Why do Tech Start-ups Fails – 10 Common Reasons

In this article, Zechariah J. Dean, Chief Dreamer of Dean Ventures outlines 10 reasons why technology start-ups fail. The focus of this article zones in on pre-seed investments.

"I have not failed; I've found 10,000 ways that won't work." This famous statement by the great Thomas A. Edison, is quiet rightfully cited when the topic of failure is discussed across the entrepreneurship world. Failure, by its very nature has a negative connotation. For me, understanding failure and how to learn from such events is integral to my personal development. I have had my fair share of failures, but graciously I have always taken the time to reflect and ensure I am learning from such events. When your venture fails, the pain is real. It really hurts. You recoil, locking yourself away, licking open wounds, ruminating where things went wrong.

A wise soul once told me to learn from the mistakes committed by others, as you will not live long enough to make them all yourself and then succeed. My professor at Business School, defined success as the time it takes for you to get up once you've been knocked down from a failure and start again.

I am always intrigued meeting and speaking to entrepreneurs, who tried and didn't quiet reach the promised land. Listening intensively, I have tried to glean small nuggets of information - the thought process, actions, decisions or the context, so I have a future reference point in case I ever confront such scenarios. More pertinently, I make a conscious effort to add such entrepreneurs to my network so I can seek their mentorship in the future.

In this article, I am presenting **ten** of the most common reasons why technology start-ups fail. The ten reasons listed is what I have witnessed over the past 12 years. Yes, some of them I experienced whilst others were committed by those I met, networked with or had considered investing in (but respectfully declined). That said, I was able to witness a pattern forming which allowed me to present this list.

The list is in no particular order of importance. So, here goes:

1. **Failed to raise enough capital and at the wrong valuation.**

Valuing early-stage ventures is an art more than a science. Investors will rely on the credibility of the founder(s), the robustness of the business plan and the supporting financial model which is underpinned by their own understanding of the what the future may hold. I often refer this to a Mystic Meg situation where investors try to predict the future.

More often than not and (especially) at a pre-seed stage, investors are confronted with information failure or information asymmetry. There are substantial gaps, which convolute the decision-making process. You will often find investors rely on their gut feeling and simply demand what percentage of the business they want which substantially opposes what the entrepreneur is offering. This given percentage is often dictated by how many future rounds of financing will be required, the amount of dilution which will take place through multiple rounds of financing and what share the investor will have on exit.

I distinctively remember raising investment from a European family office. They were determined to acquire 33% of my venture, and totally rejected any of the work I had undertaken to justify the pre-money valuation I had set. My research was sound, but clearly there were some gaps which only time, money and resources could address. After days of meetings, I knew I was going to lose the investor as 33% was their magic number. Not 32% or 32.5% but 33%. With this mind, I was determined to raise as much money as possible. If I was going to give away three times more equity, then I needed to raise more money and give myself a longer runway.

Some entrepreneurs simply fail to raise enough money from the outset. If you find yourself in a situation where your investor squeezes your valuation and only writes out a small cheque, you'd better be assured that the same investor can invest in future rounds if your targets are achieved. Getting your Term Sheet agreed, which facilitates future rounds of finances is where you can claw back the early squeeze. If a small cheque is written out, without the promise of a follow-up to any future round, then the execution risks increase and you're like to run out of cash if you slip on milestones. A small cheque which gives you between three to six months of cash-flow is

high risk. A small slippage on milestones means you will probably run out of cash. If the incumbent investor isn't prepared to support you, then any new incoming investor will be licking their lips (sorry for the carnivorous connotations) and as a founder you will probably find yourself heavily diluted and out in the cold. The key here is to raise as much as you can whilst giving away a portion of your business which you are comfortable with. Conversely, if your valuation is driven down then ensure you raise more money.

2. **Solution to a problem which doesn't exist.**
   You've created a solution to a problem which is either too small, too niche or isn't recognised by the customer. It is imperative that as an entrepreneur, you are able to convince yourself that there is actually a problem, you understand the size of the problem and that customers can be identified, acquired and are prepared to pay for the solution. If you cannot tick these boxes, you are starting your venture on very weak footing.

