

Feel free to fail

The more optimistic statistics show that three out of four start-ups fail. But we should not be afraid of failure, Reinhold Karner says.

Are start-ups important? Yes, of course. But it looks that things go quite wrong.

While the precise definition of a start-up is widely debated, most agree that it's an entrepreneurial venture which is normally a newly started, innovative, fast-growing business that aims to meet a marketplace need by developing or offering new, improved, newly combined or more competitive products, services or processes.

In this regard start-ups are very important, especially when we are talking about building real companies that create jobs and are drivers for economic growth. This is also confirmed by the findings of a study from the Kauffman Foundation which underpins that incumbents tended to invest in R&D that exploited existing technologies and in incremental innovations, while start-ups are more likely to enter the market with radical, cutting-edge innovations.

If you look at what's happened around the globe in recent years, it's easy to think we're living in a start-up era. You'd expect an exploding number of new successful businesses and jobs. But the contrary is the case.

Start-ups have become a fashion, everywhere. So imagination and reality is just far apart. It's a paradox which leads to opposite effects, as caused by this hype any nonsense, non-starter and lemon idea will

become a start-up, where still many turtles hatch, but very few make it to the sea. That's quite similar to the first green wave of organic products where half-baked concepts just burned a lot of cash, created a bubble and most ended up in the sink.

Let's look at the US, which most people see as the land of limitless opportunities, not just because of top-notch corporations like Apple, Google, Amazon and Facebook, but also because of its unstoppable business success vibe, especially in high-tech.

An article recently published in *MIT Technology Review* reported that the number of companies in Silicon Valley that got seed funding from investors more than doubled between 2007 and 2012. Venture capital funding in the US over the last five years has totalled a remarkable \$238 billion, and 200 companies today are so-called unicorns, privately valued at more than a billion dollars each.

But entrepreneurship is actually on the decline, and has been so for decades. According to a paper published by the Brookings Institution, the percentage of US firms that were less than a year old fell by almost half between 1978 and 2011. According to the Commerce Department, the number of new businesses started by Americans has fallen sharply since 2000, and so too has the

percentage of American workers working for companies that are less than a year old.

Since 2015, start-up activity is growing again in the US, but it's still below historic norms, and the latest data from the US Census Bureau continues to show a long-term decline.

Interestingly, according to the Kauffman Index, immigrants are nearly twice as likely as native-born Americans to start their own business.

In Europe, the situation is similar. In Germany for example – according to the latest KfW Research as well as the Global Entrepreneurship Monitor – the enterprise birth rate fell by 17 per cent. Germany only occupies the last place in Total early-stage Entrepreneurial Activity (TEA) index among 23 innovation-based countries. Italy ranked 22nd, Spain 21st, Norway 20th, UK 15th and Switzerland 11th – Canada leads the rankings, followed by Estonia in second place, the US in fourth place and Israel in fifth place.

The same research shows that in factor- or efficiency-driven economies, the top TEA rankings regarding are occupied by Senegal, Botswana, Burkina Faso, Ecuador, Lebanon and Peru.

What's the success rate of businesses? There are various statistics and studies available about start-up survival. The few optimistic ones report that three out of four start-ups fail, while the conservative ones see nine out of 10 start-ups failing within three years, with tech start-ups have the highest rate of failure.

Some sobering statistics see 96 per cent of all businesses failing within 10 years. That's quite accurate as, according to Eurostat's regional yearbook 2015, the average lifecycle of companies in Europe is down to just 11.2 years, as slightly fewer than nine per cent of the active enterprises in the EU ceased activity every year. The highest enterprise death rate was recorded in Croatia, followed by Portugal and Lithuania. The lowest enterprise death rates were recorded in Malta, followed by Belgium, Austria and the Netherlands.

But even the average lifespan of a company in the S&P 500 index has decreased from 61 years in 1958 to just 18 years today.

Do start-ups really create lots of good jobs?

Start-ups have been increasingly put forward as drivers of economic growth, in large part because it's become accepted as fact that start-ups create jobs. But do they? Scientists are now saying that it's not that simple. Furthermore, some of the empirical support for the idea that start-ups create jobs results from a kind of statistical illusion, or what is called an artefact. That said, some start-ups – especially those that become real, lasting and high-growth companies, do indeed create good jobs. However, the hype-born non-starters don't.

