You've seen it too many times before--the free-spending startup company which burns through their funds like a cocaine addict on vacation in Columbia. It's ultimately a sad tale, with great potential often wasted, many jobs lost and multiple lives hurt. But it is sometimes hard to feel sorry for the management teams that put these companies in precarious positions with poor judgment and lack of self-control---they should know better, and end up getting what they deserve.

4 ways that startup companies spend themselves out of business

- Spend it almost as fast as it comes in, because the market is overheated. This was endemic during the Internet bubble years, when even formerly conservative VCs were imploring their portfolio companies to "spend money faster", and "get the eyeballs now, we'll figure out how to monetize them later". A lot of that was going on back then. Crazy, as we all look back at it now.

- A more common situation where money tends to get spent way too fast is when a startup management team is staffed primarily with "big hitters", coming from big company backgrounds. I remember in particular a mesh networking company here in San Diego, which burned through over $60M in VC money, while creating almost no revenue along the way. They hired an almost endless list of VPs from name brand, blue chip companies, paying them well over the going rates at early stage companies. The CEO came from a big telecommunications company (with no startup experience). He was paid a SALARY of $750,000/year. Yes, you read that right--I'm not even counting his bonus and option grants. In a company that was barely past the pre-revenue stage, and nowhere near profitability. It still amazes me.

- Another scenario I have seen quite a lot, are pioneer companies that are developing a novel technology or product, attempting to create a truly new market. What happens often in this situation is what I'd call an "itchy trigger finger". That's when it's still too early to create the critical mass needed in a market. Instead of being patient, marshalling their resources and continuing to develop their products while educate the market, these innovators get impatient. They blow through their investment capital with a premature, huge ramp-up in Sales and Marketing, well prior to their product or the market being ready for this expansionary phase. Their large expenditures in Marketing serve only to prime the market, to the great advantage of their fast-follower competitors.

- The final situation that you often see leading to overspending is the company that has been bootstrapping successfully (but also painfully) for a very long time--then finally is able to attract a round of Institutional Capital.
  Every startup has a long list of "like-to-haves" that they would spend money on--if they only had it. So it's ok to knock off the most important areas at the top of the list, when that initial funding finally comes through. But like a starving man let loose after hours at McDonalds, some of these formerly prudent managers gorge on the newfound capital--spending it like its ongoing cash flow--not the precious investment capital that it actually is. Not being miserly with investment capital is one of the cardinal sins indicative of bad startup management. In this particular situation, it is otherwise sound managers who undergo a bout of "temporary insanity"-- a particularly sad story.

So that's one side of the coin--overspending. We've all seen it, and when you're not inside the eye of the hurricane that is a startup company, it's pretty easy to recognize. There is no doubt that this free-spending behavior has killed many a promising startup.

But what about the flip side of the coin--when managements are TOO miserly, and spend too little? This is an area that I have not seen discussed very much lately, in early stage tech circles.

Now please keep in mind, I'm not advocating spending funds that you simply don't have. Borrowing is rarely a good idea for an early stage software or tech company. If you don't have the money--please, don't try to find a way to spend it anyway! Conservation of capital is one of the basic pillars of good startup management practice.

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Yet, there are some places where an early stage company simply HAS to invest, or the outcome will be almost certain crib death. Below are a few important examples:

STAFFING WITH GOOD PEOPLE

Good companies are built with good people. Great companies are built with great people. Even the company with great brand equity and outstanding IP, are doomed for a fall without the continued benefit of committed, smart staff. In a startup, it's even more critical, because you don't have any of the built-in advantages that a big company has, which might allow the enterprise to coast for a bit before heading south. Without good people, startup companies will not thrive for long. Even if a profitable business can be built, it will eventually hit a wall, as a result of lack of depth in the employee pool. The initial founders can only take it so far without a strong supporting cast--growth will eventually stall. I have a client, a young CEO, who has done a great job building a strongly profitable, multi-million dollar business in a large and competitive market. But his growth appears to be stalling, because he views much of his staff like desk chairs, or any other overhead line item--an expense item to be minimized. Don't make this mistake. Your staff is your lifeblood, not a ball & chain to be jettisoned at every opportunity.

CREATING A GOOD PRODUCT

Almost important as good people to a software or high tech startup, is a killer product. Although there are many, many things that are important to a successful startup tech business, by their very nature, tech companies are almost always driven by a great product. There are exceptions, no doubt--but this is a pretty good rule. It makes little sense to cut expenses in product development (assuming that you're spending the money wisely!), until you have created a product that can lead to winning in the marketplace. With a startup, that almost certainly means something that's not "me too"--it needs to be faster, cheaper, more capable. A strong product is the muscle that allows you to break though the barrier of embedded competitors with strong positions and brands. Don't kid yourself and save your money for other things, until you've hurdled this bar.

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BUILDING A CRITICAL MASS OF UNIT SALES

Lastly, you've built a killer product and have a savvy staff pushing it out into the market. With whatever you've got left in your tank--use it. Stomp on the gas peddle, spend whatever you can muster on outbound sales and marketing programs. This is where the proverbial "crossing the chasm" really takes place. There are a certain number of successful customers you need to sell, before you get over the peak of that initially steep sales curve--and things start to get easier. Once that happens, people know your company name and product. Enough happy clients are out there so that word of mouth marketing kicks in. Instead of fighting for every new customer, they start coming to you in increasing numbers--without any effort at all. Your product is now showing up in the market share figures. The press and analyst community start to call you, instead of you leaving endless unanswered messages in their voicemail boxes. Yes, at some point, believe it or not, it really does get easier! But this happens only if you are able to close the number of initial sales necessary to reach critical mass in your specific market. Until you reach this point--SPEND WHATEVER MONEY IT TAKES--AS LONG AS YOU HAVE IT.

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About the Author: Phil Morettini is an experienced High Tech senior manager with functional expertise in product marketing, new product planning, business/corporate development and sales management in a BtoB and BtoC environment.

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