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# The Process And Problems Of Business Start-Ups

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## ABSTRACT

*“... there is little known about the initial phases of the process (of entrepreneurship). The conception, birth and early development of new ventures are very much an uncharted territory”.* (Reynolds and White, 1997:1).

*This paper sets out to examine the process and problems encountered by new business start-ups. A didactic overview, based on past and current literature in the field, identifies the most common theoretical frameworks frequenting the academic literature and assesses their contribution to explaining and understanding the Process and Problems of New Venture Creation.*

*The founding of a new organisation is not instantaneous and the process is a largely complex one. The nature of this process - which is characterized by spontaneity and uncertainty - makes it more difficult to pin down an exact theory. As Gartner (1985) points out, entrepreneurial firms are too diverse to permit generalization, and the process of starting up a new business has become a multidimensional phenomenon. The different approaches, suggested in literature, explaining the process of new venture creation, have attracted much academic controversy, given the lack of consistent empirical research on the process of new business creation. In this light, the author suggests that a more holistic understanding of the process may be gained through the integrated theoretical frameworks of new venture creation presented in the literature, which aim to capture the most important variables and characteristics of the new venture creation process.*

*The second part of the paper deals with the problems facing entrepreneurs in new venture creation. Many start-ups never reach establishment, and the majority close up within one year after they have become established. Embarking on a new business is one of adventure and challenge but it brings with it high risk and uncertainty. This paper does not seek to detail each and every industry-specific problem that start-ups experience, but aims to identify and examine the most common difficulties encountered by Start-Ups in the early stages of establishment, irrespective of sector or industry.*

## 1. Objectives of paper

### 1.1 Objectives And Scope

This paper will examine the process and problems encountered by new business start-ups in the field of entrepreneurship. It aims to provide a didactic overview based on past and current literature in the field, identifying the most common theoretical frameworks frequenting the

academic literature and assessing their contribution to explaining and understanding the *Process and Problems of New Venture Creation*.

Entrepreneurship is one of the youngest paradigms in management science (Bygrave 1989b) and there is no general agreement on the defining concepts and variables explaining it. This too is reflective of the Start-Up process in the study of Entrepreneurship, where little agreement can be made on a common theoretical framework (Bhaves, 1995). In practice, the founding of a new organisation is not instantaneous and the process is a largely complex one. It evolves over time, as one must seek resources and compete in the marketplace. In much of the literature, this process of establishing the entrepreneurial start-up is characterized by both uncertainty, in terms of outcomes, success, failure, survival, lack of knowledge and understanding (Deakins & Whittam, 2000:116). Reynolds and White (1997:1) comment that “there is little known about the initial phases of the process (entrepreneurship). The conception, birth and early development of new ventures are very much *an uncharted territory*”.

The different approaches, suggested in literature, explaining the process of new venture creation, have ignited much academic controversy. Moreover, there exists little consensus found across empirical studies for describing the process of new firms upon initiation. Despite the limitations in empirical evidence and diversity of academic opinion, insight can be gained by adopting important and empirically tested aspects of these different approaches and models to explain the start-up process. The most relevant aspects can be integrated into a theoretical framework to encapsulate the important stages and events encountered by start-up ventures. The scope of paper will be limited to the actual process of firm creation – from idea conception to establishment of the new organisation – and the problems encountered by firm and individuals during the start-up process.

Before launching into the theoretical approaches, the next section presents definitions and key terminology of the topic in question.

## **1.2 The Concept of “Process of Business Start-Up”**

The stages leading up to the legal creation of the organisation, when it becomes an organisation or active legal business entity, is also referred to in biological terms - the *journey from conception to birth*. Gartner (1985) has referred to this process of starting up as one which involves events before an organisation becomes an organisation, that is, organisation creation involves those factors that lead to and influence the process of starting a business.

Weich (1979) defined “New Venture Creation as the organizing of new organisations, ...to organize is to assemble ongoing interdependent actions into sensible sequences that generate sensible outcomes”.

A number of researchers have labeled this time period in an organisation’s life as “Start-up”(Van De Ven, Angle & Poole 1989;Vesper, 1990), Preorganisation (Katz & Gartner, 1988; Hansen 1990), Organisaton in Vitro (Hansen & Wortman 1989); Prelaunch (McMullan & Long, 1990); Gestation (Reynolds& Miller, 1992;Whetten, 1987); Organisational Emergence (all cited in Gartner et al 1992: 373). These all refer to the same phenomenon.

Reynolds and Miller (1992) referred to the start-up process as a *biological* cycle in that the process can be described as a “gestation process” from conception to birth. There has been little study on the gestation of firms. The authors admit that it is very complex to identify when the idea of the firm has been conceived or when does the initial idea for a business come about. The answer is “we do not know”. The process leading up to the birth of the firm is still largely a mystery and the actual duration of gestation has not been determined. Nevertheless, empirical evidence has shown that a common indicator for the birth (birth date) of the firm has been usually the date of its first sale as a sign that the firm is active participant in the economy (Reynolds & Miller, 1992). It is understanding the conception of the idea and the events leading up to the birth of the new business entity which has become the real challenge for academics.

The individual(s) which finds, manages and drives the creation of the new firm is commonly referred to as the *nascent entrepreneur*. Endemic to the process of business start up, the backgrounds and character traits of nascent entrepreneurs have been a common theme of research in understanding the start-up process (Entrepreneurial Trait approach will be looked at in the section 2.4). Reynolds (1994) suggested that nascent entrepreneurship should form part of the process and not just outcomes. He identified the principles of networking, resource mobilization, and entrepreneurial enactment should be inherent to the process of creating new business.

## **2. MAIN THEORETICAL APPROACHES TO NEW VENTURE FORMATION OR START-UP PROCESS**

The theoretical frameworks in literature have aimed to provide an understanding and explanation to the process of venture formation and factors influencing its creation. As noted earlier, diversity of opinion and little consistency in empirical evidence have prevented new

