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Improving the Startup Survival Rate: A Conceptual Framework

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Abstract

The failing of startups has raised doubts about the startups universe. Their inability to keep the healthy cashflow was suspected to be the responsible aspect of why startup industry seemed to be declining – by the failing and layoff parades. Funding logic that only focused on developing the investments – from seed to A, B, C series, that were made by investors also suspected to have taken part of the failing and layoff parades. This research offered a conceptual framework that put the point of views on how the startup should survive. Instead of searching for higher funding level, the startups should be able to develop new competitive advantages that would regain the attention of the users – and it would have positive impacts to the cashflow. The conceptual framework combines three theories; RBV theory; lean startup methodology; and effectuation theory.

Keywords: *Startup Failing, Healthy Cashflow, New Competitive Advantages, RBV, Lean Startup, Effectuation*

INTRODUCTION

The recent phenomenon that is happening to the startup universe has put us into doubt. A question emerged; does startup (and its industry) as good as how it looks? Or it is only the tip of the iceberg that has huge unidentified things underneath.

The falling of a large number of startups (Crunchbase, 2022), and the layoff parades (Trueman, 2022; Vedantham, 2023) that were being done by the startups in all over the world has made the startup industry as a whole in huge doubt. Up until December 2022, at least more than 800 major startups in the world that have laid-off thousands of their employees, due to the business condition (Putri, 2022).

The growth of the startups industry has shown a very promising development over the time. Based on the data of (*Startupranking.Com*, 2021), 2020, almost 85.000 startups in the top five startups-contributor countries in the world. Those countries are United States, India, United Kingdom, Canada and Indonesia. The numbers grows into almost 95.000 startups in 2021. In Indonesia itself, the number of startups grows from 2074 startups (2019), 2.195 startups (2020), into 2.324 startups in 2021, and it has grown into 2.436 in 2022.

As interesting is it might, people still have doubts on the business model of startups and how they actually made the business run, not to mention how they have gained their revenue streams. The fact that was being revealed stated that the startups have negative balance (CNN, 2019). The fact that startups are falling has shown that some startups could not survive the recent condition – especially the post pandemic condition, whereas the startups had to face the declining sales, impeded production process, and impeded product distribution (Ilyas et al., 2020). Another question has emerged; how to improve the startup survival rate? This research is proposing a conceptual framework based on theoretical review on how the startups should be managed in order to have the better chances to survive.

LITERATURE REVIEW

Why Startups are Dying?

When the news on the dooms of numerous startups spread, on top of the questions that have been stated above, another question has emerged; why the startups are dying? (Trueman, 2022) in her article stated that

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almost 220.000 people were affected by the laying-off actions that were made by tech startup companies. (Vedantham, 2023) citing the Crunchbase News stated that more than 46,000 employees of American IT companies have already been let go in 2023. Furthermore, it was stated that this figure includes the 22,000 layoffs announced by Google and Microsoft within a week.

The situation is not much different in Indonesia. Two of the top startups in Indonesia, GoTo and Shopee were reported to make several layoff actions during 2022 (Putri, 2022). Similar conditions happened to numerous top startups in Indonesia, all within 2022 (Dewi, 2022).

Numerous reasons have been considered as why those startups, even the top startups should collapse. According to (Bayu, 2022), the collapse of the startups were mainly happened because their inability to gain new investors. Numerous reasons have been considered as why those startups, even the top startups should collapse. According to (Bayu, 2022), the collapse of the startups were mainly happened because their inability to gain new investors. Not only limited to that, the collapse of the startups has more reasons such as inability to compete, no longer needed by the markets, terrible business model that went against the regulation and even because of the disharmony inside the team of the startups. (Bednár & Tarišková, 2018) pointed out three aspects that have pushed the startups to fail; lack of funding to maintain the business, no longer needed by the market; and their failure to get investors.

Startup Survival Rate

The survival rate of the startups was considered as concerning. This statement was released by (Gonzalez, 2017). It was stated that the startup failure number was 53%, which was also considered as the similar number for the last two decades. (Calvino et al., 2015) stated that the possibility of the startups to survive were decreasing along with the age of the startups. It went to 60% in the first three years, and then down to 40% in their seventh year.

Another more terrifying information was stated by (Keogh & Johnson, 2021). They stated that the failure rates – they chose to take this point of view – of the startups are in the 90% numbers. This number is similar by the statement of (Camberato, 2019) that also broke it down into; 21.5% failed in the first year; 30% in the second year; 50% in the fifth year and 70% in the 10th year. (Bednár & Tarišková, 2018) also stated the 90% numbers of the startup failure rate, despite the huge numbers of developed startups each year.

