

The ugly truth about startups

Celebrated for creating wealth and jobs, startups are the poster children of 21st century business. But despite successes, many fail after only a few years?

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The late, great David Bowie's breakthrough album, "The Rise and Fall of Ziggy Stardust and the Spiders from Mars," featured an alien protagonist who brought hope to the earth, but then self-destructively burned out.

There are no visiting aliens on the horizon, but plenty of parallels to be drawn to the startups of today.

Society embraces startups. U.K. Prime Minister David Cameron calls them "wealth creators." In the U.S., the Obama Administration gives credit to companies *under* five years old for nearly all of the net growth seen between 1980 and 2005.

And yet most startups struggle to grow revenues, while any growth in employment is often offset by jobs lost at other startups.

This less-talked-about side of young businesses is examined by IESE's Tony Davila, with co-authors George Foster, Xiaobin He and Carlos Shimizu, in their paper "[The Rise and Fall of Startups: Creation and Destruction of Revenue and Jobs by Young Companies](#)." The article was awarded the *Australian Journal of Management* 2015 E. Yetton Best Paper Prize.

Employing a multi-country, multi-industry sample of over 158,000 companies launched between 1999 and 2004, the co-authors tracked these firms for up to five years to offer an analysis of their rapid rise and, in many cases, subsequent rapid fall.

Five years

"Five years, that's all we've got!" sang Bowie. The same may hold true for startups. Analysis reveals that the contribution to the economy is mixed and that startups are far from the consistent "wealth creators" they are heralded to be.

Most startups struggle to consistently provide revenue and employment growth in the first five years. Indeed, those that grew in early years are often those cutting back later on. Only about 7.5 percent of the companies analyzed were able to add jobs for three years running.

And it's a dog-eat-dog world for entrepreneurs: growth and destruction coexist in startups' early years. And note that destruction is not merely stagnation or non-growth: it means prior growth is reversed.

For example, in the fifth year of operations, gross revenue destruction comes to 34 percent of gross revenue creation. In other words, one startup's sales gains may come at the expense of a competing and struggling startup. The net jobs situation is worse. In the fifth year, 65 percent of the jobs created by startups are simultaneously being lost by fellow startups.

It ain't easy

Furthermore, most companies in the study started small and remained that way; of the 38 percent of firms that realized positive job growth in their third year, only 20 percent saw growth in both the years that followed.

The co-authors consider a number of hypotheses for why companies that have previously shown growth go on to fail later, looking at a number of high-profile examples. These include:

- **Cannibalistic startups.** The early growth of the next big thing may well destroy revenues and growth of what came before. Facebook, for example, is considered to have grown so explosively in large part at the expense of Myspace.
- **Larger companies move in.** Established companies may wait on the sidelines, biding their time to see if an emerging market will succeed before moving aggressively into it.
- **Outsourcing growth.** California-based solar panel manufacturers Solyndra grew early and well, only to fold due to competition from China. About 11,000 jobs were lost, and while some may have been replaced elsewhere in the industry in the United States, a number of these were surely "exported."

- **Fizzlers.** A business model or technology seems promising but turns out, after further exploration, to be non-viable.
- **Legal and institutional hurdles.** Lawsuits, even unjustified ones, from other companies can sink a startup, as can a change in government or policy.

Hang on to yourself

Considering the scale and extent of destruction in startups, it receives little attention compared to high-profile success stories.

Yet executives and policymakers need to understand the forces of creation and destruction more clearly precisely in order to develop policies that increase startups' net contributions.

Understanding which aspects of destruction are "self-inflicted" and which are due to external market forces would be an important step toward reducing the lost opportunities.

Concentrating attention on the continued scaling of new companies, rather than merely the startup era, could also begin to address the problem.

"Managing startup companies means not only managing expansion but also understanding how to manage downturns," the authors conclude.

Or, in Bowie's words, "Come on, come on, if you think we're gonna make it, you better hang on to yourself."

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