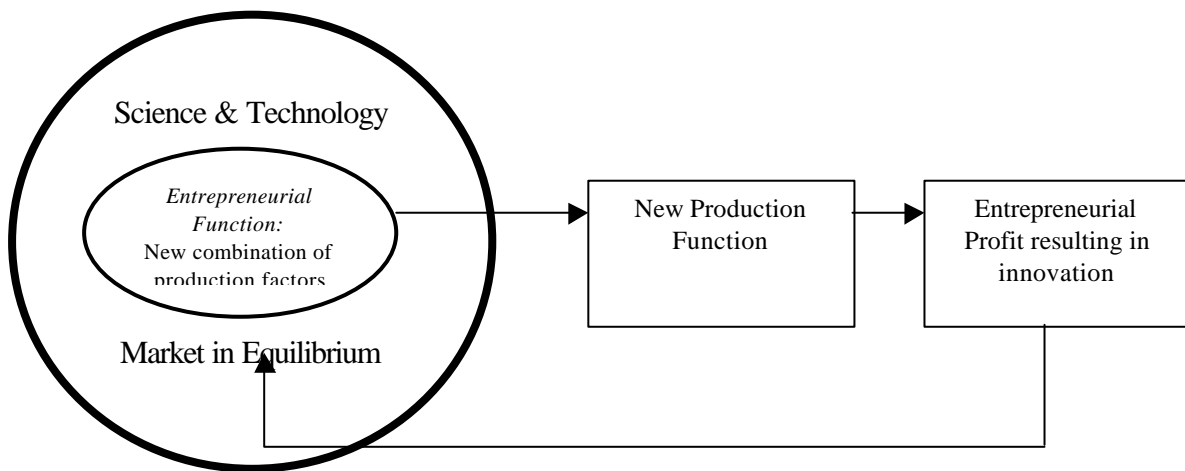
venture **creation process being underpinned to one paradigm.** As there appears no one best way of understanding this phenomenon, this section will identify the key models that have attempted to explore this area.

## 2.1 Some Macro Perspectives of New Firm Creation

### 2.1.1 Schumpeterian Conceptualization of The Entrepreneurial Creation Process

Joseph Schumpeter’s book titled “ The Theory of Economic Development”(1912), was the first to refer to the creation of new firms as a factor of economic development. Schumpeter believed that the emergence of a new firm depended on the entrepreneur’s identification of opportunities for combinations of production factors, which can result from technological change. The Schumpeterian model of new firm creation is illustrated in figure 1.

Schumpeter postulated that innovation is a central factor in new firm creation and the driving force behind industrial change. According to Schumpeter “A perennial gale of creative destruction” brings firm creation – destruction is the price of innovation leading to the emergence of new firms in economies. He proposed that if innovation can determine the speed of structural change in industry, then technological change acts as the “cue” for the leading on of new firms to take the stage.



**Figure 1: Schumpeterian Model of Entrepreneurial Function (Veciana, 1999)**

Schumpeter’s views may be useful for explaining the emergence of new firms in high growth sectors characterized by short product cycles such as Internet services, telecoms, electronics, games and entertainment software; where the rate of product innovation is very high. From a macro perspective, Schumpeter’s economic theory may explain the creation of new start-ups in this these dynamic highly innovative industries here-mentioned.

### 2.1.2 Population Ecology Theory

Population ecology theory (Hannan & Freeman 1977) assumes that the external environment determines the entire existence of a new firm from the beginnings at birth, growth and death. It takes the population of the organisations as the unit of analysis and examines the external environment i.e., structural, economic and political conditions, that lead to the creation of new forms of organisations. Hannan & Freeman (1984) propose that organisational death rates should decline monotonically with age because organisational learning and inertia gradually increase with age. The emphasis is on the resources in society, not individual motives, nor decisions or behaviour as the driving force behind the creation of organisations. Hence, one could argue that view contradicts the classic notion of the entrepreneur who is regarded to hold the *locus of control and determine his or her own destinies*. Nevertheless, from what follows, the population ecology offers a valuable insight into understanding the pluralistic emergence of new firms in industries.

The population ecology approach to explain the birth of new firm is a macro perspective of the emergence of new organisations and tells very little about the process of starting-up at firm level. The process itself is beyond the individual and firm control (as already mentioned) and thus this theory gives no insight to understanding the process of venture creation at micro level. However, from a macro perspective it provides insight into the creation and cessation of new firms and why and how new organisations emerge in sectors, industries, communities and economies - an important area of study for public-policy makers. Furthermore, this stream of population ecological research has provided valuable knowledge into time-dependant patterns of organisational demography, particular for new firms (Van de Ven, 1992). Aldrich (1990) indicates, the ecological perspective stresses that new firm start-ups are highly dependant on the macro processes both within and between organisational populations. A body of population empirical evidence has demonstrated the consistency of this theory across a number of sectors. These include: Newspaper, Automobile, Brewing and Semi-conductor sectors (Veciana, 1999). The Population Ecology Theory and its supporting empirical evidence has stimulated scholars of entrepreneurship to examine more macro related questions regarding the factors that influence the rates of organisation births and deaths.

## 2.2 Literature Review of Approaches to New Venture Creation

A number of academics have presented frameworks for discerning the characteristics of the venture creation process. A summary of the key frameworks (Gartner, 1985; Gartner & Katz, 1988) is provided below and will be explored later in this section.

Gartner (1985) outlined a framework of four dimensions to be considered whilst studying new ventures: **1)** the individuals involved in the creation of the new start-up; **2)** the activities undertaken by those individuals during the new venture creation process; **3)** the organisational processes structure and strategy of the new venture; **4)** and the environment factors under which it must operate. Also in a series of stages, Van de Ven et al (1989) proposed that researchers must take account of **1)** how a business idea emerges over time, **2)** when and how different functional competencies are formed to develop and commercialize the first market offering, **3)** when and how these functional competencies are redeployed to create subsequent new line products believed to sustain and grow the business, finally **4)** how these efforts for business development are both influenced and constrained by organisation and industry factors (N.M. Carter et al, 1995: 153).

Karl Vesper (1990) contended that a new start-up has five components: 1) *technical know-how*; 2) *a product or service idea*; 3) *personal contacts*; 4) *physical resources*; and 5) *customer orders*. Vesper proposed a number of start-up sequences that vary among the five key ingredients (Timmons, 1980). Probably the most pioneering work was carried by J. Katz and W. Gartner (1988) who explored the organisation theory and entrepreneurial literature to identify a theoretical and empirically based framework for identifying the properties that would signal that an organisation is in the process of creation. In their framework, (which will be dealt with in section 2.6.2) the authors suggested four emergent properties that would indicate that an organisation is in the process of coming into existence: *intention to create an organisation, assembling resources to create and organisation, developing an organisational boundary, and exchanges of resources across the boundary* (e.g. Sales). In the last decade, integrated frameworks based on past models have emerged (Veciana 1988, Bhaves, 1995; Deakins & Whittam, 2000). These aim to provide a more comprehensive model to understanding the phenomenon and have attempted to encapsulate the key characteristics and variables describing the process of new enterprise formation in their proposed frameworks.

