Can we stop calling these Start-ups?

Every time I see another article about a “Startup” raising several million dollars I internally brace myself for the inevitable phone calls from inventors and R&D team leaders who want these same savvy investors to throw that sort of money at their new idea.

It won’t happen, people!

The reason why it doesn’t happen comes down to a poor choice of words in the Innovation industry in the USA. I am sure a little understanding will change all of that for smaller innovators who are not at the scaling-up stage of the business operation. Let’s try to put some perspective to the differences of terms used by developers and venture capitalists.

When you read about these firms raising millions of dollars for starting up, it’s actually for advanced business ventures looking to SCALE-UP. This is a big difference. In every case, they have surpassed the requirements of a true Start-up and are at the tail-end of the commercialisation pathway - ready to launch globally.

A venture capital firm views start-ups as a business with a solid, positive trading record, with a substantial potential to scale the business geographically and/or demographically. They will generally look at businesses where the model can deliver a 100-fold increase in sales and profits, given the right funding and other resources they have.

For early-stage commercialisation, we refer to Start-ups as projects which have completed the ideation phase and are about to start to firm up the concept and build the business model which will commercialize the intellectual property, once it is owned. For the Innovators who are just starting out and would classify themselves as Start-Ups, let me explain the stages without any complexity. First, the model (there is always a model).

Stages of Development	Capital Sources
7. Live it up	IPO or Trade Sale
6. Sell it up	
5. Scale it up	Venture Capital
4. Grow it Up	
3. Stitch it Up	Cornerstone Investor
2. Prove it Up	
1. Start it Up	Friends & Family

Fig 1: stages of Early Stage Commercialisation explained

1. Start it Up

This is traditionally where you have an idea and you want to firm up the value model and examine where this would fit (market demand, competition, pricing, costing, etc). You might have some sketches of the object on a napkin or perhaps you have a flow-chart of how it works for the people who need it. You have spent no money so far and the only essential issue is non-disclosure, for any party you share this with. You have not accumulated any tangible value so far, but your cursory investigations suggest people will pay money for this and you should be able to make it for a fraction of what they would pay.

2. Prove it up

Now we want to build some certainty into the concept. We search for published information on the market (buyers with the problem you solve), the industry (competitors who solve this in other ways), similar claims or patents (held by others) and the potential, how much people spend to solve the problem – locally, nationally and globally.

The most critical feature of this stage is the business model. You have to have a very clear process of creating, storing, selling, delivering, installing, servicing and supporting whatever this concept is.

This is also the point where a prototype might be constructed, to prove the concept works. Outcomes would be (1) independent market validation, (2) Proof of concept and (3) a transition audit – where an independent party can verify that you have everything you require to build, sell and support your concept, given the appropriate amount of funding.

3. Stitch it Up

At this point we will need to get some ownership into the project. This usually starts with agreements with all parties you will seek help from, to ensure there are no claims to ownership at a later date. This may be complemented by copyrights, applications for provisional patents, cooperation and/or collaboration agreements and staff and supplier non-disclosure agreements. You should now have an asset, which as yet, may not be worth much, but is owned. Most projects would now incorporate a separate entity to own the intellectual property, as this will be easier to manage value and risk at a later date.

Once you reach the end of this stage, you are ready to search for a Cornerstone Investor. This is traditionally a single person or entity who is heavily vested in the market or industry and who can obtain a competitive advantage for their current operations, if they are able to become a minor shareholder and technical (or marketing) contributor to the project.

4. Grow it Up

This is they stage where our project begins to trade. Our cornerstone investment is designed to get us from here to the scale-up- ready status, so we have to prove our product and the business model both work, as well as both being able to be scaled to meet the qualified national and global market demand.

Think of this as the first test drive after you have built the race car. You want to run it through a few laps and make sure it will be competitive when you ask the big sponsors for commitment. You should be able to source your supplies, create product in production runs, establish and feed distribution channels, and have sufficient profits to prove that this project will and money, even at its minimal production levels.