Interesting fact was found by (Headd, 2003), by stating that one-third of the business that closed were not the type of failed business so they had to be closed. Those one-third business were quire successful and the closures might be the result of the retirement of the business owners – due to certain reasons, or because of business acquisition. Therefore, closure of the business does not always consider as failure, but also possible due to other reasons, such as the experience of the founders (Keogh & Johnson, 2021).

Funding Stages Logic in Startup Universe

(Janaji et al., 2021) divided the startups stages into three stages; (1) bootstrapping stage – where the startup gain the money from any possible sources that they knew such as business partners, founders, employers and/or even customers; (2) angel investors – this type of investors give the startups the funding to fill the gap between the initial startup financing to the venture capital financing; and (3) venture capital – which is expected to help the startups to grow bigger.

(Hofstrand, 2013) stated that there are three big classification of startup funding; early stage funding, bridge funding and expansion stage financing.

The early funding stage consists of seed, pre-launch, startup, and first stage funding, while the expansion stage funding consists of second and third stage funding. The bridge funding stage usually plays the role in between the two stages of funding – by getting the fund from government grants or from the commercial banks.

(AlphaJWC, 2022) mentioned that there are stages in the startup funding universe. It all started with the pre-seed funding stage which includes the bootstrapping fund, and it would be followed with the next level, the seed funding stage – where angel investors would be involved. The next stages would be Venture Capital

funding stages which would be involving the Venture Capital from Serie A to Serie C. The final stage of the funding stages would be the Initial Public Offering (IPO) into the stock market – where the startups went public.

RESEARCH METHOD

The research was started by collecting numerous supporting literature review on startup funding. In this phase, the researchers found that the word "growth" and "scalable" in the startup universe are not necessarily similar to the word "survive".

Taking this as the starting point, the researchers conducted a series of Focus Group Discussion and interview with related parties such as Startup Founders, Investors (Angels and VCs), and academician. Based on the results of the FGDs and the interview, a conceptual framework was finally designed.

To support the development of the framework, we decided to combine the Resource-based View theory by Wernerfelt (2007), and the Lean Startup methodology by Ries (2011). To complete the development of the framework, we added the effectuation theory by Sarasvathy (2008).

RESULT AND DISCUSSION

The Startup Funding Rounds Point of View

It is well known that the funding of startups consists of numerous levels. Each level represents the amount of money that were being invested by whoever the investor might be – could be personal investor, angel investors, or VCs.

Based on the discussion and the interviews, the investors' goals are clear. The investors have at least two main concerns; would their investment be secured; and when it would be returned (with additional benefits). In order to secure their investment, they would look at the business comprehensively, which consists of the business model; the team, and the them plan for the development. The last aspect, the team plan for the development is highly related to the second concern of the investors.

One of the most surprising facts that it was found from the discussion and the interview is that to support the second concern, the investors usually have their agenda. The agenda is by supporting the startups to move to the higher rounds. By moving to the higher rounds, it was expected that they investors could get their return faster, including the benefits that they aimed earlier – compared to; if they chose to go along with the startups' development – up until it gained its profits. This finding is considerably relevant when we discussed about the pre-seed level to seed level movement, seed level to angel investor movement, or angel investor to VCs movement. The discussion and interview results showed that those movements were from the different (and larger) investors.

However, it is not quite relevant to the fact that in the higher lever of startup fundings such as the Series A, B, and C, the same investors might put back their fund – although it was combined with other new investors.

Another concerning points of the startup funding point of views that was found in this research is that most of the investors were only concern about the growth. The growth is usually measured by the growth of the users (references). The fact that the startups did not have positive cashflow was often neglected. The "burning money strategy" that were often applied is one of the evidence that the effort to gain more traction – even without considering traction with revenue was being done by the startups, which could really hurt their cashflow.

Growth and Scalable vs Survival

Inside the startup business universe, we found that huge numbers of startups were considered as startups that have high growth and also considered as scalable **(reference).** However, this research found that the word "growth" and "scalable" are not parallel with the word "survival"

The evidence are quite obvious. The collapsed startups these days are the shown evidence of how the high growth, and being categorized as scalable is not necessarily related to its capability to survive.

Conceptual Framework for Startup Survival

Based on the results above, we have managed to design a conceptual framework for Startup Survival. In this framework, we put our focus on how the startups could survive – not only to pursue the higher funding round level, but also managed to ensure that the startups could last longer that what the history has shown.

We laid the framework on the statement that "the healthy business is a business that has healthy cashflow" which means, it has free cash flow – the amount of operating cash flow that is being generated is higher than the cash that the company needs for important spending such as capital expenditures (Stice et al., 2017). Furthermore, the healthy cashflow is the positive cashflow. A positive cash flow simply implies that more revenue enters the startups than the money that went out, and this is necessary for a business to maintain long-term growth. A constant negative cash flow puts a business in the hazardous condition (Smith, 2021).