### 2.3 Early Approaches to New Venture Creation Process – Systematic Models

No single model or isolated sequence of events can apply to all start-ups during their process of creation. According to J. Timmons (1980), *Trial and Error* replaces the sequence of events that had traditionally been applied to describing the start-up process in literature. Equally, Gartner (1985) concluded that *entrepreneurial firms are too diverse to permit generalization*. However, in the 1970s, a systematic approach to understanding the process of start-ups was quite popular amongst academics. They proposed the firm being created would follow a sequence of mechanical steps before it could establish itself as a legal business entity. Flow charts were also common models outlining stages in the venture creation process. In his Article, titled (1980), “New Venture Creation: Models and Methodologies”, J. Timmons undertook a review of the models on the venture creation process. As noted earlier, K. Vesper (1979) proposed five key ingredients for creating a business. Timmons equally contended that five key components were required to start a firm. There existed over 100 sequences to new venture creation and start-up process. Birley (1984) proposed eight events in the start-up process. These events were assumed to occur in the following order: 1) *owners decision to start a firm*; 2) *own quits job and becomes self-employed*; 3) *incorporation*; 4) *bank account established*; 5) *premises and equipment obtained*; 6) *first order received*; 7) *tax first paid*; 8) *first employees hired* (Reynolds & Miller, 1992).

No consensus existed amongst academics as to what was the correct systematic model. A common denominator of these process models was the individual as initiator of the business – the Entrepreneur. The numerous models outlining sequences and stages to new venture creation were theoretically based on assumptions, which gave very little insight into current practices at the time. This came as no surprise in light of the absence of empirical evidence to support them. However, these sequential models served as a basis for subsequent research.

### 2.4 Entrepreneurial Approach (Trait Approach)

The Founder / Nascent Entrepreneur of the new organisation is perceived as the key determinant of the firm creation in this approach. This is the classic approach to venture creation in entrepreneurial literature, which has mainly focused on the traits and behaviours of the founders with little or no attention paid to organisational and environmental factors to explaining the process of start-ups (Aldrich & Wiedenmayer, 1993).



This approach states that there exist linkages between individual traits and organisational creation (Van de Ven et al 1984). The individual is the unit of analysis in the organisational creation and innovation. This approach devotes attention to the background, characteristics, and psychological make up of the entrepreneur as key indicators of firm creation and its performance. Motives and personal attributes are considered to be strong influential factors in differentiating entrepreneurs with non-entrepreneurs. The concentration on entrepreneurial traits, such as character and hard work has been the dominant theme for explaining entrepreneurial achievement. However, this approach has lost its popularity amongst academics in entrepreneurship. Research has consistently found that personal traits, taken out of context, offers little understanding of this phenomenon (Aldrich, 2000). According to Gartner et al (1988) research on personal traits have reached an empirical *cul-de-sac*. Focusing on personal traits and character alone are no longer accepted for explaining the complex process of starting a business.

## **2.5 Human Capital /Knowledge Approach to Start-up Formation**

Most organisation founders identify opportunities for creating new organisations from expertise, experience and education gained in previous work organisations (Aldrich 2000). Researchers have only begun to devote attention to these factors in the study of organisation creation. The nascent entrepreneur's past experience, education and skills set can affect the formation of business ideas and the ability to start successful enterprises. This accumulation of experience and "know-how" is termed "*Human Capital*". The formulation of business ideas may be influenced by work experience, training and by recognition that a particular product or process could be done better. Education can play an important role in creating an inductive environment for idea formulation. Importance is also placed on "enterprise abilities including problem-solving, group work and idea generation". Timmons (1994:43) states "the notion that creativity can be learned or enhanced holds important implications for entrepreneurs who need to be creative in their thinking". Thus education can become an important conditioning experience. Creative thinking can be enhanced by the education system, which may affect the way opportunities are viewed later on in life (Deacons & Whittam, 2000).

According to H. Aldrich (2000), nascent entrepreneurs require several kinds of knowledge such as work experience, advice from experts, and copying existing organisation forms. This focus on human capital has been regaining importance as a key factor in understanding and explaining why and how start-ups emerge. An extension of this knowledge factor in the start-

up creation process is the *networking ability* of the entrepreneur to accumulate and leverage knowledge. Although it is worth noting that networks have direct linkages with human capital as described here, the role of Networks in business creation, given their importance, will be treated separately in section 2.7.

## **2.6 Organisational Approach to New Venture Creation**

The organisational approach focuses on the *process by which founders construct new organisation*. It posits that the creation of an organisation is not down to the individual founder or entrepreneur, but it is a collective, network building achievement that centres on the inception, diffusion and adoption of a set of ideas among a group of people who become sufficiently committed to these ideas to transform them into a social institution (Van De Ven et al, 1984: 95).

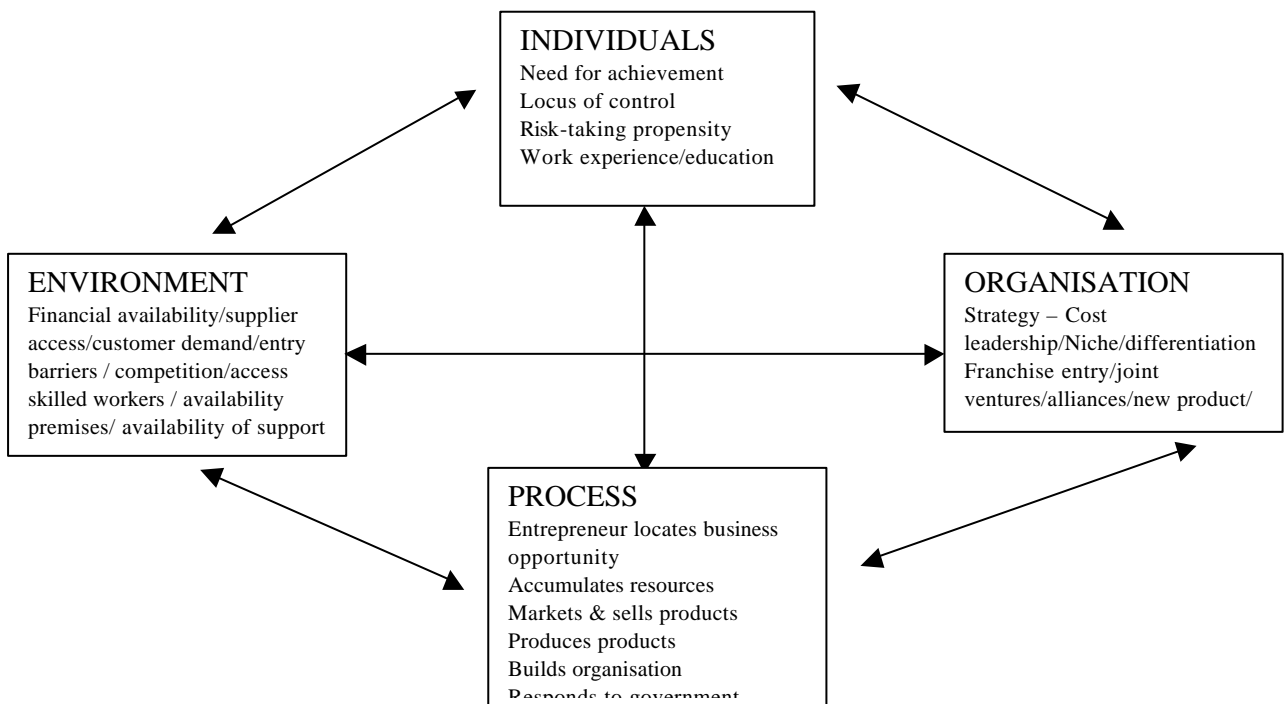
This view contends that the conditions under which an organisation is planned and the processes followed in its initial development have important consequences on its structure and performance later on in its business life cycle. The organisational approach to new venture formation has attracted much attention by scholars (Gartner, Katz, Vesper & Van de Ven are prominent writers in the field) and has become a widely accepted point of reference amongst the academic community for understanding the process of start-ups. This section focuses on two popular frameworks building on the organisational approach to new enterprise formation: W. Gartner's (1985) 'Conceptual framework for describing New venture Creation' and second W. Gartner and J.Katz pioneering paradigm on 'Properties of Emerging Organisations' (1988).

