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Financial Issues & Aspects Related to Sustainability, Survival and Growth of Startup

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Abstract

Startups are unique and innovative venture with growth and technology at their core. Startups usually carve out niche markets for themselves and are market disrupters for old business establishments. Their importance is such that Government of India has recognized their worth and is promoting startups through programs like Startup India, Standup India, Digital India etc.

Encouraging establishment of startups is applaudable but the main concerns like profitability and sustainability of startups should be addressed. Mostly quantitative measurement are considered as yardsticks for measuring the performance of startups and very little research is done on the qualitative aspects. This has created lack of knowledge to provide solutions to startups problems. Thus, in this research paper financial qualitative aspects are covered.

A self illustrated diagram of startup life cycle and its detailed explanation is given. Then reasons for financial failure of startups like lack of credit and capital, improper fund estimation and allocation, wrong investors, lack of professionals, cash management issues, etc. are discussed and explained in detail. All these challenges point out a common factor that financial aid, assistance and mentoring for startups is necessary. If we are to see a rapid growth in the success rate of startups then mere profitability and growth aspects are not enough, one has to focus on their sustainability too.

It is observed that startups are mushrooming all over the Indian economy signaling a positive contribution to the growth of the nation. In order to induce a more conclusive environment for startups, measures like credit availability, mentorship, tax exemption, relaxed norms etc. should be given by the Government. This would ensure growth and survival of startups which would ultimately benefit the customer, the market, the economy and the country.

Keywords: *Startups, sustainability, finance, innovation.*

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1. INTRODUCTION

A startup is an entrepreneurial venture which aims to provide its customers the most unique, customized and useful features in its set of goods and services. As notified by Government of India through its DPIIT website.

"A startup is termed as:

(i) The startup should be incorporated as a private limited company or registered as a partnership firm or a limited liability partnership.
(ii) Turnover should be less than Rs 100 crores in any of the previous financial years.
(iii) An entity shall be considered as a startup upto 10 years from its date of incorporation.
(iv) The startup should be working towards innovation/ improvement of existing products, services and processes and should have potential to generate employment/ create wealth."

(Source: DPIIT Website)

Startups have many features and its difficult to give an overall comprehensive definition of a startup. But there are two main factors that help identify a startup, they are: Growth & Innovation. Startups are generally found in areas which have growth and innovation at their core. As rightly coined by Paul Graham- "Startup = Growth" and "Everything we associate with startups follows from growth"

But can only growth and innovation be considered as the main factors in the success story of startups. Sustainability in the long-term is another important factor contributing to a successful startup. As an innovative and fast expanding startup is of no use until one is sure of its existence in the long run. Apart from being an innovative and growth driven idea it should be viable too. The sustainability is an important aspect in the Indian scenario because a recent study by IBM Institute for Business Value & Oxford Economics found that "90% of Indian startups fail within the first five years."

Thus, to find a solution to the problem of survival of startups we need to understand the phases of a startup. A flow chart has been drawn on next page to identify the different stages of startups and their characteristics over the years of their life cycle.