3. **Being a perfectionist.**
   Entrepreneurs can be guilty of the perfectionist syndrome. Every element of the business must be a magnus opus. Remember to focus on the most important elements of your venture, which will allow you to generate revenue promptly and with the least amount of investment. You need evidence that customers have recognised your business and are prepared to pay for it. Once you are able to demonstrate this, the next wave of products, services or features you develop are used to solidify your customer base, attract and acquire new customers and build deeper barriers to entry. I am not asking you to cut corners or launch a slapdash product. I am encouraging you to focus on what is important today and to get your product out into the market. The entrepreneurial world is replete with great ideas that reside on shelves.

4. **Poor business model**
   The manner in which you have configured your assets and resources to take your product to market is fundamentally flawed and exposes you to operational risk. The costs increase, and if the market reacts negatively to your business, the business model renders itself worthless. I once remember walking away from an investment opportunity in the food industry, where the entrepreneur had pinned herself against a 36-month fixed term contract with a foreign supplier who was guaranteed a minimum order quantity each month. Between the supplier and the end customer, were a raft of stakeholders. At each point a small risk meant the knock-on effect would be great. Everything had to work like a Swiss watch otherwise you were doomed.

   The liability and exposure for the supplier was minimal, and there was zero flexibility. A small downturn in the market, meant the business was forced to pay for the minimum order quantity, whilst also maintaining relationships with all the stakeholders. Soon the business ran into financial difficulties. Products were then discounted and sold at a loss. The entrepreneur chased a lower price point and wanted to improve margins, and thus refused to work with a local supplier, who was higher priced and had a tighter supply-chain. The underlying supply-chain was fraught with risk, with too many moving parts and the business failed.

5. **Inability to quantify regulatory and legal risks**
   About a decade ago, I led an investment into an education business, which was intricately linked to various regulatory and government policies most notably related to immigration. When assessing the risks associated to the organisation our risk register coined some of the immigration risks as "low" and the likelihood of such risks impacting the business as "low". Unfortunately, at that moment in time, our research was reasonably sound, but we failed to model (in-depth) the sensitivity around what impact a slight policy change could have on the business. Within three weeks of launching the business, the unbelievable had happened. The immigration policy changed and unlike most government policy changes which have a circa six-month lead in time, the policy changes were enacted immediately, and our new investment was adversely impacted. Having a deeper assessment of the "what-if" scenarios would have left us in a much better position to pivot but unfortunately, we couldn't pivot in time. We were left to lick some deep wounds.

6. **Incorrect pricing model**
   Of course, the classic principles and theories related to supply vs. demand apply here. Often, I

have seen companies enter the market offering customers too much for free. It is essential to entice customers in, but if your business is offering too much for free, then customers may bounce off to another firm when a cost is eventually introduced.

It is essential to ask what level of service is required to entice, attract and acquire the customer, but be careful not to give so much away that your business begins to suffer. Acquisition is important, but so is retention. In some instances, if you are sufficiently capitalised, then of course it is ok to provide a service for free, knowing that customers are registering, recommendations are being made and market share is being acquired. Eventually, this needs to stop and the transition towards a conventional model is imperative. At this stage, ensure your pricing is correctly layered and that you can justify a sound commercial model for your venture. Investors are often left peeved, when due diligence reveals that some technology start-ups may have acquired 10,000 customers but generated no revenue. Remember, it is important to demonstrate that customers have recognised your business, appreciate the service and are willing to pay for it.

7. **Disconnected co-founders**

It seemed like a chapter out from a fantasy novel. Five friends come together to conceive a venture. Everyone is a 20% shareholder, a company is registered, an office is established and the fun starts! Really? But what if, one or two of the founders are collectively doing 95% of the heavy work whilst the others are onlooking spectators. This is ok, in the short run, but eventually this has a pernicious effect. Schisms are created, frustration builds up and then out comes the sledgehammer. The romance of forming a business requires discipline. From the outset, you must co-document, agree and sign-off on what you are forming and why you are forming this venture. More importantly, you want to clearly articulate the Key Performance Indicators ("KPI's") around what is being expected from every individual over the next 6, 12 and 24 months. Roles and responsibilities and the standard of output is incredibly important. In some instances, there will be some founders, whose real value will only surface from month 12 and beyond. This is ok, and it should be visible and understood by all. Also, try not to fall for the old trick that five founders must divide their shares equally. This isn't realistic as some founders will bring a much greater set of skills and value to the table. This requires everyone to be sensible, mature and appreciative of reality. There is also the challenge of clawing back shares if poor performance cannot be remedied. I will not mention my solution here, this will be addressed in a future article…I promise!