### **2.6.1 Gartner's 'Conceptual Framework for Describing the Phenomenon of New Venture Creation' (1985).**

Before his major work with Katz in 1988, Gartner (1985) proposed a conceptual framework for describing the phenomenon of new venture creation. Gartner contended that firms vary vastly in their characteristics as do the entrepreneurs who create them. He added the process should not be perceived as one-dimensional, carried out single-handedly by the entrepreneur. He argued that designing specific stages and fixed ingredients to form a new organisation which had been proposed by former scholars, and attaching a "type" of entrepreneur to each start-up was also too simplistic a process. Instead, Gartner argued that the process of new venture creation was a complex and multidimensional phenomenon.

In his 1985 framework, (see figure 2), he suggests a new enterprise is the result of four key variables – 1) Individuals - the person(s) involved in starting a new organisation; 2) Environment – the situation surrounding and influencing the emerging organisation; 3) New Venture Process – the actions undertaken by the individual(s), to start the venture; 4) Organisation – the kind of firm that is started. Each variable describes only one aspect of the process of venture creation and is interdependent on other variables in the framework. He adds that entrepreneurs and their firms do not represent a ‘homogenous population’ as previously assumed. Entrepreneurs and firms differ greatly in actions; choices; behaviour; environments they operate in and how they respond to internal and external situations. Gartner points to the importance of recognising this variation as a key characteristic in the process of new firm creation where it is unacceptable to “focus on some concept of the “average” entrepreneur and “typical” venture creation (Garner 1985, 697). A study conducted by Cooper ad Dunkelberg (1981) empirically backed up the logic of Gartner’s argument on variation, revealed that entrepreneurs in certain industries can be very different from those in other industries. Similarly, Karl Vesper (1979) a famous scholar in the field suggested 11 types of entrepreneurs, also indicating early recognition of intrinsic variations in new venture creation processes. Gartner’s framework has achieved much popularity for being able to highlight the diversity of entrepreneurs and firms and at the same time to encapsulate the complexity, intensity and diversity of this multifaceted phenomenon.

**Figure 2: A Framework for describing New Venture Creation (Gartner 1985: 698) and some examples of variables in new venture creation**



## 2.6.2 Katz & Gartner Framework (1988)

The most groundbreaking work in analysing organisation emergence has been the Katz & Gartner Framework (1988), identifying properties of organisations ‘in creation’ or ‘emergence’ (1988). The authors sought to identify when an organisation was in the process of starting up i.e in the ‘preorganisation’ period, since much research at the time was conducted in the ‘organisation’ period - after they were created. Based on B. McKelvey’s definition of a organisation<sup>1</sup>, they suggested four key properties or characteristics that would determine whether an organisation was in the process of creation. These four properties were:

- Intentionality                      intention to create an organisation
- Resources                              assembling resources to create and organisation
- Boundary                                developing an organisational boundary
- Exchange                                exchanges of resources across the boundary

According to Gartner & Katz (1988), this framework can be used to identify the different ways in which a start-up process might occur based on these properties. The properties contain structural characteristics – *resources and boundary* - and process characteristics – *intentionality and exchange*. These properties are defined below.

*Intentionality* property refers to the intentions and goals of the founder(s) entrepreneurs and the goals of the various environmental sectors at the time of creation. These goals may span technology, equipment, capital, community etc. In the initial stages, the intentionality of an imminent start-up may overlap other agents’ goals that are operating in their environment. As the start-up develops its goals it will become increasingly distinct from other entities in the environment and become itself a separate entity (Katz & Gartner, 1988). Intentionality would also require the would-be venture founder(s) to engage in the gathering of information to establish these goals with the aim of venture creation. The *Resource property* refers to the physical components – human and financial capital; property, raw materials - that combine to form an organisation. As resources accumulate, the need for funds increase. Delving into personal savings and borrowing from family, friends become apparent. As costs amount, external sources of financing are necessary, hence the entry of venture capitalists and

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<sup>1</sup> McKelvey (1980) an organisation is “a myopically purposeful boundary-maintaining activity system containing one or more conditionally autonomous myopically purposeful subsystems having input-output resource ratios fostering survival in environments imposing particular constraints”.(Gartner & Katz, 1988:430)

investors. *Boundary* is defined as the barrier conditions between the organisation and its environment (Katz & Kahn, 1978). The organisation has control over assets that fall within its boundary, however, it must establish a physical and legal basis for exchanging the resources it requires across its borders. When an organisation defines its boundary for example through incorporation, applying for tax number, establishment of physical offices, phone line etc., it creates its own identity and differentiates itself from other legal entities. Finally, *exchange* refers to cycles of transactions within the organisational boundary and outside with other economic agents (Katz & Gartner 1988:432). Exchange is necessary for the organisation to operate and must be conducted efficiently i.e. selling goods for no less than the cost of producing them. The other three properties must be in place before exchange processes can occur. These four properties of emerging organisation are necessary to make the transition to an 'organisation'.

The authors see these properties as useful tools for researchers to build models for analysing potential sources of new ventures in a way that allows the identification of organisations the process of creation (Katz & Gartner, 1988). Moreover, the ability to recognise organisations early in creation should prove beneficial for determining the success and failure of different strategies adopted in start-ups.

