Time To Cash

The Seven Keys To Successful High Tech Startups

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Chapter One

Everything is Created Twice

Second Time Right

All things are created twice. There's a mental or first creation, and a physical or second creation of all things. You have to make sure that the blueprint, the first creation, is really what you want, that you've thought everything through. Then you put it into bricks and mortar. Each day you go to the construction shed and pull out the blueprint to get marching orders for the day. You begin with the end in mind.
[Stephen Covey, The 7 Habits of Highly Effective People]

Having the end of a startup in mind is for many entrepreneurs the reason to persevere, deal with new adversities and remain motivated even when the very survival of your company is at stake. You picture your little startup to have matured into a company which is highly successful, a leader in its market and a source of tremendous wealth for its founders and investors. But then you open your eyes and face reality again and you understand that this source of wealth is born out of pure hardship.
Maybe you can draw comfort from the fact that each startup has a severe shortage of money. After all, it takes money to set up the company, hire staff, purchase office equipment and develop a product (in this book I will use the word product in a comprehensive meaning and depending on your personal situation it may mean device, network, system, service, software, website or something else). You need cash to pay suppliers, office rent and necessary expenses, like an internet connection and phone subscription. You are contemplating how to pay for attending tradeshows, demo the technology and visit potential customers. It takes time, thus money, to reach that important milestone of a first customer win. Once you have reached a

point where you can issue an invoice to a customer, you may expect that a little later some money comes in. The hoped-for receipt is immediately disbursed to pay salaries and overdue bills. Other prospects stay on the sideline however, often providing advice how they would like to see some enhancements being implemented. So more money is spent on product adaptations and improvements. Meanwhile, the clock ticks further…
Eventually, the next customer signs up. The product is delivered, but this customer refuses to pay the invoice, because she is disappointed about the performance. It takes several meetings to explain that there is a difference between the potential of your visionary technology and the present product, in which merely a part of the breakthrough technology has been applied. A settlement is reached – half of the invoiced amount will be paid now, and another half when certain features have been made available. So more money is spent on the development of these features until, suddenly, there appears to be interest from a Fortune 500 company. Flights are booked and a team flies off to meet this *whale* of a prospect. In the meantime, the cash position has grown very dire. Salaries, expense declarations and suppliers have not been paid. The immediate future of the company suddenly has become dependant on winning the whale prospect.

Sounds familiar? I'm sure it does, because the majority of high-tech startups go through scenarios like this. They run into liquidity problems because:

- Vision is confused with reality
- Preparation is poor and planning is naïve
- Desire is not sifted from objective
- Execution and sales is opportunistic and event-driven

What advice is available for high-tech entrepreneurs being confronted with a shortage of funds? The overwhelming advice is to get funding. A plethora of books and articles have been published about how to get funding. An industry of middlemen has emerged on the claim that they can help entrepreneurs raise money. Yet, fewer than 1% of the startups which submit their businessplan to venture capitalists actually receive funding.

What happens to the other 99% of ventures? They, too, got advice to write a businessplan. Those plans offer an identical hockey stick

curve in the graphs called revenues and cashflow. But their struggle towards profitability is thwarted by a shortage of cash. They desperately seek funding, bouncing louder and louder on the doors of VCs (who often politely delay their decision, in stead of decline explicitly, fuelling the hope among increasingly desperate entrepreneurs). Some find money outside the VC community. Others change their business model from technology supplier to consultant. or get addicted to subsidies and sell their souls to comply to ever more programs which deliver funding, but which do not bring the company forward.

Waste Treatment

To my big surprise I couldn't find a single book devoted to the subject of cashflow for startups. Yet, having been a CEO of several startups and consulting on many high-tech enterprises, I know that cashflow is the number one issue. As a matter of fact, even the ventures who do receive VC-funding, often suffer from a lack of cash (and the current economic recession will definitely exacerbate this problem). Cash is not merely a chief concern because so much money needs to be spent before revenues start to ramp up (the so-called burn-rate effect), it's also a principal problem because so much is wasted.

