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A Study on Factors that contribute to the failure of startups

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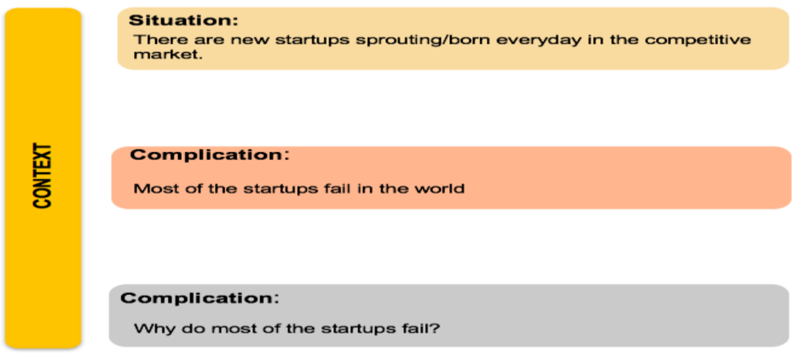
Abstract: The purpose of the paper is to adopt the problem solving approach by using problem definition card. It is one of the tools of problem solving that helps in framing the problem by asking right questions, describing the project on what needs to be done to solve the problem and framing the diagnosis by asking who or why questions (Chevalier, 2016, pp. 21-27).

Keywords: Startup, Industry, Innovation, External, Internal Factors, Technologies

1. INTRODUCTION

Startups are one of the building blocks of economic growth of a country. They play a vital role in a country's economic expansion and are the major drivers of digitalization and innovation in the society (Titus, 2004, p. 1).There are over 100, 000 million startups are born each day as per the Global Entrepreneurship Monitor (GEM). Although there is a tremendous growth of these startups each year, many startups struggle to survive. About 71% of the startups are failing each year within the 10 years of their operation (Statistic Brain, 2017). With these key findings from the scientific data and articles found online, the paper focuses on understanding the situation, complication and the problem statement to get to the end result.

1.1 Problem formulation using problem definition card



Hypothesis
The hypothesis is formulated by considering the two important factors that go into account while understanding the success or failure rate or startups. The hypothesis for the research is the most of startups fail because of the external and internal factors that influence the working of startups.

2. LITERATURE OVERVIEW

The reason for doing the research explained in the introductory part of the paper is further elaborated with suitable data to substantiate the evidence for the hypothesis established. Determining why startups fail can help in understanding the decline of these companies (Titus, 2004, p. 7). The definition of a startup is studied to get a better understanding of the hypothesis. A startup is a young company that is starting to grow and finance by self or group of individuals in its first stages of operation. It is as a company with unknown business model and emphasizes on innovation to develop a product or service for which they believe to have a demand for their customers (NASSCOM, 2015, p. 6).

3. THE RESEARCH FRAMEWORK

The research adopts issue based problem solving method to solve the 'why' question and the reasons are branched out in the form of an issue tree using Mutually Exclusive Collectively Exhaustive (MECE) method of consulting. The paper focuses on two main factors for the failure of the startups. The two important factors are external and internal factors.

External factors affecting the failure of startups

The external factors are the aspects that affect the working of these startups by the external environment over which firms have no direct control. The external factors are best analyzed by considered the three important aspects of the external environment (Titus, 2004, p. 7). They are the Marco environment, the industry or sector and the competitive environment.

The macro environment analysis of startup ecosystems

The macro environment of the startups is studied by considering the startup ecosystems across the world. Startup ecosystem consists of multiple organizations that interact with each other and influence the external environment of the startups. The entities such as organizations, universities, big companies and SMEs play a key role on influencing the development of the startups (Kotsch, 2017, p. 12). The dynamics of an ecosystem can change with factors such as market disruptions, financial factors as well as government policies, social attributes etc. (Kotsch, 2017, p. 12).

In one of the surveys conducted by Startup Genome (2017) on the global startup ecosystem rankings, the research found to have some key findings. They measured 55 startup ecosystems across 28 countries and ranked the top 20 startup ecosystems. Out of the 20 ecosystems, Tel Aviv of Israel is found to be one of the growing startup ecosystems.

One each startup ecosystems of the developed and developing countries are considered for our research. Israel startup ecosystem is compared with the startup ecosystem of India to understand why startups fail in the ecosystems. Israel has the one of highest startup densities in Europe (Startup Genome, 2017, p. 53). Whereas India is still gaining momentum to enter the top 20 startup ecosystems in the world.

The analysis is done by considering PESTEL framework for long term performance of the startups in both the ecosystems. The political factors are the factors mostly affected by politics and government policies on the startup ecosystem. Economic factors are the growth or decline in economy favoring startup growth. The social factors are the include the cultural factors and the acceptance of changes in the society that influences the startup ecosystems. The technological factors are the advent of new technologies. The environmental factors are the factors such as the weather, climate change and environmental laws that affect the industries and the legal factors are the legal challenges along with consumer, employment laws that have to be followed by these startups (Dart Consulting, 2016).

