

From Startup to Scale Up : The Key Challenges

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Abstract

The present study was an effort to identify the various impediments faced by startups in scaling up their business. The study also attempted to find the various factors that create a stumbling block for the new ventures to grow. The study was principally based on primary data and the essential primary data were collected from startup companies in Karnataka. A sample of 357 startup companies were selected using simple random sampling. To decipher the information regarding various impediments faced by startups in scaling up their businesses, survey method with structured questionnaire was used. Factor analysis was used to group various factors which are most inter-correlated with each other. Accordingly, we have logically labelled the factors as *utilitarian and judicial factors*. Further, to check the influence of independent variables (age of the founder, age of the company, and prior experience of the founder) on utilitarian and judicial factors ANOVA was used. The results of ANOVA show that the utilitarian factors are highly influenced by the age of the founders, age of the startups, and prior experience of the founders. The study successfully unwinds the factors that are significant for scaling up of startups to presume unattainable growth to build economic prosperity.

Keywords : Co-founders, founders, Karnataka, scale-up, startup

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The word startup is gaining cynosure in recent years. Particularly, in a country like India, it has strengthened its roots very firmly by gaining the attention of various stakeholders. India, being a vigorous and active start-up nations in the world, is home to majority of budding entrepreneurs who are less than 35 years of age (Malliakarjunan & Thimmaya, 2015). Behind the success story of every startup there are hundreds of failures. Startups being at the initial stage of the business cycle, may survive successfully for the first two to three years, and on the basis of favorable internal and external factors, it takes effort to cross different milestones in the journey referred to as *Scaling Up Phase* (Marian, 2017). According to Silicon Valley Report (2012), the large volume of financial rewards gained during scaling up phase makes it the most important phase in the business cycle. Establishing a new venture calls for challenges and risks which are unknown to entrepreneurs who often fail to scale up the business at the initial stage of business cycle and hence, many businesses are futile and are unable to succeed in the first twelve months of their operation (Mehralizadeh & Sajad, 2005). Well before establishing the firm, large percentage of startups seize their functions within a time frame of one year (Evers, 2003). The failure of startups not only affect business, but it also produces cascading negative effect on the stakeholders, employees, customers, suppliers, Venture Capitalists (VCs), and the society at large. Therefore, the Indian entrepreneurial ecosystem, rather than just fueling more startups should start nurturing more startups that have a potential to scale up. Many startups fail to scale up and prosper in businesses (IIFT, 2007), but the cause of failure is not well studied unlike the cause of business success (Bruno & Joel, 1988). Large number of startup companies face lot of challenges in scaling up business and lack strategies to mitigate the challenges leading to closure of business. As India is home to the third largest number of tech startups in the world, apparently in Karnataka, Bangalore is the hub to the largest number of technology startups in the country followed by

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NCR and Mumbai (PTI, 2016). The demographic dividend of young India's population can be capitalized by building a startup ecosystem. Failure to understand the difficulties and challenges faced by startup companies in scaling up business may lead to negative effects in the form of monetary and emotional costs that manifest in the society. Bangalore is the ninth largest start-up hub in the world (Pullen, 2013). It has lot of opportunities to foster economic growth towards sustainable development of startups. In this backdrop, the present research was an attempt to study the factors which are required for startup companies to scale up.

Theoretical Review of the Selected Variables of the Study

The theoretical frameworks in literature have tried to provide an understanding and explanation of the various difficulties faced by startup companies. As observed, the performance of a new enterprise depends on a number of factors such as location and time convenience, education and experience, working with partners, starting with huge capital and applying better management practice (Vesper, 1990). Further, the background and experience of the founders, founders' networking ability, gender diversity and composition of new boards are also important in determining the route to success or failure of new firms (Wilson, Wright, & Altantar, 2014). Besides, lack of well designed human resource planning and a dedicated Human Resource Department to implement HR policies creates major problems in accelerating the growth of startups (Sujana, Shetty, & Mathew, 2013). Further, factors like poor management team and marketing problems are the prime reasons for the failure of startups (Kandasamy, 2015). Startup companies face problems in terms of government policies, access to finance, marketing, acquiring skilled manpower, access to modern technology, high cost of raw materials, and infrastructure (IIFT, 2017). Large proportion of start-ups lack innovative ideas that could distinguish them from their competitors. On one hand startup companies face lot of challenges in recruiting and hiring the right candidate (Sharifi & Hossein, 2015), and on the other hand, funding (Bannock, 1981; Evers, 2003; Storey, 1985), lack of timely mentoring and guidance (Singh & Kaur, 2017), dearth of infrastructure (Storey, 1985), lack of single window clearance policies and tax structure in India debilitate growth of startups (Kaur, 2017). Regardless of high capital investments raised by the founders, many startups fail to sustain competition and require external funding sources to scale up (Singh & Kaur, 2017). The different challenges mentioned in the literature provide an abstract view of the problems faced by startup companies in scaling up their business. In this light, it is suggested that a more holistic understanding of scaling up challenges faced by new ventures should be understood.