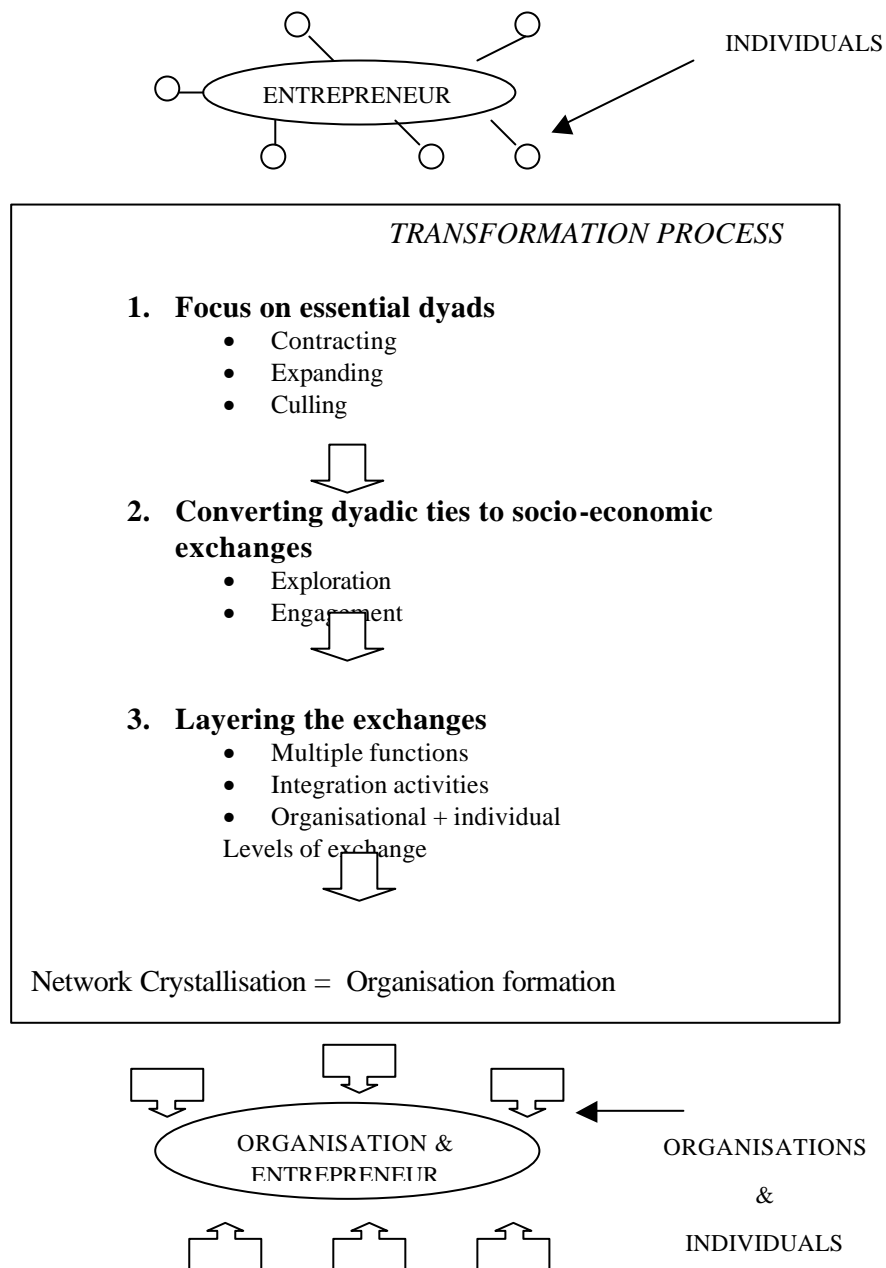
## **2.7 Network Approach (Social-economic model)**

The role of social networks has become quite a fashionable approach to new venture creation. There have been many contributions to explaining networks as a factor in new firm formation. Nascent entrepreneurs' personal networks are the set of persons to whom they are directly linked - impact their social and economic resources and support. Founders draw upon their network ties and build new ones as a means to obtain knowledge and resources for their emerging organisations. Aldrich (2000: 235) argues that nascent entrepreneurs "who occupy impoverished social locations may find themselves cut off from emerging opportunities and critical resources".

Larson and Starr (1993) propose a Network model (see figure 3) of organisation formation embodying socio-economic characteristics. Their model is a stage model that describes the processes by which the essential relationships between the entrepreneur and resource providers evolve to create an organisation. The model builds upon the theoretical and empirical research of network analysis. Although the network approach captures aspects of previous models (Katz & Gartner 1988) by linking the entrepreneur and the environment in which they

operate, it emphasizes the exchange processes between actors and units and recognises the social and economic aspects of these exchange relationships (Larson & Starr, 1993:6). The author's model is illustrated in figure 3 and outlines three stages that transform a preorganisation into a new organisation.

**Figure 3: Network Model Of Organisation Formation (Larson & Starr, 1993:7)**



According to Larson & Starr (1993), the outcome of the staged model of networking is the crystallization of an individual/organisational network made up of a critical mass of dyads that

establish the new organisation as a viable entity. The organisation has been formed mainly through collective activity between the various actors and units (network ties). This results in a stable, commitment of relationships between the entrepreneur and their resource providers. The network approach has been an accepted perspective for explaining a business start-up. It views the entrepreneur as a whole individual, a socio-economic actor with personal and economic interests. Their network model analyzes the role of economic relationships set in a social environment. This model is a socio-economic model emphasising people in relationships rather than pure economic units in transactions. It places a dual emphasis on social and economic dimensions of exchange.

The authors of the model see it as complementing the Katz and Gartner Framework (1988). They (Larson & Starr, 1993) consider the proposals of four organisational properties to “fit comfortably” with their network model. For instance, the structural properties are founding the pattern of mobilized resources. The boundary is defined by the extent of business relationships. The activities and intentionality of the founder and his/her network ties combined with the actual exchange processes described to constitute the process properties (Larson & Starr, 1993:12).

To exclusively rely on the network model to explain new venture formation would be a too simplified approach as it undermines the importance of the business idea, strategy, the industry and the abilities and skills of the entrepreneur themselves (J.M. Veciana, 1999). There has been empirical research (Birley, 1985, Aldrich et al 1986,) that could not confirm the role of networks as a key ingredient in the formation of new start-ups. Birley concludes “information on... the role of networks in connection with new venture creation is still scarce and anecdotal” (1985:85). Despite these findings, the amount of empirical research is too limited to be conclusive. Moreover, the study of the role of networks in the new venture creation process is still in its infancy, and requires more research. However, one cannot deny that co-operation and business relationships have always made sense for new businesses since Commerce began.

## **2.8 Integrated frameworks on New Enterprise Formation**

The models presented above offer relatively broad categories and generalized variables which reveal no nuances in particular areas of the start-up process. However, they do capture important aspects of new venture creation, which numerous authors have integrated, based on

empirical evidence, in an attempt to present a generic theoretical framework. This section provides a sample of selected frameworks, chosen by the author, that have managed to integrate the key concepts and events of the process of venture formation. These models captures elements of each approach -Entrepreneurial, Knowledge, Network and Organisational – and presents them in a comprehensive and unified framework for explaining the process of new venture creation.