Yes, that is exactly what it says here. As Vice-President Joe Biden would put it: "Let me repeat that. A lot of money is wasted by startups!"

Startups waste up to 50% of their most scarce resource. There are small ticket items on which often far less money should be spent, notably travel, office rent and marketing. A bigger waste of valuable money is in productivity: startups are strongholds of hard work and long hours, yet productivity is often quite low.
Yet, by far the biggest cash leakage comes from time – it takes time to develop a product, have customers sign up for it, deliver it and get paid. And startups take much longer than is necessary to round this cycle.

The essence of Time To Cash is that cashflow can be dramatically improved by creating a well-aligned company. About 15 years ago we

would have called this a *lean organization*. After that, *TQM (Total Quality Management)* was in vogue. This was superseded by *Process Redesign* and *Core Competencies*, only to be surpassed by taking a company from *Good to Great*. Many of these terms have become caricatures, unfortunately. But each of these paradigms have helped us to see our business in a different perspective and through that, these *paradigms* have stimulated strategic thinking. In this book, I will respectfully refer to any of these concepts with the sole intent to trigger the thought process for which these paradigms were published in the first place.

Spend Cash on Execution and Earn it on Strategy

The primary objective of this book is to kick off strategic thinking to guide day-to-day operations. Strategic thinking is not a cumbersome process, which leads to a document that is updated once a year. Strategic thinking is the intellectual process of shaping an understanding of the situation and the likely developments in order to create a plan which guides execution, and to use the information generated by execution to create a better understanding. Strategic thinking is creating a picture of the future, by using all available information.
Cashflow is the result of a company's actions. Each activity, each task, every minute of each day impacts cashflow. Cashflow is impacted by the level of inventory which is a function of, among others, the architecture of your product. Cashflow is impacted by the level of accounts receivables, which is a function of, among others, the customer's expectations created during the sales process. Cashflow is impacted by the credit offered by your suppliers, which is, among others, a function of the level of trust they have in you as an entrepreneur. Cashflow is impacted by the time it takes to design, sell and supply a product, which is a function of preparation, processes, internal alignment, sales proposition and many other items.

Improve your strategic thinking and you will improve your cashflow.

In this book we will build a successful startup from the ground up. We start with the people. There is always a core team (typically the founders and some early employees) who define a company's culture,

or ethos. A distinct ethos which supports the endeavors of your venture may turn out to be your biggest asset. Define your ethos and make sure it is aligned with your ambitions, your objectives and your plans. This requires insight into the personalities of the core team. Why did you become an entrepreneur? Is it for the money or is it to make an impact? When are you satisfied? What is your highest goal? Are you willing to set everything aside for it, or is it basically a nine to five job? These and many more questions need to be asked and answered. It helps to define the "ethos" which you will imprint on your organization.

Economic theory learns us that entrepreneurs start a company because they see a demand for a product or a service. In most cases, however, a startup is created around a specific technology. Even so, it remains essential that the technology is used to solve a real and pressing problem with a specific set of target customers. That is why my most valuable advice is to trim down the overwhelming potential of your technology to a clear-cut focus market.

Next, you need to map out the strategy of your company. This is a complex, and time consuming effort, but the payback is huge. Strategy is the result of an intellectual debate about the many potential avenues a venture can take towards its destiny. The input to such a discussion comes from answering questions like where are the opportunities, where are the constraints, which objectives should be pursued, how to reach customers, how to serve customers, how to retain customers, what kind of employees are required, how to retain employees, how to execute successfully? This is a self-feeding process. The more questions you ask, the more answers you get and the strategy starts to shape up. The strategy definition phase provides you with the best ways forward to leverage your strengths and cover your weaknesses. Everything is created twice – and in this stage you have created the first-time success of your company.

