so that the problems can be easily solved. Above all, build one thing at a time. Running many projects at the same time will only hinder the performance. Even if the entrepreneur manages to keep ahead of expenses, it will end up as a jack of several trades and a master of none [14].

4. CONCLUSION

Most start-ups do not succeed because cannot find market needs, run out of cash, and are not the right team. Being an entrepreneur requires being prepared for every challenge and making the right decisions every time. The challenges that we have to face in order to become a successful start-up are (1) strength of your business model, (2) securing funding, (3) financial planning, (4) people and talent, (5) competition, (6) leadership, (7) market demand, (8) planning, (9) scaling your business, and (10) mentors and top-level guidance.

Start-up businesses should create solutions to minimize the risk of failure by focusing on delivering value for cash, aligning skills with the product or service you intend to sell, keeping a stream of income, surrounding with mentors, and avoiding unnecessary expenses. By doing these steps, a business can minimize its risks and avoid failure in its early stages.

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