J. M. Veciana (1988) outlines four phases of venture creation process with an estimated timeframe as illustrated in figure 4. The author presents each of the most relevant variables occurring in each phase. The variable presented is one most likely to impact that particular phase on the process of venture creation. The five-year period of establishing a new venture may be a realistic one, in light of the activities the entrepreneur must undertake. Further comments on the author’s interpretation of the model is restricted by the fact that the commentary is in *Spanish*.

**Figure 4: Process Of New Enterprise Formation**

		1-2 YEARS		2-5 YEARS			
GESTATION		CREATION		LAUNCHING		CONSOLIDATION	
Childhood		Search for & identify opportunity		Team Building		Getting through the knothole	
Antecedents		Elaboration & configuration of the entrepreneurial project		Purchase & organisation of the production factors		Getting rid of partners	
Incubators		Network creation		Product/Service development		At last “everything under control”	
Critical Event/Role Determination		Opportunity Evaluation		Search for finance			
Decision to create a firm		Preparation of a Business Plan		Launching of product/service			

*Source: Veciana, J.M. (1988): The Entrepreneur and the Process of Enterprise Formation, in “Revista Economica De Catalunya”, Num.8,May-August.*

Studies of entrepreneurship aim to generate generalised conclusions about variables relevant to all firms. Yet on the other hand, each enterprise is unique and conceived by individual and personal means, with varied circumstances facing entrepreneurs throughout start-up process and when the firm is established.



P. Bhavé's paper (1994) presents a *Process Model of Entrepreneurial Venture Creation*. The author aims to provide a "well-grounded-theoretical, integrative process model of entrepreneurial firm creation by linking conceptual categories and sub-processes in the firm creation process based on qualitative research" (Bhaves, 1994:225). The author states that this process model intends to provide an integrated framework to bring cohesion to the vast body of literature. This model is important as it extends its concern to sub-processes of venture creation, which have been largely ignored in literature.

A final and a most recent paradigm developed by Deakins and Whittam (2000) is illustrated in figure 5. The authors suggest that the business start-up process can be broken down into a number of stages:

- Formation of the idea
- Opportunity recognition
- Pre-start planning and preparation including pilot testing
- Entry into entrepreneurship launch
- Post Entry development

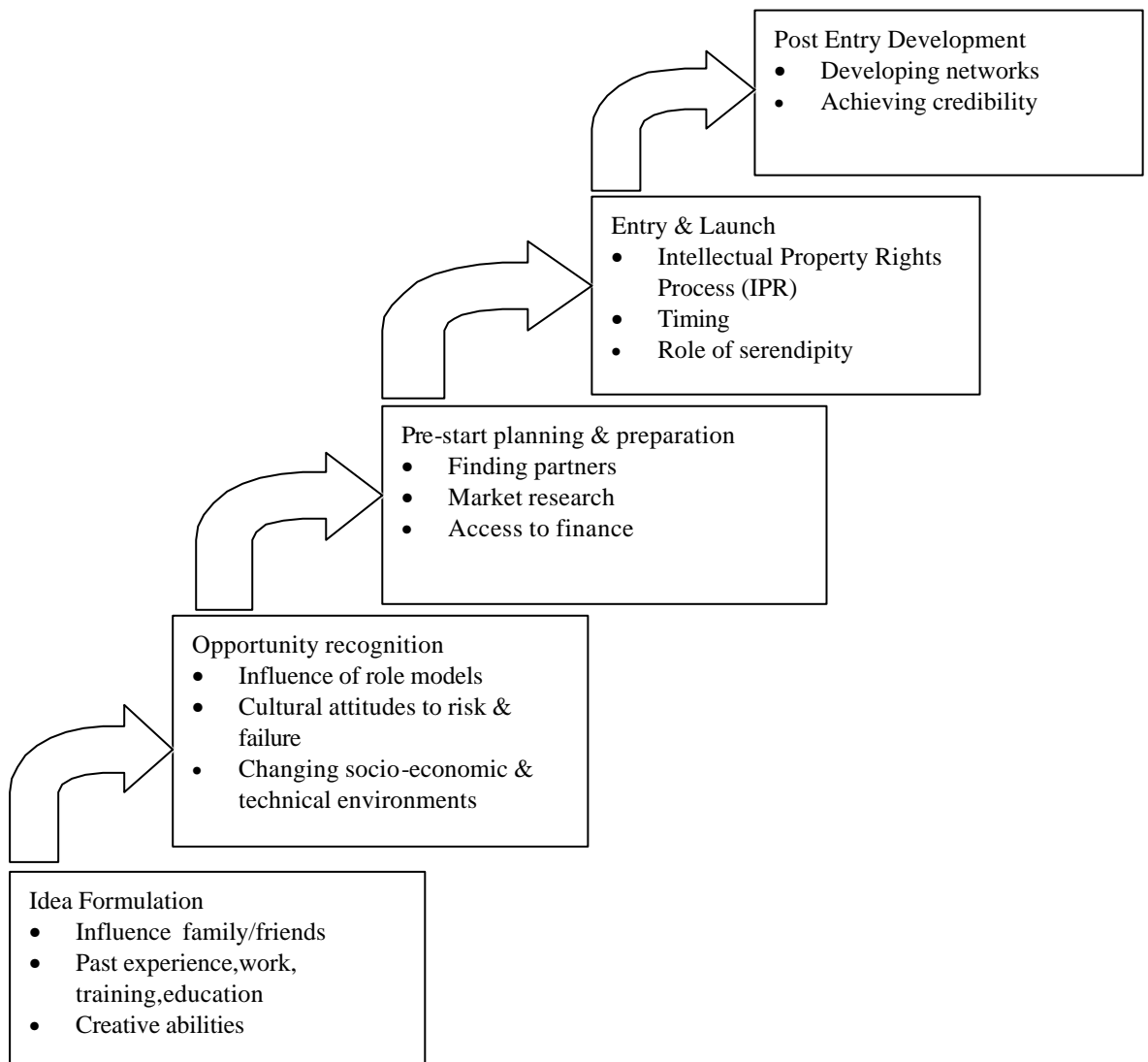
Each of these stages will consist of a number of positive and negative factors that impact the process of starting up. The authors also point out that the number of factors affecting each stage is not exhaustive, a host of other influences exist including the cognitive behaviour of the individual entrepreneur, such as tenacity and ability to overcome obstacles to creating a new business (Deakins & Whittam, 2000).

## **2.9 Empirical Findings**

Subsequent empirical explorations, (Reynolds & Miller 1992; Reynolds & White 1993; Reynolds 1994) confirmed the conclusions of the Katz and Gartner (1988) framework that no one pattern or sequence of events is common to all emerging organisations. Moreover, the sign of the exchange process of the "first sale" is a conceptual event in new venture creation (Block & MacMillian, 1985). First sale has been used as a measure of successfully establishing a business based on Katz & Gartner's (1988) properties of emerging organisations framework as described above. Reynolds and Miller's (1992) study of new firm gestation indicators concludes, "Date of first sale appears to be a suitable indicator of "Birth" if only one event is to be used (p. 406).