With your organization's ethos, focus and a strategy defined, the time has come to explore the requirements and possibilities of funding. To execute your strategy and attack the focus market, you need to stock resources. Some resources need to be on board, others need to be within reach. Stock your venture efficiently and effectively. As part of stocking, you will need a certain amount of money. Some startups

need significant amounts of funding, others can do without. Some ventures have traits which make them ineligible for funding. A lot of time can be saved when you map out a strategy where funding is not the first big hurdle to take, but rather integrated into your strategy in such a way that alternative ways of “stocking” can be explored and which includes a number of small steps towards funding.

You are almost ready to go. Before hoisting the main sale you have to make sure that the essential processes are defined. This means you need to shape an operational blueprint of the company, which helps scalability, quality and productivity. Processes can initially be defined for the high level processes, providing guidance to filling out the detailed processes after you have taken off.

Now you are ready to go! Kick off and execute the plan. Execution is everything! Keep your eyes wide open and your ear to the ground and use all information for feedback into your strategic plan: What seems to be happening? What possibilities do we face? What are we going to do about it?

Beyond doubt, the most important part of execution is winning customers. Hence, a chapter is devoted to this topic. In sales all the elements of your venture come together and is therefore the most satisfying part of running a business. Nothing is more fulfilling than helping customers achieve their objectives, through selling the products of your venture, which are the fruits of your vision.

The sweet taste of success comes faster to those who are prepared well.

Chapter Two

The absurd world of startups

Would you like to work for a company which is unknown to the general public and even unknown to its target customers? A company which pays poor salaries and where moving up the career ladder is highly unlikely because the company only has two layers? Would you leave a secure job behind, one that pays a decent salary enhanced with a number of benefits, ranging from health care to pension fund contributions? A job which requires you to work a mere five days a week, eight hours a day? Would you give it up to pursue your dream – a venture which brings to the market the latest and the greatest in a technology area you are passionate about?

Many people have done exactly that. They gave up their well-paid jobs (wrongly perceived by many to be more secure than a job with a startup) to pursue the ambition to bring a world-changing technology to the market. Their enthusiasm leads other people to do the same. More people join the new venture. A company with no product, no customers and no money in the bank. But with a gung-ho team. So these people put their personal money into the venture. They work long hours, often without pay – knowing that the ultimate financial reward will be that, someday, maybe their equity – their hard-earned sweat equity! – will be so valuable that they join the ranks of high-tech millionaires. They convince friends and family to cough up some money in exchange for a few shares – or are it lottery tickets?

Such founders have become the heroes of the global high-tech startup community. Founders, after all, do the ultimate thing: they

start something – a venture – to create something – a product; a customer win; wealth.

Many have tried, few have succeeded.

The world of startups is an absurd world. Here are some of the paradoxes you should be aware of.

Paradox 1: The Illusive First Mover Advantage

Many startups are in a hurry to be first to market. They believe that there is a big pot of gold waiting for them, as long as they get to market first. But the first-mover advantage is illusive. How did the first-mover advantage become the myth that it is? The answer is relatively simple. Many entrepreneurs and investors fail to do their historical homework. They assume that market leaders today developed their product's category because the dominant firms themselves now claim to be the pioneers and because the first-mover failures have been lost to history that is all too rarely studied with the care that Gerard J. Tellis and Peter N. Golder have done in their excellent study "Will and Vision" [Tellis, 2002].
The case against the first-mover advantage that Tellis and Golder make goes beyond evidence from the highly interesting cases they vividly describe (the Gillette case will stick with me forever. Their central conclusion is that the first-mover advantage has never been the advantage it has been cracked up to be in any but six of the 66 industry groups they studied. Moreover, the failure rates of pioneers is quite high - 64% for all industries studied; for high-tech industries still a massive 50%. What is the secret of market leadership if first-mover is not it? Tellis and Golder draw the following lesson:
We find that at the root of enduring market leaders is a unique vision of the mass market. Coupled with this vision is an indomitable will to realize the vision. Will manifests itself in four important components: persistence, relentless innovation, financial commitment and asset leverage. (...) Firms endured as market leaders because they had most or all of these attributes. On the other hand, many market pioneers failed because they lacked one or more of these factors.
[Tellis, pages 54 – 55]

