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3 Big Reasons Startups Fail (and How to Avoid Them)

by Nicole Fallon, Business News Daily Assistant Editor September 12, 2014

Across all industries, the majority of startups will fail within their first several years. Some flop right away, while others enjoy a few fleeting moments of success before crashing and burning, but the fact remains that any new venture is more likely to sink than swim.

While social media buzz and crowdfunding campaigns have made it easier than ever to start a business right now, the future looks pretty bleak for new entrepreneurs. In a recent Fox Business article, Alan Patricof, venture capitalist and managing director of Greycroft Partners, predicted a much higher startup failure rate in 2014 and 2015, despite the lower barriers for obtaining funding and support.

Why do so many new companies continue to fail, even with the advanced consumer data and technology available to today's business owners? In some cases it's out of their hands, such as a sharp economic swing or decline in market demand. But often there are things an entrepreneur could have done differently to save his or her company. Successful entrepreneurs shared the top three controllable reasons for startup failure, and what to do to ensure that your business thrives.

Lack of research and planning

Startups without a solid business plan and a good grasp of what their target market wants are doomed to fail. It may seem like an obvious correlation, but many businesses still move ahead without having done the requisite market research and planning.

"Market validation is critical," said Elton Rivas, founder of entrepreneur accelerator program KYN Group. "Startups think that a lot of users equal profitability yet often forget to ensure that users of a product will turn into actual revenue."

Part of the process of turning potential consumers into revenue includes defining your startup's unique value proposition and what differentiates you from the competition.

"[Startups that fail] miss the step of defining their value," said John McGee, founder and president of marketing automation company OptifiNow. "You should succinctly be able to define what you do, why a customer should work with you, and the value of choosing your business over another."

While a long-term plan based on your value proposition can keep you on track for success, McGee also said it needs to be flexible enough to navigate any unexpected challenges your business faces.

"The plan is always changing, and you need to be able to adapt," McGee told Business News Daily. "You may start out with a plan that you think is perfect, but three months in [you may find] it's not working. Take a step back, re-evaluate and adjust to a new direction."

Financial mismanagement

Nothing kills a startup faster than running out of money. Whether you burned through your funding too quickly or didn't raise enough in the first place, you can't do much with your business if your finances are in disarray.

Ken Rutkowski, host of Business Rockstars Radio, said that poor accounting and lack of a cash cushion are among the top reasons new startups fail.

"You can't be in control of your business if you don't know exactly what's going on with your books," Rutkowski said. "If you don't know the real bottom line, you can't make the things happen needed for the business to thrive. You [also need] to have enough cash on hand to cover costs when you need it. Businesses can't survive paycheck to paycheck."

Poor hiring and leadership practices

So you know your startup is a surefire hit, and you've got enough cash to keep you going. But do you have the right team to make it all happen?

"It always goes back to picking the right people for your team," Rutkowski said. "When you have the right time, everything falls into place and becomes consistently predictable. I'm a big fan of slow to hire and fast to fire, but it's tough to do that in startup mode [when you] need to move fast. It's best to go with recommendations and referrals."

However, the right team with the wrong management style will be just as susceptible to failure.

"Too often, startup managers wear multiple hats and get stuck working in the day-to-day, as opposed to setting goals and a vision," McGee said. "They grow these great to-do lists, as opposed to delegating responsibilities. This [will get them] through the short-term goals, but long-term goals of growth require using your team to accomplish tasks."

Even if you've mastered the art of delegation, your team truly needs to feel that you trust them with the tasks you assign them. If you give your team responsibilities but shadow and micromanage them every step of the way, you won't have the right dynamic to make everything work.

"Teams fail when trust fails," Rivas said. "Founders often mistake accountability for trust. The two are very different, and a lack of trust within an early-stage team will kill the company before you can blink."

Although there are many reasons a startup could potentially go under, there are even more reasons to forge ahead and try to beat the odds.

"The economy is shifting and creating lots of great opportunities for new entrepreneurs," McGee said. "Get off the sidelines and get into the game."