8. **Product mistimed**

At times, the market is just not ready, the end customers have not matured and may simply do not appreciate the product you've developed. Your product is good, but it's too sophisticated for what the market requires today. They simply don't get it. You are ahead of your time. This all sounds nice, but the reality is unless your product is adopted by the customers it will be rejected. Market forces and traction (or a lack of it) can be brutal. It is vital that you remain focus on what is required for the market today and how your product can evolve (pre-emptively or proactively) over the short to medium run as the market evolves. I once created a piece of technology which solved over 160 market risks. The problem was that my end customers, were simply not sophisticated enough to appreciate the solutions my technology provided. On reflection, the pain points which my technology addressed were not hard hitting enough to the end customer because the regulators were unaware of the level of fraud taking place. It was clear I had produced a piece of technology which was a few generations ahead of its time. I simply entered the market too early.

9. **Major investor and hidden agendas**

Don't get bullied into losing control of your business. As a founder, there is value and a premium to the intrinsic knowledge you hold about your venture. Major investors, need to remember they are investing in you and your vision; they are buying the right to a slice of your dream. Often, major investors, will use the process of investing a large sum of funds into your business as an excuse to dictating and demanding things which are unreasonable. This is dangerous for you and sensing this is critical. As an entrepreneur, you may feel intimidated and even hopeless, thinking if this investor walks-away, I'm

doomed. Hold your nerve and ensure you do not reveal your cards. Investors only become willing and engaged partners once their funds have hit your business bank account on terms that you are happy with.

There have been instances where major investors have hidden agendas of chipping away. An early sign of this is how the investment is structured. Rachet models, complicated milestones which are derivatives of matters outside your immediate control or convertible loan notes are all warning signs. Remember, one small mistake from you and before you know it, a massive chunk of your business is lost. I promise to write about disingenuous shareholders in the future.

10. Suppliers delivered incorrect product

So, you have a great tech idea. Your research and the opportunity stack up. The issue is that you've never built a technology solution, or your experience is very limited. Technology isn't my forte I often hear. So, you engage an external company to help you translate your vision into a technical solution capable of being launched and making your business a reality and hopefully a success. When such external suppliers fail to produce the correct product, you're doomed. You've probably spent a vast proportion of your own or investor funds and lost valuable time.

During my early entrepreneurial days, I was encouraged to engage an external technology supplier. A premium rated vendor, who prima facie, ticked all the boxes. But there was a major disconnect between the sales executives who engaged me upfront and secured a contract against the technology resources who follow through and build your system.

I was guilty of dropping the baton, I was in cloud nine, in awe of the executives who conceptually understood my vision. They shared my passion and vision, or I was led to believe they did. I needed to stick to basics. I should have asked CV's to be furnished. I should have evaluated them. I should have interviewed them, assessed them and put them under stress tests against certain use cases. If I was not satisfied during the delivery cycle, I would have the right to remedy the situation by asking for a replacement at the supplier's cost and not mine. In this instance, the supplier produced a system with over 412 defects, 7 of which were so great the end product was worthless. We called the end product the dead horse. Of course, litigation ensued, parties settled out of court but more damaging is we lost time and allowed competitors to enter the market.

If you find yourself in a situation where your technology expertise is limited, then try to find a mentor who is willing to guide you through this tricky phase. Master classes over a meal or a zoom call are invaluable. Having your tech mentor review proposals, contracts, designs or deliverables is priceless. Even having your mentor seated during meetings or "show-and-tells" reminds the supplier to bring their "A" game to the party. Engaging an external supplier requires you to remain vigilant at all times and ensure they do not over-promise and under-deliver.

Zechariah J. Dean is the Chief Dreamer of Dean Ventures. Zechariah is a social impact technology entrepreneur who believes technology entrepreneurs have the potential of solving many of the issues facing our world, whilst also providing a superior return to shareholders.

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