Traditionally, venture capitalists will be looking at this phase of the operation to determine if you can obtain a significant market penetration with useful margins, in a local market. You are better off having a larger share of the local market than a minuscule portion of a global market, even if the latter is more profitable in the short run. At this point, you should have a profitable business operating in a single market, with an significant and obvious potential for scale. This is what will attract the venture capitalists and/or private equity firms, who want to add their funding, skills and contacts to ratchet up your productivity by 100 fold.

5. Scale it Up

at the commencement of this stage, we are where the venture capitalists refer to as start-up. In fact, you have an operating business which is profitable and yielding a steady but consistent growth. There are some innovators who consider that they can grow their business organically, once they reach this stage. The attraction of venture capital is that you can achieve 10 years growth in one year, and global markets in the time it will take you to get national markets, with a tenfold to 100 fold increase production, which would yield you significant economies of scale. All of these add substantially to the bottom line and any good innovator should be prepared to share this bottom-line with a venture capital firm, if they can deliver those sort of attributes from their partnership.

6. Sell it Up

venture capital firms understand that a project has a life span. For these funding and growth firms, they are only interested in the high-growth phase of the operation and would plan their exit well before they begin. This may mean that they would like to have your projects sold at a particular point, so they can realise their investment and take the profits to their next project. They do not want to be married to your project for life and will set a window of perhaps 1 to 3 years, before they would seek to dispose of their equity position.

Their exit may be in many different forms. These will include a management buyout, where you leverage the assets of the company to borrow sufficient funds to buy their equity yourself. They may even give you a vendor finance package, with security over the firm. Other exit options may include an agreed trade sale to a third party, which may include the entire operation as a strategic business unit for the buyer. This would require the services of your team to remain within the project. The upside to this would be that you would receive shares in a public listed company, which can be traded as cash.

Another popular option is to list the company on the stock exchange in the local jurisdiction. There are requirements for each different stock exchange in terms of size, number of shareholders, turnover and profit, in order for the project to qualify for a listing application. Most stock exchange applications will require a rigorous due diligence process, which is very expensive and can take 6 to 12 months to fulfil. As exits go, the venture capital firms can then choose to liquidate their stock at different points in the market cycle, given that the stock is then publicly traded.

7. Live it up

once your project is fully funded and you have your exit implemented, you may still own the project or a substantial part of it. As a mature trading company, your role may change to a senior executive in a large public firm and this may not fit your lifestyle. You may choose to retire from the company and play an active role in further developments or take on an external role to acquire similar businesses in which you can add value in research and development to create new income streams for your public company.

So where does the confusion lie? As an innovator, you would see start-ups as the ideation stage which is generally in research and prior to development. The capital markets see start-ups as operating businesses with sensible profit margins who could scale the business model geographically and demographically to acquire a tenfold to 100 fold increase in their current operational capacity. This process can become very frustrating when innovators spend days or weeks preparing a business plan for venture capitalists, when the project is still at the ideation phase.

If you are looking to fund an idea, and somebody tells you that venture capitalists, government or investors are looking for start-up projects to fund, you will understand that your project is not ready for scaling up. These funding entities are actually looking for profitable, operating businesses with intellectual property that has a high degree of innovation and sustainable competitive advantage, with the business model that lends itself to scaling. Your capital requirements are more suited to friends and family, until you have proven concept, independent market validation and you have conducted a transition audit to determine that you have all elements of your project available for inspection. At that point, you're still only at the cornerstone investor stage, but you will need this type of capital to set the growth trajectory and to capture markets as you put your project into production.

If you would like to determine where your project is right now, you can get a copy of my helpful 4x4 worksheet, which is a 16-box matrix presented as a project assessment tool. You can download this free at www.profitfrompatents.com.

Daniel J. O'Connor B.Bus, MBA, FAICD (Dip) CPM, AIMM, MAIM, MAIeX.

Daniel has spent 30 years in the commercialization of intellectual property and has worked with innovation teams across Asia, America and Australia. He is a published author (www.billion-dollar-napkin.com) and is Consultant Principal of the on-line coaching and mentoring group www.incub8IP.com. Daniel is a member of the UN Task Force on Innovation and Competitiveness and has created a 6-week on-line training course for Innovators who have great ideas which have stalled in the commecialisation process. He is active in the International Group SkyQuest, which is a global network for IP trading. Daniel can be contacted on daniel@incub8IP.com