


# Chapter 20

## The Role of Innovation in Startup Business Financing, Performance, and Survival

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### ABSTRACT

*Startups are the new firms that drive innovation. However, they struggle due to their newness and smallness to finance their innovation, which often tends to fail. In this context, the chapter unfolds the role of innovation in startup firms' financing, performance, and survival. Contrary to conventional investments, innovation projects require heavy funds in R&D activity. The risks in innovation projects combine with the firm's information asymmetries elevate the cost of financing for the innovative startups. Equity investors such as business angels and venture capitalists mainly fund innovative startups. Founder's human capital signals also affect startup financing. Innovation positively impacts startup firm performance. Process and incremental innovations improve startup survival chances, whereas product and radical innovations reduce the same. The authors propose that innovation enhances survival if it increases market power and lessens production costs while hampering longevity if the innovative firm is burdened with the immoderate liabilities of newness and tininess.*

### INTRODUCTION

In recent times, it is increasingly acknowledged by researchers and policymakers worldwide more than ever before that entrepreneurship, technology, and innovation play a remarkable role in the social and economic development of the nations. The innovation positively contributes to meeting the needs of society through the new innovative firms called startups (Sopjani, 2019). Especially in developing na-

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tions, it is seen that the startups, having determined to address social concerns, are attempting to solve real-world problems through their innovative ideas and technologies. Similarly, startups being the means of innovation and entrepreneurship are also regarded as the drivers for the creation and advancement of new technologies, new industries, and new jobs. Colombelli, Krafft, & Vivarelli (2016) emphasized that the focus should be shifted to innovative startups from regular companies since they contribute significantly to the economy. They also suggested that scientific research and governments need to develop an environment that enables the advent and survival of disruptive startups. However, innovative startups face numerous problems right from their inception. Lack of sufficient finance is one such problem. Contrary to typical startups that depend more on owner-financed bootstrapping, innovative startups require huge amounts of external funds to finance their R&D projects. Innovation embodies bringing new or significantly modified products and processes to the market and thus involves substantial inevitable risks. Information asymmetric issues emerge from being new and tiny, together with the risks posed by innovation pursuit influence financing, performance, and survival of startups. In this context, the current chapter aims to achieve the following objectives.

To describe how the financing of innovation or innovative startups is different from conventional investments and present the reasons for the high cost of innovation financing.

To highlight the investors of innovative startups

To study the role of innovation in startup performance and survival

## **BACKGRUOND**

### **Startup Definition**

A Startup is defined as “a new independent business entity with scalable business model working towards developing innovative products or services or processes.” Startup firms are new and independent because these firms are not formed by splitting an already existing business. Simultaneously, they are also known for risk-taking and innovation because they create entirely new or substantially enhanced products or services, or processes over the existing ones. Startups, in many cases, represent a form of innovation. The startup firms’ contribution to innovation activity is significant and even more than the large companies in some industries. At this juncture, as rightly pointed out by Söderblom & Samuelsson (2014) in their report on innovative startups, it is essential to present an important distinction between small firms and young firms. According to them, young firms are most likely to be small firms, but all small firms need not always be young firms. Hence, it is recommended that firm age is primarily considered over the firm size concerning the concept of startups. Moreover, studies on entrepreneurship are covering both small and young firms, and their results should be interpreted accordingly.

### **Importance of Innovation for Startups**

Innovation has become necessary for every company, be it a new or established firm, mainly attributing this to globalization, and rapid technological advancements, and cut-throat competition in the market. Companies have elevated their standards of innovating products and processes considering the increased pressure to be innovative. However, innovation is more emphasized in new firms regarding their sustenance and success and is most likely to be the heart of the startups. It is often seen in practice that some

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