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EXECUTIVE DIGEST

From startup to scalable enterprise: Laying the foundation

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Abstract The essential steps in the transition from a nascent startup to an organization capable of sustained and profitable growth are not readily apparent to many early stage entrepreneurs. The life cycle of an entrepreneurial venture consists of four stages (startup, transition, scaling, and exit), each defined by the principal challenges faced by the founding team. The popular lean startup methodology emphasizes a disciplined process of exploration, validation, and refinement of the business concept as the essential first step in the process. Although it is undeniably important to get the business concept right in the beginning, there is a period of transition during which the founding team must establish a solid foundation for growth and scaling that may ultimately have a greater influence on venture success. To date, limited research has focused on transition and the field has offered little normative guidance. Entrepreneurs have largely been on their own as they struggle, through trial and error, to lay the foundation and build a scalable business. This article describes the essential tasks to be undertaken—the eight hurdles of transition—and provides normative guidance, solidly based on experience, regarding the actions required to establish the foundation for a scalable business.

1. Laying the foundation: The critical period of transition

In recent years, the lean startup methodology has been popularized as the scientific method applied to startups. This approach emphasizes a disciplined process of exploration, validation, and refinement of the business concept as an essential first step in the development of an entrepreneurial venture (Aulet, 2013; Blank, 2013). Although undeniably important, refining and validating the business concept is only a first step. Much work remains to be done as the entrepreneur and his/her team lay the foundation for a scalable enterprise.

Various models have described the chronological evolution of entrepreneurial firms. Most follow the classic life cycle model of organizational growth: Steinmetz (1969) and Kroeger (1974) focused on evolving managerial functions and roles at different stages; Greiner (1972) described periods of growth and evolution punctuated by crises of leadership, autonomy, control, and bureaucracy, each setting the stage for the next period of growth.

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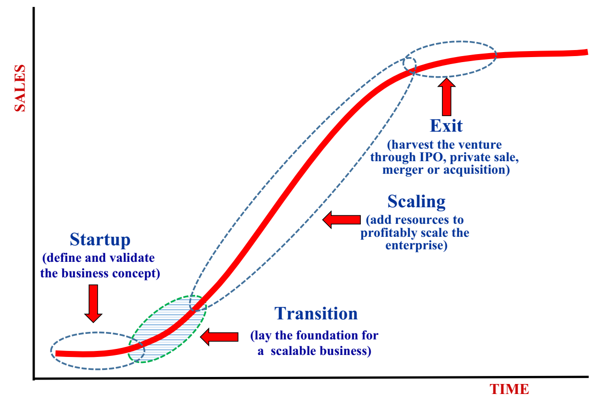
Figure 1. Four stages in the life cycle of an entrepreneurial firm



In our view[1], the entrepreneurial innovation process proceeds through four stages (startup, transition, scaling, and exit), each defined by the principal challenges faced by the founding team. As illustrated in Figure 1, the boundaries between the adjacent stages are fuzzy and frequently overlapping. While it is essential to get the business concept right in the startup stage, laying the foundation for a scalable enterprise during the period of transition is equally critical and may ultimately have a greater influence on venture success than startup.

The entrepreneur's challenge in *startup* is to define and validate the business concept: the market opportunity (i.e., critical need, target market, market size, and timing); the offering (i.e., product or service and value proposition); the business model (i.e., resources, processes, and economic model); and the go-to-market strategy needed to deliver the offering reliably to the target customer at a profit. In startup, the focus is narrow, the commitment of time and resources is limited, and the economic risks are modest. The organization of a startup is typically informal, loosely structured, and fluid.

The period of *transition* begins about the time an entrepreneurial firm first gains traction in the marketplace. Transition represents an essential bridge between the loosely structured informality of the startup and the structured and disciplined form required for rapid scaling. The entrepreneur's challenge is to complete the development of the offering, establish a solid foundation, and position the organization for rapid scaling. Once the startup engages customers, additional resources are required, new capabilities must be developed, and the scope and complexity of the challenges faced by the founding team increase dramatically (Hambrick & Crozier, 1985).

In the *scaling* phase, the entrepreneur must add significant resources and leverage processes and partnerships to grow the business within the framework of the validated business concept and a sustainable business model. The objective becomes rapid growth in order to achieve competitive scale and establish sustainable market leadership. Scaling requires a very different kind of organization—one with structure, process, and discipline. As the firm grows, the fluid and flexible environment of the startup organization becomes unwieldy. Informal communication and decision-making processes are no longer effective. Functional specialists now assume roles once covered by generalists, and processes and policies replace ad hoc decision making (Hofer & Charan, 1984). Consistent profitability is required to provide a return for investors and fund the drive to market leadership. At some point, a successful *exit* (by IPO, private sale, merger, or acquisition) is usually required to harvest the value accumulated by the venture for the benefit of the entrepreneur and investors.

Transition, as the nascent startup matures into a disciplined business, is arguably the most critical period in the life of an emerging firm. During this relatively brief period (typically 18—36 months), the founding team must lay the foundation for a rapidly growing business, establish credibility and legitimacy, and acquire the initial resources essential for growth. The experience and competence demanded of the management team expands dramatically in this stage (Wasserman, 2003). The founders must simultaneously deal with strategic direction and market positioning, building a management team, implementing discipline, structure and management processes, acquiring resources, molding a supportive culture, and managing risk proactively. The increased scope and complexity also requires that the founding team adjust its leadership style and management behaviors (Picken, 2017).

Many new ventures fail to negotiate these challenges. No matter how brilliant or compelling the original idea, only about half survive more than 5 years (Bureau of Labor Statistics, 2016), and only the most promising receive early-stage professional investment. Even with substantial funding, more than 75% of venture-backed firms fail or sustain a marginal existence (Ruhnka, Feldman, & Dean, 1992). Management inexperience or incompetence (Gorman & Sahlman, 1989), the failure to manage

[1] The model of organizational development reflects the collaborative contribution of the entrepreneurship faculty at the Jindal School.