Anordea Insights

Beating The J-Curve – 7 Ways IDEs Can Scale Faster & Smarter

Innovation Driven Enterprises (IDEs) differ from regular SMEs in a variety of ways. Most founders and Senior Management Teams (SMTs) will be familiar with the J-Curve and the difficulty it presents new ventures as they try to grow and scale up. What many don't know however, is that an estimated 70% of startups fail because of premature and mishandled scaling.[1] One of the most crucial aspects of scaling an IDE is the timing and management of accessing funding for growth. In this article we look at the key factors founders and SMTs must consider in order to effectively manage the funding aspect of scaling up.

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1. Testing Commercial Readiness

Commercial readiness is a factor that is often assumed by SMTs and founders, so it can come as a surprise when potential investors in later rounds disagree on the extent to which the underlying technology of products and services is in fact ready for market. There can be a big difference between a technology that is value generating and one that is the basis for a commercially viable business model. Simply put, if the technology is not there, there is little scope to access scale up funding in subsequent rounds. A good indicator to use, and one often deployed by growth equity and private equity investors when judging IDEs, is NASA's technical readiness assessment.[2] This framework can be used to judge the readiness of the underlying technology beginning with an observation of basic principles and running through system and subsystem prototyping all the way to having a 'flight proven' system. Founders and SMTs should embrace a critical and objective view of their underlying technologies and how developed their offering is, not only to access funding, but also to improve the growth prospects of their IDE for the longer term.

Figure 1. Technical Readiness Levels

Source: Adapted from NASA Technical Readiness Levels[2]

2. Objective Market Selection

Once the underlying technology is sound the next consideration is the market selected in which to deploy it. Often founders and SMTs will have developed a very strong technology that provides considerable value, but selected markets based on ease of access or their role in the innovation process in terms of feedback and R&D cycles. However, these early market segments are not always the most profitable ones for the potential technology over the long term. The SMT and founder have to ask if the best market segments are being targeted and served with the product from a profitability standpoint and if there are other areas in which greater value could be generated. Tried and tested research suggests that several basic questions need to be answered here:[3]

1. What markets should be served by the new technology?
2. What form should the product or service based on the technology take?
3. What should this new product or service ultimately do for the user?
4. Who can this new technology generate the most value for?

Successful founders are more objective in the markets and segments they are willing to target and deploy their underlying technologies in. Ultimately, they realise that their technologies will evolve and the markets and users they serve will also develop over time. This is a natural development and something that is built into the IDE process, as well as the development of the technology and the ecosystem as a whole.

3. Appreciating Industry Dynamics

One area that founders and SMTs often do not consider, is how the industry dynamics will change and evolve over time as their IDE grows. This requires a focus more on the wider ecosystem and industry level. It is natural for founders and SMTs to be focused on the commercialisation of the underlying technology and the growth of the venture but thought has to be given to how industry incumbents and competitors will respond to their growth and success. Moving from being a small-scale disruptor to a medium-sized player will put new competitive pressures on the IDE. Competitors may try to lock the company out of the ecosystem altogether or respond in more subtle ways. An understanding of these competitive dynamics is crucial if the IDE is to successfully navigate the scaling process. Additionally, there are certain sweet spots within the industry or the ecosystem where, if the IDE places itself smartly, it can maintain a dominant influence over the flow of innovation and value generation for time to come. These architectural bottlenecks are few but hold the dual benefit of being both highly defensible competitively and highly influential for the generation and flow of innovation.[4]

4. Business Model Scalability

The next aspect that must be considered is how the business model of the IDE can be best scaled successfully. This can be a more complex question than it first seems. Aspects such as increased overheads, competitive scrutiny and regulation will all start to put pressure on the IDE as it grows. Additionally, there can also be market concerns. On the internal side there will be cultural changes which can impact performance, particularly where the IDE has a strongly informal innovation culture. This is a natural byproduct of the recruitment drive that accompanies most scaling efforts. It has been shown time and again that the more adaptive the ecosystem in which the IDE is based, the harder it can be to predict the capabilities and expertise that will be required later as the IDE grows.[5] For these reasons it is imperative that founders and SMTS have a good understanding of business model transformation and how it is used to manage the growth path of the IDE. Research suggests that business model transformation succeeds when founders and SMTs:[6]

- Build a transformation road map early on.
- Map possible trajectories, not just desired ones.
- Consider the evolution of the industry and the ecosystem, not just the IDE.
- Engage in a more integrated form of value engineering across the enterprise.
- Build several strategic options.
- Start with implementation in mind.

