What start-ups get wrong: Lessons from WeWork

The company had no use for past learnings about market, strategies, capital, governance, and sustainability. It paid for its arrogance

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WeWork's 13-year journey from a startup to $47 billion valuation four years ago and bankruptcy last week is a cautionary tale of what entrepreneurship is not. Of course, entrepreneurship is the pursuit of unrealistic ambition against odds that, more often than not, leads to failure. And stupidity is not illegal. But WeWork is different. Historians warn against a disease called presentism, which believes current circumstances are so special, unprecedented and disruptive that rules from the past no longer apply. WeWork's bankruptcy is a child of presentism about markets, strategy, capital, governance, and sustainability.

Before the customary entrepreneurial schadenfreude — joy in other people's misery — about WeWork peaks, it's helpful to remember that most startups fail, don't socialise their losses, and solve big problems. Society progresses through innovation but doesn't know which new ventures will succeed. Hence, it encourages many statistically independent and genetically diverse tries by entrepreneurs who underestimate their odds of failure (less than 1 per cent succeed). This high failure rate is not a problem — society only needs a few successes to harness the gains of innovation, productivity, and job creation.

Every entrepreneur knows that postmortems have a certainty that prescriptions don't. And nobody should celebrate the pain of WeWork's bankruptcy inflicted on employees, suppliers, investors, and lenders. But as Tagore said, we don't learn from experience but from reflecting on experience. The rise and fall of WeWork suggests caution for entrepreneurs about presentism in five areas.

Markets: WeWork confused a large market (office space) with a large addressable market (people paying the premium for co-working spaces that will cover investments and costs compared to normal renting). It replaced the product market, fit with customer subsidies and risky arbitrage between long and short leases, where WeWork bore all the duration risk. Many fortunes have been made in real estate, but WeWork weaponised delusion by rebadging a property-leasing company as a "tech-enabled physical, social network" whose mission to "elevate the world's consciousness" would "transform how people work and live".

Strategy: The art of creating unfair advantages is the long-term essence of strategy but it is also the short-term science of reducing the negative unit economics (you must lose less when you sell more). The notion of blitzscaling — winner-take-all markets that require prioritising growth over avoiding losses — formulated by Reid Hoffman, the founder of LinkedIn, is real but rarer than most think. It applies to social media, stock exchanges, search, operating systems and other network businesses, but its applicability to property leasing was a birth defect that became impossible to overcome.

Capital: Referring to the recent peak of imbalance in venture capital funding, a unicorn founder told me his strategy was “raising more money than my competitor”. WeWork simultaneously excelled at fundraising ($16 billion in equity and $19 billion in debt) and disrespecting capital. But while growth or profits frequently go in and out of fashion, return on equity is evergreen. It doesn’t matter how much money you make; what matters is how much money you spend to make the money you make. WeWork’s substantial capital and revenue spending could not substitute for strategy or capability. Or as Field Marshal Rommel said, “Sweat saves blood. Blood saves lives. But brains save both”.

Governance: Effective entrepreneurs know that the most dangerous lies are the lies we tell ourselves. They counter this with boards that act as hearing aids, mirrors and seat belts. But WeWork’s board let entrepreneur Adam Neumann buy personal stakes in buildings he leased to the company, borrow more than $1 billion against his equity, approved 10 times higher voting rights for his shares, and let WeWork open an elementary school called WeGrow after Neumann and his wife were unable to find the right school for their five children. Applause is a poor use of a director’s time.

Sustainability: Successful companies achieve a balance between the next quarter and quarter century and cognitive diversity between thinkers and doers. WeWork’s culture shut down doers speaking up against unrealistic goals or irrelevant expenditures by suggesting they lacked imagination. Obviously, Neumann had never read Greek historian Thucydides, who suggested that any army that has too big a separation between its thinkers and doers will have its fighting done by fools and thinking done by cowards. Corporate longevity matters because entrepreneurship is iterative, compounding needs time, and dessert as the first course is unhealthy.

WeWork was entrepreneurial hype but was only possible with the investors that gave it money with the willing suspension of disbelief around its addressable market being $3 trillion. The hype cycle was partly fueled by the quantitative easing of Western central banks after the 2008 financial crisis that mispriced money, risk and assets. The full price of this mispricing is yet to be paid in rich countries.

The implications for India are less grim. The boom in venture capital had excesses, and some companies will fail, but our economic outlook — we are the only large country in the world with 20 years of high growth ahead of us — is blunting fear for existing investors and attracting new ones. This new fuel is powerful — venture capital makes Indian business a fertile habitat for first-generation entrepreneurs in ways not dissimilar from the higher meritocracy created by IPL for cricket players and streaming platforms for actors. This crisis will accelerate the ongoing revolution in Indian business in financing (more institutional equity), management (a separation of shareholder, board and executive roles), and governance (voice of capital, minority protection, and boards that protect entrepreneurs from themselves).

Adam Neumann of WeWork often told people he hoped to be the world’s first trillionaire. I am certain reaching this ambition would require suspending economic gravity for a hundred years, not unlike the presentism he sold to his investors. Maybe he should have taken Nobel Prize winner Ivan

Pavlov's advice, "If you want new ideas, read old books", and then browsed Hemingway. A hundred years ago, Ernest wrote that bankruptcy happens slowly. And then suddenly.

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