Paradox 2: The Vision – Execution Gap

OK, so the ideal founder is a man (or woman) of vision. A very clever, technology-savvy entrepreneur who has the foresight to see and articulate why her “thing” is going to be a multi-billion dollar market and who, during her years as a scientist at a university has created the core technology which will drive a wave of disruptive innovations.
It turns out, however, that many of these ideal founders do not succeed! They get stuck in the Vision – Execution gap. A person who has a vision he firmly believes in, will usually execute towards the fulfillment of that vision. An important assumption for realization of the vision is that the market will adopt your visionary “thing”, typically a disruptive technology, product or service. Geoffrey Moore identified this problem already in 1991 with his excellent book titled “Crossing The Chasm” [Moore 1991]. The time lag between the launch of an innovative product and the adoption of it by the mass market is called the chasm. Moore states:
Most companies fail to cross the chasm because, confronted with the immensity of opportunity represented by a mainstream market, they lose their focus, chasing every opportunity that presents itself, but finding themselves unable to deliver a salable proposition.
[Moore, page 67]

The vision may be correct, but it takes small steps and disciplined execution to win niche markets, which populate the chasm, before mass market adoption becomes a fact.

Paradox 3: The Paul Principle

One of the most common paradoxes in the world of startups is the Paul Principle. What is the Paul Principle? Most of us are familiar with the Peter principle – in a hierarchy every employee tends to rise to his level of incompetence. The Paul principle is the transposed version of this axiom – competent people who have moved up the career ladder at large organizations sink to their level of incompetence at small no-frills startups.
Take the case of two very clever guys who started a software company. Both were committed to a vision that they could contribute to a safer world, and worked hard to win initial customers. When

applying for venture capital, the participating VCs believed that one of the two founders was too much of a researcher and that the other lacked leadership qualities. The founders met with an acquaintance of one of the general partners. He was a very successful executive at IBM The VCs had made the appointment of an "accomplished" CEO a condition for closing the deal and under pressure from time the founders matched his salary, his bonus, his pension plan and his company car. To top it of, they gave him five percent of the company in stock options. The day the new CEO started, he initiated a search for an assistant. Next, he hired a marketing director, with whom he spent a week in New York to gauge the strategy of the company. Their first act was to create a new corporate visual identity. After that, a new office building was rented. When the founders objected to the amount of money being spent on the decoration of the meeting room (which was aptly renamed into Board Room), the former IBM executive explained that customers only purchase from successful and trustworthy suppliers, and that this investment was part of creating a favorable perception. In the months after that, many executives from the likes of IBM, Cisco and HP visited the new CEO. After that investment bankers came to visit. Then there were two late night meetings with the same VCs which had advised the founders to hire the former IBM executive. A few days later the company applied for bankruptcy and shut down.

Paradox 4: The Inverted Risk-Reward Curve

Investors are well aware of the trade off between risk and reward. Investing in government bonds was (at least up to mid 2008) considered to be a lower risk investment than buying shares in a company. Therefore, government bonds are priced at a lower expected yield. Similarly, venture capital companies, who invest in high-risk assets such as startups, need to show much higher returns than other fund managers, who for example manage investments in bonds or commodities. This phenomenon is called the risk - reward curve. The higher the perceived risk, the higher the required expected returns an investor will demand. But when it comes to startups, the curve is inverted. The higher the assumed risk, the lower the reward!
What is going on here? When you start a venture, you need to make sure that there is money to pay bills. What do you do? You convince

friends and family to donate cash in exchange for shares, contending that wouldn't they have liked to purchase a percentage of the shares in Microsoft in the early 70s for $ 25,000?. So these "angels" put some money into your venture in return for which they get a few shares. Let's assume that you convince 10 people to do this, so after a day of extracting money from friends and family, you have issued 10% of the shares in exchange for $ 250,000 in cash. Now you can pay some bills.

A few months later you need more money. The good news is that your prototype performs according to expectations. Everybody is enthusiastic, but there is still a long way to go. Nevertheless, a VC decides to fund your venture. It offers $ 2,500,000 in exchange for 63% ownership. You need the money and there are no other avenues to get this amount, so you agree. Lo and behold, a few months later the venture gets an all share offer and is acquired for $ 10 million.