An interesting study exploring 71 US based nascent entrepreneurs in new venture organisation was conducted by Carter, Gartner and Reynolds (1996). This study was based on primary and secondary data. According to their findings, what was most common as a first stage in the start up process was the *personal commitment* by individuals engaged in the new venture (five out of six firms), some emerging organisations (two in five) reported the first event as having sales, whereas others began recruiting or seeking financial support (one in four). The most common final events in the process of new business creation was recruiting employees and making sales (half of new ventures), financial support (two in five), and a huge personal commitment to the venture (one in four). In addition, Reynolds et al (1994) discovered that the average time a firm was in the process of creation was one year. In contrast, Van de Ven et al (1990), in a study of hi-technology firms, found that the average time for entrepreneurs to create the business from inception to birth was four years. (N.M. Carter et al, 1996: 154).

**Figure 5: Business Creation And The Start-Up Process: A Suggested Paradigm**



*Source: Deakins & Whittam, 2000:121*

An important field of research that has emerged in recent times is the role of cognitive psychology in new venture creation (Aldrich, 2000, Gatewood et al, 1995; Carter et al; 1996). Gatewood, Shaver and Gartner (1995) carried out a longitudinal study of individual level factors (cognitions and actions of the entrepreneur) influencing the process of starting a new business. The primary focus was to determine what appropriate measures could be used to identify cognitive factors, which might influence an individual's persistence in entrepreneurial activities despite the uncertain chances of start-up success (Gatewood et al, 1995). The researchers concluded that by doing longitudinal research design, stronger claims could be made between the relationship between individual attributes and subsequent success in starting a venture.

A second study, conducted by Carter, Gartner and Reynolds study (1996), revealed that cognitive factors played an important influence on the process of starting a business. The study suggests that the behaviours of nascent entrepreneurs who have successfully started a new venture can be identified and differentiated from the behaviours of the nascent entrepreneurs who failed. However, the precise type of behaviours appropriate for new venture conditions were not identified and would require being studied in future research.

### **3. COMMON PROBLEMS FACING NEW BUSINESS START-UPS**

Creating a new business is fraught with difficulty and failure (Reynolds & Miller 1992; Van De Ven 1992b). Many start-ups never reach establishment, and the majority close up within one year after they have become established. Embarking on a new business is one of adventure and challenge but it brings with it high risk and uncertainty. Although some start-ups survive and become highly profitable, empirical evidence has shown that there exist key problems, which are common to all new start-ups regardless of level of innovation in their new product, the sources of finance, business experience, knowledge, and networks ties of the entrepreneur. Raising capital, establishing reputation, securing resourced providers, premises constraints and high labour costs have been recurrent problems stated in the literature and also in empirical evidence (Storey, 1985). This section does not seek to detail each and every industry-specific problem that start-ups experience, but aims to identify and examine the most common difficulties encountered by Start-Ups in the early stages of establishment, irrespective of sector or industry.

Many entrepreneurs, who possess the initiative and incentive to start their own business, often lack business experience in the industry they wish to compete in. However, some successful businesses were started by inexperienced founders, for example Bill Gates and Michael Dell were college dropouts. Steve Wozniak, founder of Apple Computers, “was an undistinguished engineer at Hewlett-Packard”,(Bhide, 2000:36). As well as lack of experience, the nascent entrepreneur tends to have limited knowledge of the industry they enter. Most start-ups lack innovative ideas or assets that could differentiate them from their competitors. In Bhide’s survey of the 1989 *Inc.*500 list, a compilation of the fastest growing privately companies in the United States, he found that only 10% of these businesses offered novel product or services when start-up, with the majority of firms offering nothing original or new to the market.

Bhide (2000) conducted a further survey of all the Inc. 500 founders, between 1982 and 1989. He discovered that 12% of the founders attributed the success of their companies to “an unusual or extraordinary idea”; 88% reported their success was mainly due to the “exceptional execution if the idea”, (Bhide, 2000:32). However, most new businesses which pursue an unnovel idea turns out to be unprofitable, and equally encounters more problems in their start-up phase. The widespread lack of innovative ideas, often accompanied by limited experience and knowledge can create huge barriers in raising capital.

Obtaining external financing is one of the key factors if the not the most in preventing start-ups from growth and development. The economics of information suggests that asymmetric information plays an important role when an entrepreneur seeks external financing for their new venture. In theory, when conditions of uncertainty combine with asymmetric information (where investors and borrowers have different sets of information), for the funders there are problems of selection (choosing profitable ventures) and moral dilemma (what will entrepreneurs do with this invested capital).

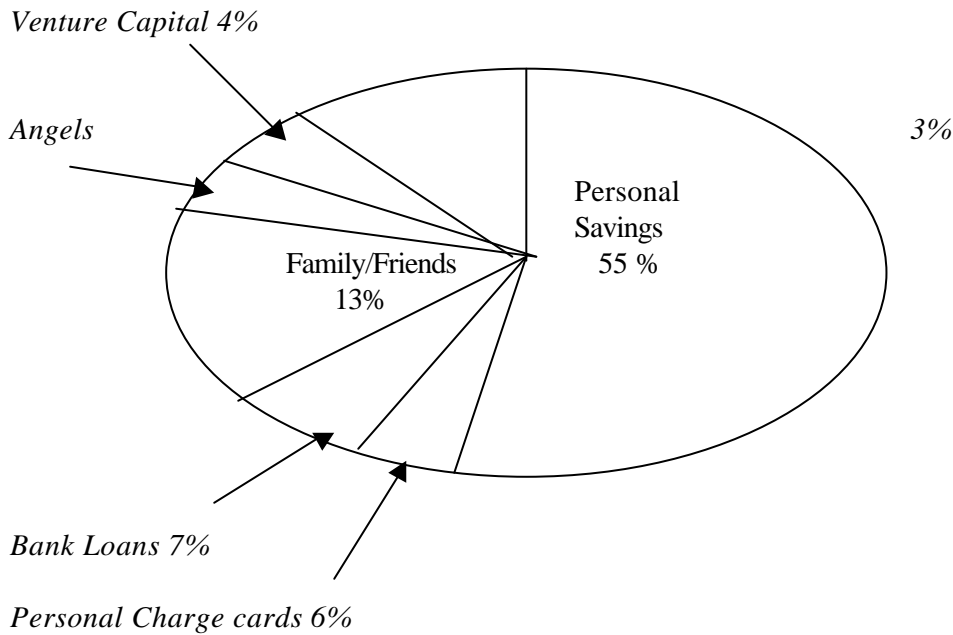
Most Entrepreneurs use their own personal finance as seed capital as venture capitalists and private investors require a strong highly credible business venture to ensure a return on their investments and recuperate their costs. Start-ups face disadvantages as they have a non-trading track record and may not have sufficient information to make risk assessments (Deakins & Whittam, 2000). The pie chart one illustrates that of the 1996 Inc. 500 companies, venture capital made up only 4% of start-up funds, with over half raised from personal savings. This indicates the enormous difficulties for even potentially properous start-ups to raise finance.

