When startups fail: What happens when the cash runs out

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Silicon Valley has long lured ambitious entrepreneurs into shiny co-working spaces and startup accelerators, promising them the chance to create the next Google, Facebook or Uber.

But the reality is most startups fail, a risk that some say is growing as funding that once poured into the booming tech market begins to slow. For founders and employees, the results can be devastating.

"It sounds good on paper, but that's not really how it is," Dr. Michael Freeman said of the Silicon Valley dream. A psychiatrist at the University of California at San Francisco who studies and counsels entrepreneurs, Freeman likened the tech boom to the Gold Rush. "A lot of people in 1849 came to California looking for gold. And some people found it - and most didn't."

Lately, it's the entrepreneurs in the "didn't find gold" category who are making headlines. San Francisco-based smart motorcycle helmet maker Skully ran out of funds and shut down in August after its founders were accused of spending company money on luxury cars, vacations and strippers. Weeks later, job platform WrkRiot went offline after a former employee claimed the founders forged wire transfers because they couldn't pay workers.

Those failures can be crushing for employees - and not just because they find themselves out of a job. Carlos Rodriguez, Skully's former vice president of sales and marketing, said the company's demise was especially painful because he was personally invested in Skully's mission to prevent motorcycle accidents.

He worked 80 or 90 hours a week, spending some nights in a hotel to be closer to work. His children had Skully stickers on their laptops. As the company fell apart, Rodriguez pulled himself away for a preplanned trip to France with his wife for their anniversary. On the plane, he was hit hard by what happened.

"I was looking out the window, and I just started bawling," Rodriguez said. "I was saddened for customers ... I was grieving for them. I was grieving for the work I put in for the development of this product. I was grieving for the time that I was away from my family."

Now Rodriguez works as an adviser for a few other tech companies, but they compensate him mostly in equity, forcing him to live off his savings while he hunts for another job. Despite his experiences at Skully, he's considering signing on with another small startup.

"You can have a greater impact," he said, "whereas in corporate America you're literally a name on a list."

Zirtual founder and CEO Maren Kate Donovan felt a similar heartbreak when her startup went under last year.

"It was very much like several deaths," she said. "It was the death of hopes and dreams. It was the death of a community that I and my co-founders had spent five years building. ... It was absolutely devastating - definitely one of the worst things I've ever been through."

Zirtual, a San Francisco- and Las Vegas-based startup, matched small-business owners with remote online assistants. The company ultimately was resurrected after being acquired by Startups.co, but Donovan didn't stay.

Silicon Valley hadn't prepared Donovan for failure. People rarely talk about startups that don't make it, Donovan said. Now she offers one piece of advice to other entrepreneurs: Get a therapist - you're going to need one.

Failures don't just affect the founders and employees - a startup's customers also pay the price when the company collapses.

Emilie Fairbanks, a lawyer who runs a small landlord-tenant law practice in Washington, D.C., used a Zirtual assistant for three years before waking up to an email that said the company was no more. Fairbanks panicked. She changed the passwords her assistant used, got a new credit card and ran damage control with clients who were used to emailing her assistant directly - and now were seeing their emails bounce back. It was disruptive, and Fairbanks worried it made her look unprofessional.

"It really has made me less willing to use other startup services," she said.

Still, for entrepreneurs, failure is nearly a Silicon Valley rite of passage.

"The cost of failure has gone down pretty dramatically ... and that's a good thing in some respects, but that's also a bad thing," said Harvard Business School professor and startup expert Shikhar Ghosh. "It creates a certain recklessness."

Digital publishing company Mode Media, which was valued at $1 billion and rumored to be on the verge of an initial public offering a few years ago, became another Silicon Valley casualty last month. Mode struck advertising deals between bloggers and third-party companies, posting ads on the blogs and doling out cash to the bloggers. When Mode shut down, many of those bloggers claimed they were owed thousands of dollars.

"I'll be honest, I cried," parenting blogger Jeanine Macintosh, of Toronto, wrote in an email. She says Mode owes her almost $1,300 - a chunk of cash that could feed her large family for three weeks. "I just had baby number seven ... and count on every cent I do make from my blog."

Sometimes the money runs out for employees, too. In a scathing blog post in August about an anonymous startup later revealed as WrkRiot, former employee Penny Kim described waiting for paychecks that never came as the company's funds dried up and the founder made empty promises.

It's not an uncommon complaint in Silicon Valley. Founders frequently put off paying employees as they wait out their next round of funding, even though the practice is illegal, said employment attorney Sebastian Miller. And if that funding falls through, often there's no money left to pay those back wages.

Ghosh estimates that between 70 and 75 percent of venture-backed startups don't return the money investors put in - and of those, more than half return nothing. Venture capital database CB Insights tracked more than 1,000 startups that raised seed rounds in 2009 and 2010, and found that by the end of 2015, less than half secured a second round of funding. Just 22 percent achieved a sale or IPO, and 1 percent reached a value of $1 billion.

Startups may fail because there's no market for their service or product, their technology doesn't work or because they grow too quickly or too slowly. But personality also comes into play - entrepreneurs tend to have an appetite for risk, an elevated level of self-confidence and a tendency toward aggression, Freeman said. Those qualities can be effective in business, but they also can make a founder unwilling to compromise or listen to his or her board - factors that can lead to a company's implosion.

Those personality traits also may be what keep some bruised and battered entrepreneurs coming back for more. After Zirtual crashed, Donovan considered jobs at large corporations. But in the end she signed on as chief operating officer at Roam, a startup that rents international co-living spaces.

"At the end of the day," she said, "I'd much rather do something that's a little high risk and really, really love what I'm doing."