As the *Harvard Business Review* recently published, it's common knowledge that jobs created by a newly formed firm variety are less equal, in two ways.

One is that they pay less. A study in the UK shows that on the average, a start-up reaches only \$180,000 in revenues after its sixth year, barely enough to pay salaries. Another study in Denmark has found that indeed, start-ups create quite a few jobs, but that a disproportionate number of them are low-skilled service jobs. And keep in mind that even successful start-up entre-



Start-ups enter the market with cutting-edge innovations.



Reinhold Karner

preneurs work for low or no salary for months or even years after their company appears as a start-up in census data and they are often registered as employees.

The Brookings Institute published another quite interesting research: "Business dynamism is the process by which firms continually are born, fail, expand, and contract, as some jobs are created, others are destroyed, and others still are turned over. Entrepreneurs play a critical role in this process, and in net job creation.

"But recent research shows that dynamism is slowing down."

Has the world of entrepreneurship lost its appetite for risk? Maybe, remarkably in the innovation-driven economies, as at the moment it looks that as many seeds as ever are their being planted, the fewer trees are growing to the sky.

Inherent to any entrepreneurship is to take risks of various kinds and dimensions. This is also reflected in the results of the research of the Global Entrepreneurship Monitor as fear of failure index which varies a lot by country. This index shows a self-perception about entrepreneurship of those seeing opportunities to start a business but would feel constrained by fear of failure.

Societal attitudes provide a signal about how entrepreneurship is regarded in an economy. A society's culture, history, policy and business environment, together with many other factors, can influence its view toward entrepreneurship, which can, in turn, affect entrepreneurial ambitions and the extent to which this activity will be supported.

More distinct these days in the innovation-driven countries (including Europe), though, are the dramatically lower intentions to start a business, with only one-third the level of intentions as the factor-driven country average. Consequently, although people in the innovation-driven economies generally see



opportunities, comparatively few intend to pursue entrepreneurship.

But the story behind this perception in our innovation-driven countries, especially in continental Europe, is in my view, how these maybe-potential-entrepreneurs are expecting to be treated in the event of failure. In Germany, a recent survey shows that nearly two-thirds of the population have no tolerance for entrepreneurial failure as well as no real culture to naturally grant a second, let alone a third chance.

In Germany, entrepreneurial failure is – as opposed to the Anglo-American countries – mostly equated to a personal failure, says Rolf Sternberg, a start-up researcher. No wonder that many see failure as humiliation for their whole life, not just career.

This is not only in Germany – there are many more countries in Europe and even Asia with similar ways of thinking.

Apart from the fact that the lifespan of companies within the EU is just 11.2 years, with this attitude, so many famous entrepreneurs wouldn't have made it, as they failed numerous times before they finally made their great breakthrough. Just to mention a few: Henry Ford, Bill Gates, Steve Jobs, Steven Spielberg, Walt Disney, Henry Heinz and Thomas Edison.

As the Romans said, *quae nocent, docent* – what harms teaches.

How do we fix this? In my opinion we have to address a five-point-plan: inform, encourage, educate, support and mentor young entrepreneurs in the right way.

The natural key-disadvantage for start-ups is lack of experience. That's why most successful entrepreneurs, especially high-growth entrepreneurs, have prior industry experience. This is reflected in data showing the peak age for entrepreneurship is around 40.

Back to the first point: the right information. In my view all starts with misguided expectations. Today's information variety creates an ambivalent, opposing and distorted picture about entrepreneurship.

Young people subsisting on a diet of *Dragons' Den* might be given the impression that it is easy – and cool – to turn an idea into a business and become a millionaire overnight.

But let's examine the facts: the vast majority of fast-growing companies never take any angel or venture funding. Other people's money is quite often deceptive, a popular misconception about funding. Don't get me wrong, there are some very supportive investors, with strong skills and backgrounds in entrepreneurship. But the genuinely helpful ones are in a minority, and one should be aware that venture capitalists bury their dead very quietly – they emphasise the successes but they don't talk about their failures at all.

“What is needed is a much more professional information about the truth and challenges of entrepreneurship”

John Mullins, bestselling author and Professor of Entrepreneurship at London Business School, says that automatically going down the venture capital route is risky and needless. Mullins says that almost all fledgling businesses should be looking to another source of funding first: their customers. His research has found that numerous businesses – young and old alike – have found inventive ways to get their customers to pay for their earliest stages of development.

