Entrepreneurs: 2 Warning Signs That Your Startup Is About To Fail

Description

Everybody dreams of launching their own business to leave the rat race behind. There's no better feeling than making sacrifices, putting blood, sweat, and tears into it, before achieving a meteoric rise to unicorn status, complete with funding and publicity.

That is until we realize that nearly 90% of startups fail within the first five years, with the rest not achieving profitability for even longer, if ever. The entrepreneurship road is fraught with survivorship bias – we tend to only idolize the ones who made it.

Keeping appraised of these following "key risk indicators" (warning signs) can help you pivot strategically to avoid disaster. Think of them as a smoke detector. The trick is listening and responding accordingly.

Watch your burn rate!

Cash is king. It is the lifeblood of your startup. Without cash, you cannot pay staff, launch marketing campaigns, fund research & development, or cover legal / accounting costs.

The biggest warning sign to watch here is your burn rate. The burn rate is how fast a new company is running through its startup capital ahead of it generating any positive cash flow. You can calculate it in terms of how much cash the company is spending each month.

Your burn rate, when held against your cash reserves, produces the metric for your cash runway. This is the amount of time your company has before it literally runs out of money.

As an example, startup ABC might have $1 million in cash and cash equivalents in the bank. ABC currently spends $100,000 a month. ABC's burn rate would be $100,000/month, and its runway would be 10 months.

You can reduce the burn rate by selling more, which increases your revenue. If you don't have a tangible product or service yet, cutting costs may work. You can also initiate another fundraising round, at the cost of losing more equity or taking on potentially toxic debt that may be difficult to service.

Keep the bickering to a minimum

Few companies are run as a one-person show. The best startups often have a diverse leadership team, with various individuals playing complementary, yet important roles. However, being humans, we often get caught up and emotional and the stresses of running a new business are a catalyst for this to occur.

Depending on how the voting equity is split among co-founders, you could find yourself at an impasse, or worse, a legal deadlock if disagreements arise over vital company decisions. Things like strategy, operations, and financing can grind to a standstill while your leadership group bicker.

These types of stalemates can cost you heavily, whether from lost opportunities and delays or from the company dissolving altogether into a quagmire of legal trouble if the issue is irreconcilable. It sounds foolish for a promising startup to fall apart because of drama, but the reality is that these types of conflicts occur every day.

You can mitigate this risk by having clear equity ownership structures that minimize a “democracy” sort of arrangement. When it comes to companies, sometimes somebody just needs to take charge. This means having a majority of the voting shares, so they can veto.

In the fast-paced world of startups, sometimes making the wrong decision is preferable to getting stuck and never making a decision at all. The former can often be reversed. The latter can kill your momentum, culture, and vision.

The Foolish takeaway

As a graduate student in risk management and business owner myself, I think there’s a case for looking at failed startups postmortem. While hindsight is 20/20, there are often a few lessons we can glean to apply to our own ventures.

From the above, we see that both managing the financial and human resource aspects of our new business are equally as important as strategy, product/service design, R&D, and operations. Without ample cash, nothing works. Without a motivated and cohesive team, nothing gets done.

Keep both optimized and in check, and you have a better chance of surviving to become one of the success stories!

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Date
2025/08/25
Date Created
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