Objectives of the Study

This paper examined the various impediments faced by startup companies in scaling up their businesses. It aimed at providing a didactic overview based on past and current literature in the field by identifying factors influencing startup companies in scaling up business.

Research Methodology

The study was mainly based on primary data. The required primary data has been obtained using survey method. The survey was conducted with the founders and co-founders of startup companies. To carry out the survey, structured questionnaire method was employed. To decipher the information related to difficulties faced by the founders and co-founders in scaling up startups, we included 10 variables on the basis of extensive review of literature. The key variables are '*lack of knowledge about the business*', '*Unclear taxation policy (lack of clarity on VAT and Service)*', '*issues related to legalities and requirements such as clearances, licenses, approvals required*', '*hiring and retaining high quality talent manpower*', '*lack of infrastructure facilities*', '*unavailability of funding to set up the business*', '*lack of adequate mentoring and guidance*', '*problems related to marketing*', '*stiff competition from other organizations*', and '*procedural delays and difficulties in establishing the enterprise*'.

(1) Population : A total of 5000 startups were registered in Karnataka according to the report published by Karnataka Economic Survey (2015).

(2) Sampling Design : New ventures in Tier I and Tier II cities in the state of Karnataka were outlined for the present study.

(3) Sampling unit : All the new ventures that were established between 2010 to 2015 in Tier I and Tier II cities in the state of Karnataka were considered as a sample for the present research.

(4) Sample Size: For 5000 registered startups with 5% margin of error and 95% confidence level, a sample of 357 was derived by applying Krejcie-and-Morgan formula. A sample of 357 startup entities was randomly selected from identified Tier I and Tier II cities of Karnataka.

(5) Limitations of the study : The study was limited to registered start-up ventures in Karnataka. The data for the study was restricted to those start-ups that have been in operation atleast for two years.

Data Analysis

It can be seen from Table 1 that '*talent acquisition and retention*' is the major challenge faced by individuals in scaling up their startups in Karnataka, followed by '*unavailability of funding to scale up the business*', and '*marketing problems*'.

To categorize the factors which affected founders and co-founders in scaling up business, factor analysis was used.

Table 1 shows that Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy for the study was 74.5 %. Certainly, it is a good result, as it exceeds 0.5 Bartlett's Test of Sphericity which is 0.000, meaning that the factors that form the variables are adequate. Table 2 shows the reliability and validity of factor analysis, which were tested using KMO and Bartlett's test. The principal component analysis extraction method was used to examine the data with varimax rotation method. Table 3 shows the rotated component matrix in which the extracted factors are assigned a new naming related together. From Table 3, it can be seen that all the loading factors which have the loading value less than 0.5 are rejected.

(a) The factors viz., '*deficit knowledge about the business*,' '*talent acquisition and retention*,' '*poor infrastructure facilities*,' '*insufficient funds*,' '*inadequate guidance*,' '*marketing problems*,' '*fierce competition*,' are well correlated with each other. These statements disclose the operational challenges faced by startup founders to scale up business. Hence, the factors are grouped as '*Utilitarian De-activators*'.

