THE PHASES OF A STARTUP

There's a lot published about the phases a company goes through from startup to maturity. However the startup phase itself has several distinct phases. The following is a brief description of these phases with examples from Toolco (name disguised), a company I worked with, to illustrate how these phases fit a real startup. The phases below are also discussed in a book called *Guts and Borrowed Money* by Tom Gillis (see further references at the end of this paper).

The Idea

It all begins with an idea and a desire to start a business based on this idea. It could be a new product, it could be a new service, it could be a new way to produce something, or it could be something as simple as starting a new restaurant. The key is that there is an entrepreneur that wants to do something different and has the motivation to pursue it.

Generally in this phase, things look better than they later turn out to be. It appears that riches are assured, the size of the opportunity is overestimated, the time and effort required to get there are underestimated, and potentially fatal flaws are not visible. To help avoid over-optimism during this phase, I recommend that you do two things:

- Talk with one or two trusted friends of have had their own business before. Describe your idea and listen carefully to their opinions and recommendations regarding what you should do before you jump in.

- Make an assessment of this opportunity and your own abilities. In particular, (a) try to get an idea of what the potential market size would be and (b) try to find competitors that are currently serving this market that you can learn from. Making an assessment is further covered in another brief I've written called *Assessing a Business Opportunity*.

In Toolco's case, the company was founded in 1977 as a plastic injection molding company that was an offshoot of an existing molding company called CompMold (name disguised). A manager from CompMold decided to start his own firm in a different town and even got the owners of CompMold to put up 50% of the initial investment. It all looked rosy, but didn't stay that way for long.

Survival

Once you dive in, reality can hit quickly and any flaws in the homework you did before become visible. Some of the key success factors for getting through the survival phase are to:

- learn quickly,
- stay flexible and
- keep your cost structure low until revenues catch up.

During this phase, it is also important to be clear about your goals and to track whether you're making progress towards these goals. An entrepreneur needs a good internal compass to navigate through this phase.

I've further divided companies in the survival phase into three sub-phases:

- No revenues. This is before the first customer is signed up. In this stage, one is trying to get the product finished, the first customers signed up and something started that someone will pay you money for. Unless you have deep pockets or a sponsor with deep pockets, it is best to try to identify ways to keep this phase as short as possible, by developing the simplest first release or by providing services to others that generate some revenues while you work on your main product.

- Revenues, but no profit. It is an extremely useful milestone when you sign your first customer. This helps validate that your idea can go further. It also helps prioritize what's important in the product and what works in your marketing. By working out how to get to this phase as quickly as possible, even if it is not the ideal or optimal product or service, you will learn a lot.

- First profit. When you get to this point, you know that you have a recipe that works. The challenge now is to scale up the recipe and refine it so that you can grow.

In Toolco's case, reality sunk in after about 18 months. The company was not profitable. The founder had given up believing that he could turn it into a viable business. In addition, he was facing personal issues--his wife was asking for a divorce. As a result, the founder and the investors from CompMold decided that something needed to change. They found another entrepreneur with different skills, he was a mold-maker, who was willing to buy out the original founder. The new entrepreneur set the company on a slightly different path. Instead of molding, he found revenue by repairing molds for another company in the area. His goal was to take this mold repair work and evolve to building whole molds, then to doing the molding itself. Although it was rough going, after a couple of years, the company started doing better, was able to hire some additional staff and could afford to move from the old tin shack they were operating in to a slightly better cinder-block building.

Growth

Many people think that things are done when the company has started being profitable and is growing. Although it is more fun when you get to the growth phase, it is no easier than the earlier phases. Because it takes investment to grow, which usually cannot be paid for from the profits of the company, risks get higher for the owners. They may need to take out additional loans or find other investors. These investors might require personal guarantees. Before you know it everything you have (including your house) might be lost if the business goes the wrong way. Generally, I've found that people are working even harder during this phase than when they were just starting to survive. This is not for everyone and any personality quirks the owner has may come out under this stress.

Toolco had a long growth phase. The company originally had four employees. This grew over the course of about fifteen years to over 100 employees. During this time, the second founder was able to grow with the business, which was quite an achievement. He did this by sticking to certain important principles in his relations with customers and employees. He also did it by reading about other businesses, hiring and developing people to manage parts of the business, and continuing to evolve his network of friends and advisors. It also required him to keep taking risks, to invest his profits and take out ever-larger loans. During the last five years of this process this became an increasing strain. It was around this time that I joined the business on a full-time basis.

Big Business

Just when you think you've made it, there is a whole new set of challenges. As the business gets bigger, it takes different skills. In the mean time, industries, customers, and neighborhoods (if you're running a restaurant) change. The business has to evolve. Many of the books about the phases of a business cover the issues that companies face as they get larger and need systems, multiple layers of management, etc. Some companies, like IBM have evolved and grown for over a 100 years. The skills required change and may not be the ones that best suit the original founder.

Toolco reached this phase in the late 1990s. At that time, the company had over 100 employees and the next step to grow was to establish multiple factories in multiple locations, especially in low-cost countries. More and more manufacturing was moving from the US to places like Mexico, Southeast Asia and China. Since the founder was getting close to retirement age, we decided it was better to sell the business to a company that was planning to do this.

Conclusion

I hope that you have found this brief helpful. Please let me know if you have any questions or suggestions for areas that should be covered in more depth. The following are some references if you like to explore this topic in greater depth:

- Gillis, Tom. *Guts and Borrowed Money: Straight Talk for Starting and Growing Your Small Business.* (c)1997 Gillis.