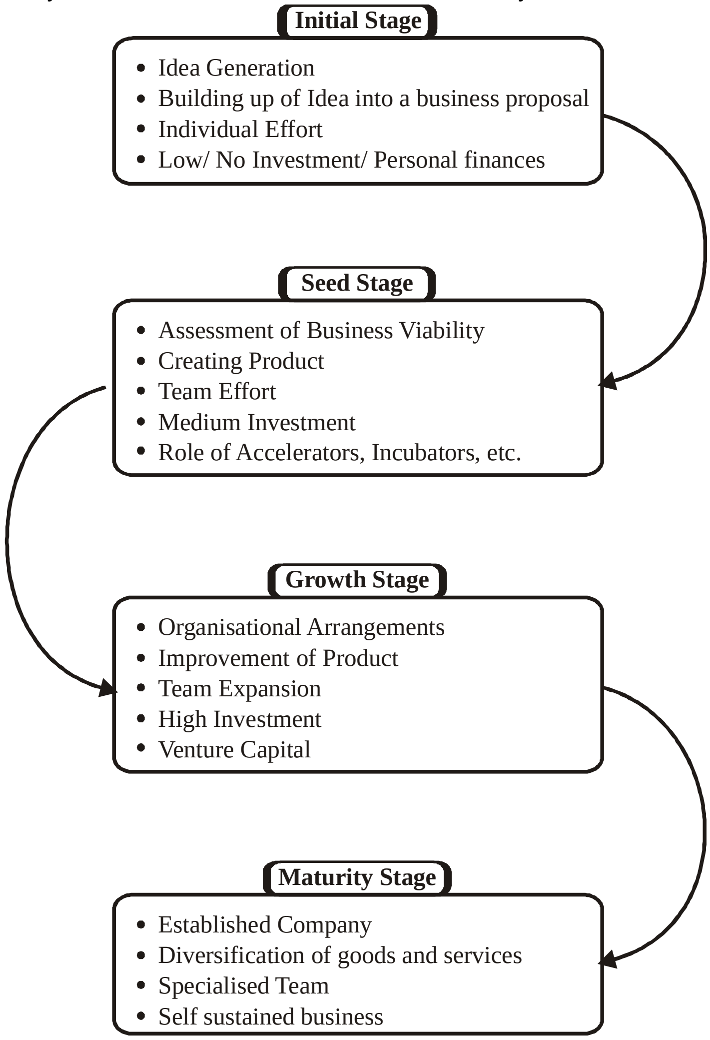
2. STAGES OF STARTUPS

(a) Initial stage – This is the stage where an entrepreneur conceives an idea and further builds up the idea into a business proposal. There is very low or no investment from outside sources and he uses his personal finances to fuel the idea. This stage is considered a pre-startup stage where it is not the company that grows but instead its the growth of the idea.

(b) Seed stage – In the second stage of startup the entrepreneur assess the viability of his business proposition. He adds members to his team and together they start working to get the business idea into reality by creating goods and services. In this stage the startups seeks funds from the outside. It also starts seeking help from incubators and accelerators to further develop the idea.

(c) Growth stage – If all goes well and the startups idea gets customers in the market, it starts the function of increasing his customer base by improving the product. Seeing the growth rate of the startup the investors also start investing more. The core team of the startup also expands by adding new employee with specialized knowledge to run the organisation.

(d) Maturity stage- At this stage the startup is well established in the market. Its growth rate somewhat slows down and it starts to diversify its portfolio of product and services. At this stage company only raises funds if it needs to invest heavily in R&D and other areas.



Flow Chart: Different stages of startups

3. RELEVANCE OF THE STUDY

Success and failure of startups are generally studied in quantitative approaches and very few studies have been conducted on the qualitative and other theoretical aspects. The entrepreneurs skills, talent, risk taking ability, financial knowledge, foresight and ability to take right decision, etc. have been long oversighted. But in reality these are the key aspects that contributing as well to the success and sustainability of a startup. Thus, sustainability is one angle which needs to be considered by entrepreneurs while running a startup.

4. FINDINGS

Following financial reasons lead to the unpredictable and insecure future of startups:

a) **Financial markets and classical ways of raising funds remain inaccessible to startups**: Capital is required by a startup in all the stage of its life cycle. But the most tough task is to procure funds in the initial phase. During the initial stage a startup lacks any previous financial records that might build confidence in the mind of the investors. The product is new and not yet tested so it is mostly seen as a risk by investors to fund such projects. "Also there is limited number of credit rating firms for small and medium enterprises." The requirement of credit is huge and the credit availability is very scant, leading to difficulty in initiation of startup venture. The popular sources of credit finance are seed funding, venture capital, angel investors, crowd funding, informal funding, etc. But procuring funds from these sources especially for the first round of investment is very difficult. According to a study conducted by research firm KPMG and Snapdeal. "About 41% of SME's in India lacked access to bank loans or other financial products offered by banks and other formal financial institutions." There is lack of goodwill or financial strength of startup and investors are initially hesitant to invest. Even if startups manage to get some initial funding, it is not sufficient enough to fuel all the operations and manage the startup at the same time. Concluding it can be said that procuring and managing finances throughout the different phases of a startup is a tough task. Lack of experience, investors hesitation, complex rules and laws, unpredictable market, etc. make it all the more difficult for startups to survive.

b) **Realistic estimation of funds:** Before initiating the first round of credit, a startup should have a well drawn plan on the amount of funds needed to start the venture. A very common mistake committed by entrepreneurs in their haste and enthusiasm to raise capital and credit is that they do not have the right estimation of funds actually needed for the business. In most of the cases startups either end up with over-estimation of funds or under-estimation of funds. Both of which are not beneficial for successful run of startups. Also, even before sufficient funding is acquired, startups require working capital before their estimated routine.

c) **Right investors and right timing**: Raising money from the right sources at reasonable terms is very essential, credit from informal sources generally carry high interest rates and ultimately lead to a debt trap for most of the startups. A survey of McKinsey found that 43% of SME's in India borrow from informal sources, partly because they had exhausted both collateral and working capital lines. So an entrepreneur should choose wisely about the investors and should then pitch forward for investment. "Many entrepreneurial dreams have failed because the founder got in front of the right people with access to capital but failed to woo the audience successfully."

