What is a startup? V2

What is the purpose of this article?
This article enables a discussion about how to define and identify whether or not your company is a startup.
The audience for this article includes: investors, founders, board of directors, C-suite, and investment analysts.
This article applies to all companies, ranging from pre-revenue through to long established global companies.

This article does not provide tax, legal or financial advice.
You must do your own research and fact-based analysis using current and relevant information.

AI did not write this article. 100% human written.

What are the critical learnings in this article?
1) A startup is a temporary organization designed to search out a repeatable, scalable, and profitable business model with lots of potential customers who are willing and able to pay to solve their problems and needs.[1] Startups are not building a solution. They are building a tool to learn what solution to build.[2]
2) Your company may slip back into the startup stage at any point. Changes may mean that you no longer have a profitable business model with lots of potential customers who are willing and able to pay to solve their problems and needs.
3) Never ending customer, competitor, external environment, talent, operational, and financial monitoring is key to ensuring your company does not slip back to being a startup.

What is the definition of startup?
1) A startup is a temporary organization designed to search out a repeatable, scalable, and profitable business model with lots of potential customers who are willing and able to pay to solve their problems and needs.
2) Startups are not building a solution. They are building a tool to learn what solution to build.

What does repeatable, scalable, and profitable mean?
Repeatable:
1) You use the same processes, technology, and types of talent as your company grows. You don't have to constantly reinvent processes, technology, and talent.

Scalable:
1) Costs do not increase as quickly as revenue.
2) You don't have to make major changes as you grow.
3) Your talent, processes and technology have the flexibility and capability to support large increases in volume arising from new markets and new customers.

Profitable:
Profitability is determined on a cash flow and net present value basis. This is different from financial statements based on IFRS or GAAP. The appendix contains detailed descriptions of the terms used.

There are 5 steps to calculating overall company profitability:
Step 1 Profit = (lifetime customer revenue) – (Cost Of Goods Sold)
The lifetime calculation must also include the impact of Churn.
Step 2 Profit = (Step 1 profit) – (Customer Acquisition Costs)
Step 3 Profit = (Step 2 profit) – ((General & Admin costs) + (New Development Costs))
Step 4 Profit = (Step 3 profit) – ((debt interest) + (taxes on financial statement profit))
Step 5 Profit = (Step 4 profit) – (debt repayment + other cash disbursements + other cash income)

There are multiple future profit scenarios e.g. debt can be rolled over and does not need to be repaid vs unable to roll over debt.

What are the three overlapping phases and steps of a successful startup?
<u>Phase 1 Understanding customers and competitors</u>
Step1 Understand potential customers.
1) What are their problems and needs?
2) What do the customers believe is the value of addressing those problems and needs?
3) What do customer perceive as their value proposition?
4) What might the customers pay to achieve their value proposition?

Step 2 What might a solution look like to customers?

1) What are the characteristics of a solution which might meet the customers value proposition? i.e. What are the benefits? There is a major difference between benefits and features.

Step 3 What are the components of the solution?

What is your business model canvas?

Step 4 What are the cash flow scenarios and related assumptions?

Build a set of cash flow scenarios using the five profit calculation steps above and the definitions in the appendix.

Phase 2 Validating the customers perception of the value

1) Implement temporary processes and technology to validate the customers value perception.
2) These processes may be manual. The technology may not be scalable.
3) Customers are not profitable at this point.
4) You will be learning by doing many experiments.
5) Revise your business model and cash flow scenarios

Phase 3 Transition to a repeatable, scalable, and profitable business model

1) Replace manual processes with lower cost technology.
2) Replace temporary technology with lower cost technology.
3) Implement standardized (flexible) processes which are both scalable and lower cost.
4) Change the organization structure. The talent you hire may also be different.
5) Continue to revise your business model canvas and cash flow forecasts

How can you tell your company is no longer a startup.

1) You have 6 months of company financial and operational metrics which validate your assumptions.
2) You interviewed customers to confirm that they are achieving their value proposition.
3) NPS (and other surveys) do not reveal major issues.

You will always continue to do the above 4 actions. Why? The world changes and your company may suddenly slip back to being a startup.

What are the critical factors to keep in mind?

1) The number and size of fund-raising rounds has nothing to do with whether or not a company is a startup. I know of one company that raised $1.75 billion U.S. that shutdown 6 months after launching services. This company never left the startup stage.
2) Your company may slip back into the startup stage at any point. Changes may mean that you no longer have a profitable business model with lots of potential customers who are willing and able to pay to solve their problems and needs.
3) Never ending customer, competitor, external environment, talent, operational, and financial monitoring is key to ensuring your company does not slip back to being a startup.

What are your next steps?

1) Define the words/concepts you're using, in a glossary. I've seen major confusion when the same words mean different things to different people.
2) Collect the facts: is your company repeatable, scalable, and profitable?

Footnotes

[1] adapted from: Steve Blank, "What's a startup – first principles". https://steveblank.com/2010/01/25/whats-a-startup-first-principles/

[2] Alistair Croll, Benjamin Yoskovitz , *Lean Analytics – Use data to build a better startup faster,* Sebastopol, California, O'Reilly Media, 2013, Page 41

What further reading should you do?

What is learning? Koor and Associates
https://koorandassociates.org/creating-business-value/why-have-your-minimized-your-talent/
Is your company planning to fail? Koor and Associates
https://koorandassociates.org/avoiding-business-failure/is-your-company-planning-to-fail/
What are the core components of talent? Koor and Associates

https://koorandassociates.org/creating-business-value/core-components-of-talent/

Appendix – Definition of operational and financial terminology

LTP (Life Time customer Profit)
What is the lifetime customer profit, after customer acquisition costs? This will take into account retention.

CAC (Customer Acquisition Cost) includes all the costs to acquire a new customer:
1) Sales.
2) Marketing.
3) Onboarding.
4) Related compensation of the people.
5) Overhead associated with the people.
6) Technology to support CAC.
7) Legal expenses associated with sales and marketing.

COGS (Cost of Goods Sold) What comprises cost of COGS? Everything required to meet the direct needs of current customers. E.g.
1) Customer support people, and software.
2) Technology e.g. software, cloud services, communications costs.
3) Bug fix and minor enhancement to the software – after all you do need to retain current existing customers.

CAC is not part of COGS.

G&A (General and Administration) What comprises G&A?
1) Payroll administration.
2) Recruiting administration.
3) Finance.
4) IT security.
5) Corporate development e.g. M&A.
6) CEO salary/benefits.
7) Legal expenses (both in house and external), other than those associated with sales contracts.

R&D/Engineering/new Development?
All of the costs associated with discovering major changes to the business model and enhancing the solution.