Table 1. Challenges Faced by Startup Founders in Scaling Up Enterprise

Particulars	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Weighted Total	Weighted Average
Deficit knowledge about the business	140	126	46	32	13	1419	3.97
Vague taxation policy	64	110	110	50	23	1213	3.40
Legal and judicial issues	75	118	75	58	31	1219	3.41
Talent acquisition and retention	150	145	44	16	2	1496	4.19
Poor infrastructure facilities	105	158	58	27	9	1394	3.90
Insufficient funding	174	99	58	22	4	1488	4.17
Inadequate mentoring	119	151	49	32	6	1416	3.97
Marketing problems	146	106	70	23	12	1422	3.98
Fierce competition	148	102	67	29	11	1418	3.97
Operational issues in establishing the enterprise	50	102	101	77	27	1142	3.20

Table 2. KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy		0.745
Bartlett's Test of Sphericity	Approx. Chi-Square	1042.265
	<i>df</i>	45
	Sig.	0.000

Table 3. Rotated Component Matrix^a

	Component	
	Utilitarian Factors	Judicial Factors
Deficit knowledge about the business	0.631	
Talent acquisition and retention	0.579	
Poor infrastructure facilities	0.645	
Inadequate funding to set up business	0.761	
Lack of adequate mentoring and guidance	0.722	
Marketing problems	0.656	
Rigid competition	0.704	
Procedural setback and difficulties in establishing the enterprise		0.633
Unclear taxation policy		0.876
Legal issues		0.891
<i>Extraction Method: Principal Component Analysis.</i>		
<i>Rotation Method: Varimax with Kaiser Normalization.</i>		
<i>Rotation converged in 3 iterations.</i>		

(b) The factors viz., '*delay in procedural formalities in setting up the business*,' '*lack of knowledge of taxation policy*,' '*elaborate legal formalities and approvals for obtaining licence*,' are highly correlated with each other and these factors reveal the startup founders' obligations in abiding to the legal formalities in setting up the new enterprise and hence, these factors are named as '*judicial imperatives*'.

Further, to determine the factors affecting startup companies in scaling up business, an attempt was made to determine impact of the variables like age of the founder, age of the startup company, and prior experience of the founder/cofounder on *utilitarian and judicial factors*, which have been identified through factors analysis.

The following hypotheses were framed to determine the influence of identified factors on the challenges faced by founders in scaling up the startup. To check the hypotheses ANOVA was used.

Hypotheses

The following hypotheses were framed on the basis of selected independent and dependent variables.

- **H₀₁**: There is no significant difference between the age group of the founders and challenges encountered due to judicial factors.
- **H₀₂**: There is no significant difference between the age group of the founders and challenges encountered due to utilitarian factors.
- **H₀₃**: There is no significant difference between the age of the startup enterprises and challenges encountered due to judicial factors.
- **H₀₄**: There is no significant difference between the age of the startup enterprises and challenges encountered due to utilitarian factors.

- H_{05} : There is no significant difference between prior experience of the founders and challenges encountered due to judicial factors.
- H_{06} : There is no significant difference between prior experience of the founders and challenges encountered due to utilitarian factors.

Table 4 (ANOVA) shows that there is no significant difference between the age group of the founders and challenges encountered due to judicial factors, as p value (0.186) is more than the significance level 0.05. Hence, H_{01} is accepted. When it comes to utilitarian factors, there exists a difference between the age group of the founders and challenges encountered due to utilitarian factors, as the p value (0.003) is less than the significance level 0.05. Hence, H_{02} is rejected.

Table 5 (ANOVA) shows that there is no significant difference between the age of the company and challenges encountered due to judicial factors, as the p value (0.130) is more than the significance level 0.05. Hence, H_{03} is accepted. When it comes to utilitarian factors, there exists a difference between the age of the company and challenges encountered due to utilitarian factors, as the p value (0.010) is less than the significance level 0.05. Hence, H_{04} is rejected.

Table 6 (ANOVA) shows that there is no significant difference between prior work experience of the founder and challenges encountered due to judicial factors as the p value (0.049) is more or less equal to the significance level 0.05. Hence, H_{05} is accepted. When it comes to utilitarian factors, there exists a difference between prior work experience of

Table 4. Age of the founder and its Influence on Judicial and Utilitarian Factors

		Sum of Squares	df	Mean Square	F	Sig.
Judicial	Between Groups	2.088	3	.696	1.612	.186
	Within Groups	152.404	353	.432		
	Total	154.492	356			
Utilitarian	Between Groups	4.885	3	1.628	4.772	.003
	Within Groups	120.458	353	.341		
	Total	125.343	356			

Table 5. Age of the Company and its Influence on Judicial and Utilitarian Factors

		Sum of Squares	df	Mean Square	F	Sig.
Judicial	Between Groups	3.692	5	.738	1.719	.130
	Within Groups	150.800	351	.430		
	Total	154.492	356			
Utilitarian	Between Groups	5.282	5	1.056	3.089	.010
	Within Groups	120.061	351	.342		
	Total	125.343	356			