The following table summarizes the capitalization of the venture (and is therefore called a cap-table):

Early Bird Catches the Worm

	Founding	Round A Cash In	Round A Ownership	Round B Cash In	Round B Ownership	Exit @ 10M	Return
Founder	100%	0	90%	0	34%	3,375,000	
Angels		250,000	10%	0	4%	375,000	50%
VC				2,500,000	63%	6,250,000	150%
Pre-Money Value		2,500,000		1,500,000		10,000,000	

- Angels invest earlier, thus bear higher risk
- Late stage investors enjoy higher returns
- Picture can be more skewed due to liqprefs

The founders seem to have done well, they get over $ 3 million. The Round A investors, your friends and family!, have done pretty good too, with a return of 50%. But the VC-investor has done best of all,

with a return of 150% (and that is not counting liquidation preferred shares ("liqprefs") and other protections VCs typically put into their conditions for investment). When comparing Round A investors with Round B investors, it turns out that the latter ran the lower risk but got the higher return.
Most ventures need several investment rounds – and often more rounds than the business plan predicts. So by the time your venture starts to gain traction (and assuming your investors are still willing to invest!) you and your family are diluted to a few percent of ordinary shares with four classes of liqprefs hanging over it. Sweat equity has evaporated and friend and family should be happy to get their pay-ins back.

Paradox 5: Small is Complex

Running a startup requires you to be fast and creative. Decisions must be taken swift and implementation often starts immediately because communication lines are short and the team is geared up for rapid execution. So, the impact of your decision is as direct as it can be, but an error will have dire consequences, because there is no backup for failure. To be successful as an entrepreneur, you need to possess many skills, talents and capabilities. You need to have the ability to focus on visionary, long-term goals and reach them through small, focused steps. You need to have the ability to muster sufficient resources and apply them as productive as possible. Furthermore, you need to win the confidence of financial backers, such that money comes available to your venture. And you need to assemble a team who can pull it off. Hiring the right people is probably the most difficult task of every manager.
Another, often overlooked skill is that you need to have the creativity to use third party resources to achieve your goals. Resellers, suppliers, landlords, bankers – without their support from day one, you won't be able to get traction.
Possibly the most difficult part of the job is convincing customers to do business with you. Startups typically lack name recognition and there is little awareness of the product you are selling, let alone interest, desire and action. This makes running a small startup one of the most demanding jobs in business. Contrary to generally held opinions, small is complex.

Paradox 6: The Resource Paradox

The digital era brought us the vision of a paperless office and the reality of information overflow printed on stacks of paper. This not merely meant a boon for paper, printer and ink suppliers, also IKEA made tons of money selling filing cabinets, as offices continued to increase their paper storage capacity. The irony was that in those offices where more closets were put up, more paper was stored and vice versa. This is the law of perpetual scarcity of resources: any activity can always use more resources, hence there is always a shortage of resources. But the fact that more resources are needed, does not mean that resources are applied in a productive manner. People who had access to fewer filing cabinets became keener to select which papers to file and which not. With fewer documents filed, they increased file retrieval speed and were therefore more productive. Similarly, small startups can be much more productive, through strict focus and a non-convoluted, straightforward strategy.

Paradox 7: The Cashflow – Profit Paradox

The seventh paradox is well known, yet often ignored. There is a difference between profit and cashflow. Being profitable doesn't mean you have positive cashflow. Since cashflow is your biggest constraint, you should manage for cashflow. Even so, most startups focus on profitability. When profitability is your top objective, you are likely to buy equipment, rather than renting or leasing it. When profitability rules, you are likely to focus on margins, rather than, for example, encouraging customers to pay early (like real early, as in advance payments).