The inability to raise sufficient capital can lead to a negative ‘knock-on’ effect throughout the start-up process such as constraining expansion, problems with attracting clients and building alliances, and establishing credibility. Bannock (1981) commented that raising external finance is an inevitable problem of a business start-up. Banks dealing with a myriad of start-ups see them as administration and financial burdens than with large established firms. Moreover, start-ups are penalised immediately for having no commercial or financial history – an undermining factor to its credibility as a business entity.

Low capital resources can prevent the start from acquiring adequate premises particularly if its demand for orders requires larger premises. This *premises constraint* can restrict growth and may cause the start-up to refuse these orders and eventually lead to closure and eventually renders missed entrepreneurial opportunity.

**PRIMARY SOURCE OF INITIAL FUNDING  
PERCENTAGE OF 1996 Inc. 500 companies**

*Pie Chart 1*



**Source: O. Bhide, 2000.**

The low endowments of knowledge; unique product offering can not only render it impossible for entrepreneurs to raise significant capital but also to secure resource providers, particularly potential customers and clients. Securing relations with resource providers such as customers, suppliers, employees etc. represents a critical problem for start-ups (Bhide, 2000). From the resource provider perspective, there exists a greater perceived risk dealing with a new firm

than with an established company with a track record. Establishing a market presence and securing customer orders is particularly difficult for start-ups.

A. Bhide (2000) treats the problem of *securing customers* as resource providers for start-ups under two headings: first, Rational Calculus of Resource Providers – that is the choices that traditional economic models assume people typically make to maximize their utilities - present difficulties for nascent entrepreneurs. Second, he terms “Behavioural Factors” – he refers to this as deviations from rational decision-making due to cognitive prejudices (Bhide, 2000:70).

According to Bhide (2000), a main concern of resource providers is the level of switching costs. Customers need to assess the chances of survival of the new firm before it makes a commitment of time and money and incurs potential costs by switching over. The level of uncertainty increases even more on the part of the resource provider, should the start-up be undercapitalized. The fact that the entrepreneur failed to raise capital as well as a “zero” track record gives a negative signal to potential clients. The latter may also believe there is a good reason to be skeptical about doing business with the start-up if the investors rejected it as a potential investment. In other words, the start-up is perceived as a “non-credible” business entity. Thus lack of external financing can itself raise negative perceptions of start-up amongst resource providers. The rationale behind the resource providers’ decision is to “let someone else go first”. This approach leaves little chance for start-ups to survive and as Bhide adds “Luck “ plays an extremely important role in the success of new ventures (2000).

*Cognitive Biases* of the resource providers can be good enough reason to avoid start-ups. Past experiences with failed start-ups, general gossip about start-ups regularly “going bust” within a few months of setting up can lead the resource provider to automatically refuse to do business with start-ups.

Based on empirical studies conducted in the UK and the USA, a major problem experienced by start-ups was *establishing a reputation* when there is shortage of demand in the marketplace (D.Storey, 1985). These studies also revealed that factors in the macro-environment such as interest rates, inflation and labour costs raised significant difficulties for start-ups (D.Storey, 1985). A further inhibiting factor to the process of starting up is acquiring legal recognition of a business. Government regulations can be quite stringent in developing countries where registering a new company is a time-consuming and costly process.

Finding solutions to the above problems and even avoiding them is difficult, and in the real world the process of starting a new business will never be problem-free. However start-ups in the event of encountering such problems may be able to mitigate the effects to a certain extent by being adaptive, flexible and alert to opportunity and threats in the market place. Establishing contacts through networks are equally important but *luck* also has a part in the process.

#### 4. CONCLUSIONS

At macro level, the views of Schumpeter and the Population Ecologists have made a valuable contribution to explaining the emergence of new firms. Their theories are useful in explaining why and how new organisational forms come about and with so much variation. However at micro level researchers are stilling grappling with understanding the complexity of the entrepreneurial process of new firms. The nature of this process, which is deeply characterized by spontaneity and uncertainty, makes it more difficult to pin down an exact theory. As Gartner (1985) pointed out, *entrepreneurial firms are too diverse to permit generalization*, and the process of starting up a new business has become a multidimensional phenomenon. As indicated earlier, there has been little agreement on dimensions and variables characterizing it. The processes and birth of firms are not well understood (Reynolds & Miller, 1992, Low & Macmillan, 1988). Equally, there exist few empirical studies exploring and identifying conceptual categories and sub process of venture creation (Bhaves 1994).

Despite these research gaps, some common characteristics of start-ups have emerged in literature. The initial models, describing start-up sequences, served as a starting point and stimulated further study on the process of new venture creation. Gartner points to the importance of recognising this *variation* as a key characteristic in the process of new firm creation, adding that entrepreneur and their firms do not represent a 'homogenous population' as previously assumed. Entrepreneurs and firms differ greatly in actions; choices; behaviour; environments they operate in and how they respond to internal and external situations.

This observation on the "variation" concept in essence is *truistic*, there exist many variables impacting the process of start-ups which brings about much diversity and variation in today's business environment. Gartner in his work with Katz (1988) made another important development by using the four properties to identify when an organisation is in creation. The main achievement of their work drove home the point that organisation emergence is not a

linear step-by step process (Aldrich, 2000). Other key developments have emerged in recent times these include the human capital, network approach and the role of cognitive factors in the entrepreneurial process of new venture creation. These approaches have highlighted important aspects for explaining business start-ups however more empirical research is required.

From my analysis, there exists no single best approach or model that best describes and explains the new venture creation process, and which encompasses all its aspects and characteristics that have been mentioned in individual approaches. Integrated frameworks have been suggested as an attempt to solve this problem. Authors of such approaches as mentioned above (Veciana, Bhaves and Deakins and Whittam) seek to offer a more comprehensive holistic approach by encapsulating all the important variables and characteristics of preceding models on the venture creation process. Despite these attempts to offer an all encompassing framework, these variables are loosely defined, where more specific factors are needed. The weaknesses of the theoretical frameworks, presented in this paper, is that their authors have wanted to be “everything to everyone” but with little success. On the other hand, how can there be one generic model that can be applied to all start-ups in all sectors of the economy and to all nascent entrepreneurs? This proposal is not viable as firms and their founder(s) are too diverse, that there exists too little uniformity in the business environment to develop such generalised model or framework. What may be more productive for future research is to develop more specific models for new start-ups and their founders in *particular sectors* of the economy, this, I believe, would be a more realistic and viable path for research to take.

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