Successful founders prepare for the challenges of business model scalability and are prepared to work with VC professionals and external advisors to overcome these challenges along the way. They recognize that the innovation in their enterprise is a continuous process that occurs not just on the technology level but on the business model level as well.

5. Investment Attractiveness

Founders and SMTs often assume that the attractiveness of their venture, in terms of funding, is wholly based on their technology and their business model. This is a crucial mistake. Potential investors will not just judge an IDE on its business prospects, but more so the investment opportunity it offers them. These two are not the same. Professionals working in VC, PE and the funds industry will view the enterprise as an investment first and a business second. This does not mean they don't care about market strategy and the growth of the business. However, their ultimate decisions will be based on the financial attractiveness of the investment opportunity, and how this opportunity compares to the others they are assessing at the time. There are a range of metrics that are used within the VC and PE industry to make these judgments, but founders and SMTs should be aware that aspects such as the current mix within the private equity portfolio can also impact the relative attractiveness of their enterprise to a given partner. Successful founders can put themselves in the shoes of VC and PE professionals, realising they have competitors for scale up funding. By being able to understand how the VC and PE professionals view their business, they can communicate more effectively and ultimately manage the process of gaining funding more successfully.

6. Managing the J-Curve

Founders and SMTs familiar with the J-Curve will know all too well the need to avoid the dreaded 'Valley of Death', that bottom part of the curve where so many startups and great ideas disappear. However, there are challenges and risks that exist in other parts of the J-Curve too that are often overlooked. The change from net outflows to net inflows must be managed wisely by the SMT as there are inherent dangers within this shift in cash flow positions, particularly around how resources are acquired. The desire to finally 'get the goodies' can be a strong one, when teams have been bootstrapping for a long time. Suddenly there is money in the bank account to afford that flashy software package long wanted by the marketing team. Temptations such as these have to be resisted. Instead, priority should be given to investing in the resources and capabilities that will continue to drive the scaling momentum the IDE has already achieved. This can lead to some hard choices and tensions within the SMT itself. Founders can avoid this potential pitfall, and the fallout that comes with it, by developing a more explicit scaling and transformation plan ahead of time. It also helps to ensure that priorities are communicated to the team well in advance, so everyone can understand why certain acquisitions are being given priority. Successful founders understand how the J-Curve will change resource demands across their IDE and proactively manage these growth tensions where they arise.

7. Understanding the Process

The VC process is not overly complex and is in many ways a logical exercise in quality assurance from an investor's standpoint. However, the more founders and SMTs can familiarise themselves with the process, the easier they will find it to navigate and the less likely they are to be blindsided by something down the line. Understanding the various stages of the process such as Deal Sourcing and Due Diligence from the VC side is a real advantage to founders. Also familiarising themselves with the various documents they will encounter from NDAs to Confidential Information Memorandums is also important.[7] Founders can go further though and should spend some time learning how VC firms themselves work and the various roles played by the General Partners and the Limited Partners involved. Most VC firms will operate a series of funds, and it is helpful to understand where in the lifecycle these funds are, as to greater or lesser extents they will place pressures on the VC firms and influence the sorts of deals they will seal. This kind of knowledge can be of great benefit to the SMT, particularly when it comes time to negotiate. As the old saying goes, to be forewarned is to be forearmed.

Conclusions

Innovation is 1% inspiration and 99% perspiration. This is a great cliche but something that founders and SMTs will recognise, particularly when it comes to scaling up an IDE. However, there is a big difference between working hard and working smart. Successful founders and SMTS cannot be everywhere and do everything, that is why they partner with the advisors in the first place, but they are mindful of the factors listed above here. They understand the gaps in their own knowledge and experience and actively try to fill these, to better manage the J-Curve as their IDE grows and scales. The smartest founders consciously incorporate the concepts and practices mentioned above into their routines and management systems. Overtime these individuals often begin mentoring their fellow entrepreneurs, often crossing the fence to the VC side themselves. However, they bring with them an appreciation for the J-Curve, how it tests an entrepreneur, and ultimately the means, knowledge and skills necessary to beat it.

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