Table 6. Prior Entrepreneurial Experience and its Influence on Judicial and Utilitarian Factors

		Sum of Squares	df	Mean Square	F	Sig.
Judicial	Between Groups	1.667	1	1.667	3.871	.049
	Within Groups	152.825	355	.430		
	Total	154.492	356			
Utilitarian	Between Groups	1.540	1	1.540	4.415	.036
	Within Groups	123.803	355	.349		
	Total	125.343	356			

the founder and the challenges encountered due to utilitarian factors as the p value (0.036) is less than the significance level 0.05. Hence, H_{06} is rejected. The results of the tests shows that the utilitarian factors are highly influenced by the age of the founders, age of the startups, and prior experience of the founders.

Discussion and Implications

The analysis of the present study supports the finding that majority of the startup founders face daunting challenges while scaling up business, of which the key challenge is '*talent acquisition and retention*' that corroborates with the findings of Sharifi and Hossein (2015). They stated that poor salary package and career opportunities were the main impediments in hiring and retaining talented work force in startup companies. The results of the study also proved that '*financial constraint*' also acted as a major hurdle in scaling up business. Accordingly, the results are inline with the findings of Singh and Kaur (2017), and reveal the reality that access to capital had been a recurring problem for startups. One of the roadblocks in escalating the new venture is a typical marketing problem and the same had been identified by Dutta (2016). The study also attempted to analyze the factors which affect startup companies in scaling up business, and the stated objective was inline with the study conducted by Okrah, James, and Alexander (2017), who emphasized that startup failure rate and success rate depended on key factors like creativity and financial support. The authors of the study also attempted to determine the effect of age of the founders on procedural and legal challenges in scaling up business. The findings of the study revealed that age of the founder had a major influence on utilitarian factors and accordingly, the results are in line with Lussier and Corman (1996), who stated that younger the age, more was the the risk of failure.

Further, it was also established that a firm's age had a high influence on procedural factors. This is in line with the findings of Coad, Segarra, and Teruel (2013), who proved that older firms leveraged their experience curve for higher productivity. Additionally, the study also investigated and found that there was a positive dependency between managing procedural factors in scaling up business with prior entrepreneurial experience. The finding validates a similar studies conducted by Ucbasaran, Shepherd, Lockett, and Lyon (2013); Fielden, Davidson, & Makin (2000); Guzman and Santos (2001) who advocated a strong relationship between entrepreneurial experience and business success in the future, and also stated that entrepreneurs' previous experience reduced initial start-up inefficiency. The ANOVA results of the study showed that the independent variables do not influence judicial factors and the findings of the study were contrary to the results of Saleem and Abideen (2011), who opined that compared to large organizations, small firms were relatively more affected by government regulations and tax authorities.

Further, it can be inferred from the study that the utilitarian factors such as '*deficit knowledge about the business*', '*talent acquisition and retention*', '*poor infrastructure facilities*', '*insufficient funds*', '*inadequate guidance*', '*marketing problems*', and '*fierce competition*' were highly influenced by independent factors like age of the founders, age of the startups, and prior experience of the founders.

It is evident that year after year, large numbers of new firms are created but all the newly created ventures do not get established as large firms. Nevertheless, metamorphosis of a new venture is a must for successful growth in the long run (Klofsten, 1993). On the basis of the identified factors and supporting literature, it is apparent that the word "startup" sounds glamorous to many founders and co-founders, but to sustain in this fiercely competitive market, the real challenges and difficulties can be encountered prudently with age and prior entrepreneurial experience of the founder and tenure of the company. To leverage the entrepreneurial strength and to build up startup ecosystem in a developing country like India, founders and co-founders should be cautious in diving while starting up a business to avoid trappings during the execution of startup ideas. It is high time for the startup founders to realize that scalable growth can provide the presumably unattainable growth that can take a business from startup to scale-up stage.

Scope for Future Research

The study can be extended by categorizing start-ups based on the nature of business and a comparative study can be

carried out to draw inferences about the key challenges based on the category of the start-up. A study regarding the stages of development of start-ups and subsequent challenges can also be explored. Future studies should also be directed to explore and understand how challenges differ across different markets, geographies, and across countries.

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