Factors	Israel	India
Political	Government has made efforts to set up incubators to provide $600, 000 risk free loans to promising startups (Subramanian, 2017).	Government Initiatives such as Make in India, the Startup India program and other have incubation programs have spurred the growth of startups (D' Cunha, 2017).
Economical	The economy is growing about 4% every year (The Economist, 2017). Public debt remains stable and startup funds are available (Bertelsmann Stiftung, 2017).	Indian economy is estimated to grow at a rate of 6.7% in 2017-2018 (IBEF, 2017). There is a corpus fund for startups with interests at lower rates for startups (Dart Consulting, 2016).
Sociological	Israel's startup economy is because of the entrepreneurial culture in their society (The Economist, 2017).	The society is slowing encouraging the risky and entrepreneurial mindset among the people (The Economic Times, 2016).
Technological	Israeli startups continue to drive innovation in various fields (Bertelsmann Stiftung, 2017). They have more R&D facilities (Subramanian, 2017).	Lack of new technology or emphasis on innovation (D' Cunha, 2017). There is no investing in R&D through internal cooperation (D' Cunha, 2017).
Legal	Israel's legal situation is strong as their government bonds yields are higher when compared to other developed countries (Bertelsmann Stiftung, 2017)	Startup India planned to exempt startups from labor inspections for almost 3 years which can help in boosting startup businesses. But the legal factor seems too risky (Dart Consulting, 2016).
Environmental	The environmental factors are not considered in many of the articles that were researched.	Indian startup ecosystem such as startup India grants credit schemes that will cover the environmental risks for these startups (Dart Consulting, 2016).

Since 2015, 1503 startups have closed down in India. The startup ecosystems of the developing countries accounted to have more startup failures as per the study. From the analysis, it is easier to distinguish and state the reason why Indian startup ecosystem is failing. The major reason that accounts to the startup failures is the lack of innovation and technology growth (D' Cunha, 2017).

Industry wise sector analysis of startups

The sector analysis of different industries can be done by analyzing the different industry sectors where startups seem to have failed the most. The analysis is done by considering the different industries that have leading number of startups. According to the research data for the startup failures by industry wise, information startups accounted to have a major failure rate of 63% (Failory, 2017). The fast growing Software industry is studied using porter's fiver forces to study the factors that affect these industries.

In the industry analysis of Porter's five forces, the industry attractiveness can be assessed using five forces. It gives a fair idea to understand the key drivers of the industry (Cullen, n. d.). The five forces are:

1. Threat of entry: The threat of entrants is high in the Software or Information startups. Therefore, barriers to entering the market are very low and there are a lot of entrants to the industry (Cullen, n. d.).
2. Bargaining power of suppliers: The bargaining power of the suppliers is limited. The influence on the suppliers is relatively low (Cullen, n. d.).
3. Bargaining power of buyers: The bargaining power of the buyers is high in the market. This is one of the driving forces in the industry that driver's competition in the market (Cullen, n. d.).
4. Threat of substitutes: The threat of a substitute product or services is high as it offers the value proposition that can meet the customer demands and thereby affecting the profitability of many software startups (Fern Fort University, n. d.).
5. Rivalry among the existing competitors: Rivalry among the existing players is more as there are big players such as Microsoft, Google and SAP, Apple etc. that provide the similar services and rage in price wars (Cullen, n. d.). From the study, it is best to say the major reason that affects the startups is the big competitors and the customers that play a main role in startups competitiveness.

The competitor analysis of startups

The competitor analysis is further carried out by considering the Big players in the market who buy successful startups. CB Insights survey reveals that most of the startups are blamed for failure because of the lack of market need (CB Insights, 2017). If the startups are more innovative or use new technologies, chances are that these startups can be bought by the big players such as tech giants who can invest in the startup for the new technology, skills and knowledge of know-how (Thomas, 2014).

Internal factors affecting the failure of startups

The internal factors that affect the startup businesses can be determined by considering the key elements in the value chain of the startups. Internal factors can be analyzed by considering the startups the major factors that affect the value chain and capabilities of the startups are timing of realization, team, marketing strategy, product fit etc. (CB Insights, 2017).

Timing of realization

The importance of timing to enter the market is very important for startups. Despite securing large investments, Z.com which was an online entertainment company, failed in the year 2003. Two years later when the cost of storage declined, people felt comfortable to use online technology to share videos. Adobe release their Flash Player at the right time when YouTube was founded, making the video content easier for people to watch them online (Kotsch, 2017, p. 20).Though first movers can have advantages, there are considerable risks of entering the market and may not always be favorable. Sometimes there is advantage of being a last mover by learning from others' mistakes and making new developments in the market. Therefore, the timing of entry is crucial as it can have a huge impact on the potential expansion of startups (Kotsch, 2017, p. 21).

Team

The ideal team founded by cofounders should have members who have right skills, passion and industry experience to work in startups. A team with different backgrounds is suitable for startups and the relationships between the founding team play a main role in the working of startups. The post mortems of the startup failure research suggest that the founding team should be able to share the risk among the other founding members in the initial phase of the startup (CB Insights, 2017, pp. 10-11).

Marketing Strategy

Knowing the target market and implementing the right marketing strategies are very important in the startup business. 14% of the startup post-mortems according to CB Insights (2017) said these startups lacked the ability to promote their product or service.

Product Fit

In the recent survey by CB Insights (2017), 42% of the startups failed because most startups' product did not fit the customer needs. Tackling big problems and not able to solve these problems or having the right technology to be more innovative matters the most when delivering the product. When there is lack of customer need, the concept of the product doesn't fit in the market need (CB Insights (2017, p.11).

4. CONCLUSION

The external factors that majorly affect the external environment were analyzed using PESTEL analysis of the ecosystem, sector analysis and the competitor analysis. From the study, it is clear that innovation and technological growth to address the customer need is important for startups to gain profitability over their competitors. Of the factors stated as internal during the analysis, cofounders' incompetence to understand the essence of technology, right marketing strategy, timing of entry and product fit can lead to the failure of the startups as these internal factors are connected to the cofounders' competencies. From the research, it is concluded that both the external and internal factors play a major role in the failure of startups and the most common reason why startups fail is because of the incompetence to realize the product need and lack of innovation and technological growth

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