Chapter Five

Key # 1: Ethos

Pitch

- People *are* your biggest asset, when they act as a coherent team.
- A coherent team shares a profoundly felt "ethos" – a mentality and mind-set to aim for deeply shared values and objectives.
- Each company features a more or less unique ethos. Yet, success comes easiest to those companies whose ethos contains discipline, questioning assumptions, discuss plans, share information, humble management and a desire for continuous improvement through root-cause analysis.
- People who inhibit the desired ethos are a liability, regardless of their intellectual assets. No player is bigger than the team.
- A distinctive ethos works as a self-cleansing filter on the organization.
- A carefully nurtured ethos provides the foundation for manageable growth, cross company teamwork, high productivity and results which match plans.

Chapter Six

Key # 2: Focus

Pitch

- Credibility, a sine qua non for commercial success, comes faster to those who are perceived to be insiders, hence walk the walk and talk the talk of their focus market.
- Replacers should target the channels their competitors are using, with a solution which resolves pain in the channel.
- Disrupters and providers of products with network effects should target niche markets by tapping (latent) demand.
- Focus allows you to understand issues and problems better than your customers, key to mining latent demand
- Applying strict focus enables a startup to generate cashflow relatively fast from a (niche) market, either through engaging with a launching customer and/or through nimbly and adaptively servicing the target customers.
- Niche markets are characterized by a rapidly achievable tipping point, which converts a niche into a "beachhead" from where expansionary strategies can be exploited.

Chapter Seven

Key # 3: Outsmart

Pitch

- Strategy starts with setting ambitious, yet achievable objectives, which are aligned with personal motives of the core team.
- Strategy drives execution and execution feeds strategy.
- Opportunistic execution is "the noise before defeat".
- Executing strategy is measured with milestones. Both the yardstick and the real-life results may be skewed, however. Variations should be analyzed by asking "why" five times.
- Success is rooted in obtaining and deploying a Sustainable Competitive Advantage (SCA). SCAs may reside in intellectual property, brand, business model, technology, customer know-how and strategy.
- Network effects can turn a SCA into a Winner Takes All market.
- Obtaining funding will be difficult if you lack a SCA.
- To bring a SCA to fruition, you need to have a vision and execute on it.
- Only a thoroughly vetted strategic plan warrants that a vision is executable and to the point.

Chapter Eight

Key # 4: Stock

Pitch

- There are multiple sources of cash to stock a venture.
- Each source will assess a venture on the basis of a set of criteria, of which your personality, commitment and credibility are very important items.
- Funding is not a one-off event. It is a process which should be ingrained in the activities of a startup just like product development and marketing and sales are.
- Manage investors through predictable performance and consistent communications.

Chapter Nine

Key # 5: Process

Pitch

- An organization primarily needs a process chart, rather than an "orgchart".
- Capital employed is the product of time and inputs. Processes help you to turn around inputs faster and more productively, reducing capital employed.
- Processes link strategy and execution to results, whilst optimizing productivity.
- Ventures who start with implementing processes from the beginning, have less growing pains and scale easier.

Chapter Ten

Key # 6: Execution

Pitch

- Execution is Everything

Chapter Eleven

Key # 7: Customers

Pitch

- Traditional marketing and sales methods are detrimental to most startups.
- Typically, startups serve markets where the need is dormant. Hence, startups first need to unlock the latent demand, after which customers develop their needs.
- Most salespeople are "tellers", who can explain all the functions and features of a product, hoping that one will stick with the customer. What startups need, however, are consultative sellers when they offer an improved version of an existing product or business developers when selling a disruptive innovation. Such people are scarce.
- Participating at tradeshows is effectively the same as firing off features in the hope one will stick. Startups often waste money by participating in trade shows.
- Business developers find pain, pinch it and only then offer a solution.
- Collaboration with competitors may create a bigger market.
- Expand revenues through adding private label channels.
- "Replacers" need to break loyalty patterns in existing channels and manage their channels to new loyalties.

Chapter Twelve

Epilogue

Giving Birth

The great American author Norman Miller once said about writing a book: "It's like giving birth". I have verified Mr. Miller's quote. Not only was finalizing this book a weird mix of excruciating pain tingled with the joy of anticipation, there were actually many more similarities, including the mood swings (thank you, family, for bearing with me) and the fact that I have gained a few kilos, which are difficult to get rid of, even after delivery.