   The timing for raising such funds should also be kept in mind. An entrepreneur should be awared that after the first round of investments, the startup would need future investments also. He should have knowledge about further sources of future credit. Because it is generally seen that there is lack of interest of investor in seed stages and later stages if the project does not convince them to be promising.

d) **Research & development expenditure:** There is positive relation between successful startup and R&D (Huge amounts are needed for Research and Development of the product from the begining in addition to the regular working capital and other revenue expenditures). Inability to invest in R&D leads to a decrease in quality and utility of a product, leading to decrease in sales, loss of profit to the startup. If this process is carried on for a long time the startup is not able to cover its revenue expenditure and starts incurring losses. Also in some cases if R&D is done, the success of new product is still very uncertain leading to insecurity to the life of startup.

e) **Financial constraint in hiring experts**: After procurement of funds an entrepreneur should have a diversified team of experts who have specialised knowledge and skills in their respective field. Having experts in the team ensures that the initiation of startup goes on smoothly. But due to financial limits of too much spending on R&D, production activity, day to day expenses, management, etc. a startup is unable to hire a specialised team which leads to various inefficiencies and slackness in the startup. And even if the startup has enough finances to hire services of experts it faces two major problems:

- **Lack of talent pool in the country:** In today's scenario it is very difficult to get the right professional to join the startup as people with specialised skills are very few or they prefer the safety of their big corporate jobs. Also working abroad is more attractive for some professionals. "In a survey by Accenture among Indian enterprises, 53% of the respondents cited lack of talent to be a key challenge in the deployment of modern technologies such as big data and cloud computing". Also India's No. 2 e-commerce site Snapdeal.com said that the company has not been able to find coders and other big data manpower it needs.
- **Dynamic nature of startups**: Professionals in India are used to big organisations and their work culture. But working in a startup is a tough job as startups are very dynamic in nature. A very different, multi way and multi talented approach is needed to work in a startup. Most of the professionals do not have enough courage to take up these challenges. "However, when one is starting up, talent acquisition becomes a pain, given that not everyone is flexible enough to work in a startup."

f) **Delay in revenue generation and more emphasis on repeated investments:** Most of the startups are in a hurry to scale up their activities. In this hurry the working capital expense rise which are compensated by repeated rounds of investment. Due to wrong scaling an entrepreneur might fail to see the higher working capital requirements than the scaling operation might need. Thus, the decision of scaling of operations should be taken after a deep study of startup position and startup should foresee if it can manage higher volumes of production and if increasing scales and volumes will also lead to increase in profit. "A scalable sales model depends on sales that are profitable, repeatable and efficient." If these measure are not taken into consideration then, this creates a problematic scenario. "Startups do not focus on revenue generation as the primary requirement for providing working capital, instead more and more credit is availed. As a result the operations of the startup come to a halt when funding ceases." Thus, the firm fails to bridge the gap that occur due to constant capital expenditure in the form of operations and low revenue generation due to heavy reliance on external credit.

g) **Issues in cash management :** Managing cash flow and working capital in the long run is a tough task, factors like burn rate, low revenue, high costs, low profit, insufficient investment capital, etc. lead to problems in cash management. No liquidity and bad allocation of funds lead to insufficient cash in hand. Lack of liquid cash halts the immediate operations of the startup which affect its profitability. Also due to loss making operations in the early years the companies quickly use up their equity and therefore need continuous equity and other forms of financing. "Due to their high upfront losses and negative cash flow, proper equity and liquidity management is key for startups." Sometimes it so happens that entrepreneurs treat capital expenditure as revenue expenditure leading to a huge mismatch in the financial accounts and creating the worse scenario of cash crunch. Thus, managing cash and liquidity is of paramount importance to ensure financial stability and sustainability of startup.

5. CONCLUSION

Startups are emerging rapidly in the Indian markets and currently India ranks 3^{rd} in the number of startups globally. The mushrooming of startups in Indian economy is a positive sign towards development of the country. More and more startups would ensure an even playground for competitors in the market and more options to select for the customers. Startups would also ensure a change in trend in business scenario where only big business houses used to survive in the global, national, regional and a local market. This would also end the phenomenon of concentration of wealth in a few hands and ensure a more equitable distribution of wealth in the nation. On observing the changes startups are bringing and would be carving in the future Government should treat them as the top preference and priority. The Government should look into the issues of startups and should extend a helping hand and promote such ventures. Because just boasting about the number of startup ventures opening in the economy is not enough, instead focus should be on the number of startups that succeeded and are sustainable in the long run providing unique services and innovative growth to the country.

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