Therefore, we put our focus on the positive cashflow (revenue higher that cost), and the ability of the profits (revenue minus cost) to cover the company's operations. The growth, however, is still in our main perspective, though it is not considered as the main aspect of startups survival.

Based on the research results, combining the RBV theory (Wernerfelt, 2007) and Lean Startup methodology (Ries, 2011), and completed with the Sarasvathy (2008), we came up with this framework.

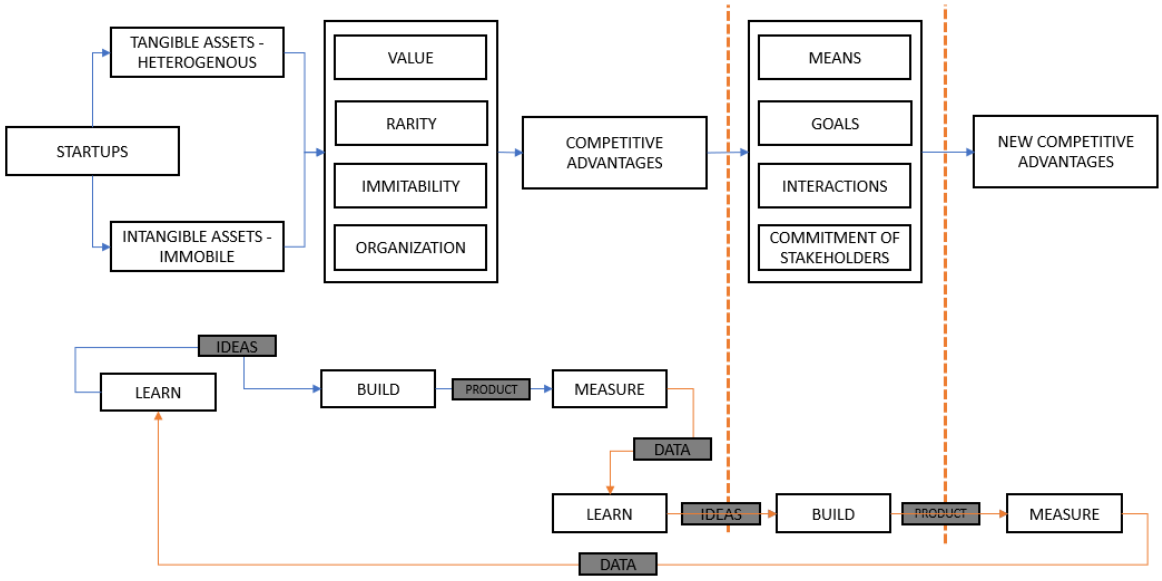

Figure 1. Startup Survival Framework

As we have mentioned earlier, this conceptual framework combines three theories: the RBV Theory, the lean startup theory and the effectuation theory. Each theory has its important roles in the conceptual framework.

The RBV Theory's Role

This theory is taken as the initial point of the framework, which sees the startups in its initial conditions, when things went as plan. The startups – normally should be able to map their tangible and intangible assets which would help them to build their initial competitive advantages that were built based on their VRIO. The original competitive advantages were initially developed – usually based on the idealism of the founders, prior it was being affected by the condition of the existing market.

The Effectuation Theory's Role

As we knew in the effectuation theory that the main goal of this theory is to be able to optimize the existing resources and the capabilities of the organization to create new opportunities. Therefore, by putting this theory onto this conceptual framework expectedly would guide the organization to be able to define their new competitive advantages – rather than sticking to the original competitive advantages that might not be that competitive anymore.

The Lean Startup Theory's Role

Since the lean startup concept is a looping concept, this theory has been impacted to the framework from the very beginning. The learning process is started even before the startup was officially launched. The data that were gained from the potential market were being used to develop the VRIO of the startups to formulize the initial competitive advantage.

In this framework, we extent the loop of the lean startup concept into two phases. The first phase, as we discussed earlier, was to develop the initial competitive advantage, while the second phase was being applied to the effectuation phase in order to develop the new competitive advantage.

CONCLUSION

The inability of the startup to survive was mainly because the inability of the startups to keep competitive to the market. As we have discussed earlier, this condition pushed numerous startups to shut down their business – or at least, lay-down numbers of employees. We believe that the inability to survive of the startups is closely related to their inability to keep the healthy cashflow.

The cashflow went into negative as the startups – and the products that it was offered to the customers has lost its competitive advantages, which pushed the users to change direction onto the new products that they considered as the more suitable products for them.

Therefore, the startups should be able to develop – and perhaps, redevelop their competitive advantages, and also find the new competitive advantages that would help them to be the choices of the customers. As the customers have gained more and more options these days – as there are huge numbers of startups come and go; having the new adaptive competitive advantage would help the startups to maintain their attractiveness to the customers, which expectedly, would assist the startups to maintain their healthy cashflow. The healthy cashflow that was successfully maintained would help the startup to survive.

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