While I was working on this book, the financial crisis unfolded and emerged as more than just a regular bust cycle, like the one we have for example seen in the tech sector in the aftermath of the Internet bubble. What we are witnessing is more akin to the Great Depression. This time, the whole world economy is engaged. It is not just the USA where the economy contracts, the same is happening in Europe, China, Japan, Asia, Africa, Latin America and Middle East. Complete sectors of the economy are forcefully reorganized, with only a few companies surviving, such as is happening in banking, automotive, newspapers and advertising, transport, heavy equipment and real estate – just to name a few. Other sectors will go through similar experiences, including the high tech sector. There are a few bright spots, such as health care and defense, where governments will be forced to continue spending, also because deep recessions create deep political tensions and these tensions lead to investments in military might (let's hope the buck stops there).

A tremendous amount of wealth is already wiped away and there is more to follow. The Keynesian policies of most governments will

require such massive amounts of money, that, inevitably, inflation will rise to levels we have not seen in many years. Inflation is another form of wealth destruction. Hence, we will see a prolonged period of shortage of investment capital. The result is that VCs will not attract new capital, and we should expect very few new funds to emerge. In the years before the financial meltdown, some venture capitalists and lucky entrepreneurs were able to cash out through IPOs and trade sales. The problem for all other entrepreneurs, and venture investors, is that it can take nearly a decade for a start-up to go public or get acquired, especially now that the market for initial public offerings is stopped up. Consequently, VCs preserve the cash they have raised in the past, thus denying funding to new startups, and maybe even let some portfolio companies die.

In some markets, this effect is abrupt. Particularly Silicon Valley is known for its rapid adoption to changed circumstances. A shockwave has hit Silicon Valley's startup community during the fourth quarter of 2008, and new shockwaves are likely to follow. VC funding dropped 25% (almost all of the money went into follow-on rounds), but, more tellingly, the average exit price dropped 80% as VCs aggressively unloaded portfolio companies.
In other parts of the world, the effects are spread out over a longer time and will be felt throughout 2009 and 2010. Indeed, in many cases the global economic environment hardly has had any impact on a startup during 2008. Many investors and entrepreneurs have continued to develop ventures, as if the financial crisis was something that would not have much impact on their plans. Weren't Microsoft, Cisco and Google not all conceived during a downturn? So why not continue with startups in 2009?
This time it is different. The recession will be deep and long and will effect all of us. Some startups may find shelter in very specific niche markets, but the majority of entrepreneurs will see their babies being injured. The damage will be difficult to escape, but those who are prepared, may stand the fairest chance to sit the storm out.

What can startup companies do, confronted with these brutal, yet unavoidable circumstances? Rule number one: survival! Start-ups typically are developing products and testing markets, and their value lies in high-growth potential – not their existing business. This is something that startups will be forced to change. They need to create

a business which delivers positive operational cashflow. Make sure that under no circumstance you run out of cash. Re-assess your source of cash in and determine if they will continue to feed you as you expect. Review your cash-out items and decide to what extend you can avoid cash leaving the company.
Focus on revenues, which come from customers who are eager to spend money on your products because they can save money themselves. Where possible offer "AAAS" (anything as a service) to lower purchase thresholds for cash-strapped customers whilst improving a stream of future cash flows. Make sure your venture is not dependent on banks, investors and other parties, as they are likely not offering you the money you need. Sell on pre-payment terms and watch your accounts receivables carefully, because a number of your receivables will run into severe financial distress.
Entrepreneurs who have not started yet and young companies who have not received funding should redefine their strategy to ensure that they start their business with cashflow positive revenues from day one. This often means that expenses are kept low and ambitions are curbed. Avoid pursuing traditional strategies like rushing to the market and building IPRs in a short period of time.
Early stage, funded companies should candidly discuss the chances of follow-on funding with their shareholders and adjust their strategies where needed.