On the other hand, the fear of failure still dominates, as there is little advice and education on how to turn such a painful event into a success.

As the saying of one of my RMK-principles goes: “To be successful isn't the problem. But to achieve enduring success is.”

To be sustainably successful is a great art, a perpetual challenge which follows its own rules and realities.

So what is needed is a much more professional information about the truth and challenges of entrepreneurship. It's hard work and you have to love it and be sure that you really want to become an entrepreneur. Hence you first have to be honest with yourself and make sure you have just a single frontline: to drive and develop your start-up business.

You also need the right encouragement. Neither fear nor fantasy are good advisors. The best way is to lead by example. That's the reason why I believe that especially mature down-to-earth entrepreneurs – both successful ones and others who experienced failure or even recovered successfully from bankruptcy – should be case studies to enlighten and encourage young people about the beauty, challenges and adventure of entrepreneurship.

The right education is also key. Today, entrepreneurship education does not work. In an article published by *Forbes*, Andrew Yang, founder and CEO of Venture for America, wrote how, “Entrepreneurship classes and programmes in colleges around the US have quadrupled in the past 25 years. Meanwhile rates of private business ownership for households under 30 have declined over 60 per cent during the same period. So, the more we teach entrepreneurship, the fewer young people actually start businesses.”

Andrew Yang is right. Entrepreneurship education has become a big business, inside and outside of universities, but the results are not convincing at all. What we need is a holistic entrepreneurship education. Why? In my belief it's quite simple, as the education programmes mostly provide just the necessary theory and how to sail in sunshine, mainly taught by lecturers who

never built, managed or took responsibility for a sustainable business or company themselves.

But this provides young people only with 180-degrees of the necessary knowledge to succeed. You need also some apprenticeship in the real world as well as to educate and prepare them intensively for failure, to deal with serious risks and survive severe turmoil, not just technically but also personally with a 360-degree perspective. This includes a survival training concerning how to protect oneself from failure as well as how to deal with failure.

Only this would help them to get the right correctives for decisions and behaviour. Therefore one needs to involve specifically and highly experienced people from the forefront, from entrepreneurs to lawyers, not just welcomed theorists.

Next is the business plan. The idea that a business plan is only intelligible for a few people who have studied a lot and made it in the leading hierarchies is just nonsense. A good business plan is legible to everyone.

Support should be high on the agenda of governments, as it's about the future and growth of their economies.

First of all, as entrepreneurship is by its nature unthinkable without taking any risks, one should be grateful to decent entrepreneurs by all means, as primarily they generate prosperity for a countries ecosystem. But nobody is perfect, and taking risks implicates failure. To achieve success often depends on a fine line where luck tips the scales.

But failure is also an indispensable lesson that creates self-awareness, progress, human capital and pushes us to try harder. Even in nature evolution wouldn't be possible without failure.

We need an open and welcoming culture for tolerance regarding entrepreneurial failure and second chances. This should be even reflected in the insolvency and bankruptcy laws and procedures with a focus on a fast fresh start. Most continental Europe countries still have quite medieval attitudes and regulations in this regard, which are highly counterproductive to overcome the fear of failure.

The next important requirement is to provide a fast-track and lean legal environment with a minimum of red tape to set-up and wind down start-ups.

Another important building block is to support start-ups with capital. Having said that, it's not just about investors' money as this would ‘force’ start-up entrepreneurs to sell shares of their company. This could even break their motivation. Therefore serious and good alternatives are essential, either provided by banks (with reasonable risk premiums) or in combination with State guarantees, public early-stage investment capital and subsidies. Several countries are already providing such smart funding schemes as well as support and professional infrastructures.

To dodge the trap of inexperience, young entrepreneurs should be mentored by highly experienced, mature entrepreneurs, managers or expats.

Young entrepreneurs would benefit from knowledge and capabilities imparted by senior colleagues, such as business acumen, promising strategies, protocol, decision-making and negotiation skills that often come with time and experience.

I strongly recommend following a new model: not to practice the usual top-down structure from senior to junior but follow an agile, bi-directional and hence also reverse mentoring.

This combination of mentoring and reverse mentoring with young and mature entrepreneurial skills creates an invincible team, open to new ways and would widely help to avoid chasing phantom business opportunities.

These mature mentors could also take on the role of the devil's advocate and help with their connections to support the business development.

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