Business Development = Exit Planning

Most startups and emerging companies miss the opportunity for effective exit planning by not integrating exit planning into their business development activities. The most likely M&A partner is an existing partner, especially if you are making the partner successful. By understanding the relationship between business development and exit planning, you can utilize your partnership efforts to accomplish both objectives.

Startups are often told that exit planning is a dirty word, because investors (mainly venture capital firms) want the startups focused on building the next $1B company. Unfortunately, only .07% of the companies make it into this "Unicorn Club" (http://techcrunch.com/2013/11/02/welcome-to-the-unicorn-club/). Additionally, only 22.5% of venture back companies go public (although that number does seem high), according to The Venture Capital Cycle, 2nd edition, 2006. The remaining startups are left to contemplate a different future: bankruptcy, M&A exit or stagnation (also known as irrelevancy to your investors looking for a return). Of course, everyone knows that significant amount of investor returns comes from M&A exits, which creates a dichotomy between what your investors tell you and the realities that everyone knows. To deal with this dichotomy, startups should integrate exit planning into the business development activities.

Without exit planning, startups often lose significant value in their exit. The startups aren't prepared for the worst-case and best-case scenarios. In the worst-case scenarios, companies wake up one morning to realize that their funding is drying up and they haven't achieved profitability. There is the inevitable scramble to find an exit. However, the harsh

reality sets-in for these companies when they realize that they haven't built the necessary partner relationships to facilitate an exit. There is a mad scramble to figure out the potential buyers, who is the right person at the partner to execute on an M&A deal, and how to pitch an acquisition to each company. Often, companies face the terrible introductory phone call of having to introduce their company to a potential buyer and pitch a sale of their business in the same call. The success rate of such "fire sales" is low, and if the company can find a buyer, the valuation is usually pennies on the dollar.

In the best-case scenario, when your company receives its first unsolicited M&A offer, you want to reach out to other potential buyers to solicit competing bids. When companies aren't prepared, they are forced to pay million(s) to advisors to find other potential buyers. However, if you have done your planning in advance, you should already know who the other potential bidders are, and can save significant fees. Additionally, the window for obtaining other bids is often short, and the other potential buyers are in reactionary mode. The internal process for potential buyers takes time. Many potential buyers can't respond quick enough to make a serious competing bid.

To avoid these scenarios, you should integrate exit planning into your business development activities. With any business development efforts, you should start by understanding your ecosystem, including your competitors, inbound partners, alliance partners, go-to-market (GTM) partners, GTM alliances and other partners in your ecosystem. As you build your business, you will start forming partnerships with the key players in your ecosystem.

Layering exit planning over your business development activities only requires a slightly different analysis of your partners. You should understand (1) your M&A fit to their organization, (2) the rationale for a potential acquisition,

(3) the partners M&A history, (4) the “M&A power structure” at the partner, and (5) the key decision makers to know for M&A activities. Once you understand these factors, you will have a roadmap for positioning your company for a potential exit.

The Masters Of Strategy: Lawyers?

Are lawyers the real masters of strategy? Maybe not from a substantive standpoint, but the legal analytical process appears to taking hold in the strategy world.

In law school, lawyers are drilled with IRAC (Issue-Rule-Analysis- Conclusion) as a means to organize their thoughts and provide a methodological approach to a client’s issue. When interacting with a client, lawyers are asked to listen a long set of facts and to figure out what legal issues are present and how the law applies to the facts. The same basic approach applies whether the client is talking about a car accident, a divorce, an M&A deal, or any other area of law.

Traditionally, in the strategy world, the approach has been fundamentally different. Strategy models are created, and sold to every client possible. New models were the “hammer looking for a nail”, or more precisely, “if you [the model] are a hammer, everything starts to look like a nail”. New models are shopped around as the latest innovation, where every company is convinced that it needs to buy into the latest strategy model.

This traditional made perfect sense when the strategy world was being created. Strategy as a discipline started in the 60’s and has been developed over the last few decades.

Strategy models were the new "rules" being created.

We are now to the point where the strategy traditions no longer work. Companies have learned that not every strategy model applies to their situation. Also, companies have the scares from trying to implement strategies that don't work for their situation.

Management consulting firms are now borrowing the IRAC analytical framework from legal community. Bain calls it Opportunity-Approach-Recommendations-Results1, which is IRAC under a different name. McKinsey calls it Diagnose-Forecast-Search-Finishing2 the Strategy, which is slight different but substantively similar to IRAC.

Lawyers	**Bain**	**McKinsey**
Issue	Opportunity	Diagnose
Rule	Approach	Forecast
Analysis	Recommendations	Search
Conclusion	Results	Finishing the Strategy

This change in approach will certainly benefit clients. The modern day strategist needs to be familiar with all potential models, and needs to listen to the client's problems. After understanding the underlying facts, the strategist can decide (1) Issue: what challenges a client faces, (2) Rule: what models might help the client understand and address their issues, (3) Analysis: how the model applies to the client's situation, and (4) Conclusion: the results from executing on the strategy.

While lawyers may not be become the masters of strategy, their analytical approach will certainly dominate the strategy world in the future.

1 See the Bain Website.
2 See The Art of Strategy

Growth and Scale: The New Skillset for Entrepreneurs

For the entrepreneur, life in an early stage startup is fairly straightforward: you build a product and acquire your first customers. Plenty of books and other materials have been written to guide help a company through the initial stages of sales and product development, including the Lean Startup movement.

After the product has been built and the startup has initial customers, the entrepreneur begins thinking about how to "scale and grow" the business. To be successful, entrepreneurs need to learn entirely new skills. They must become strategists and managers. Fewer materials exist to help the entrepreneurs through this stage of the company development, because the process is not as formulaic and crosses multiple disciplines.

Often, this is stage where the entrepreneur is replaced as CEO and/or other "seasoned managers" are brought into the company by investors. However, there is a movement in the investor community against replacing the founder as the CEO. A product oriented founder as the CEO is seen as the best way to keep the entrepreneurial and innovative spirit of the organization. Andreessen Horowitz is the biggest proponent of the product-oriented founder as the CEO.

Regardless of who is leading the organization, the startup needs to quickly evolve to handle the challenges of scaling

and growing the business. On the other side of this journey, the startup will be transformed into an “emerging company”.

Many startups fail at this stage, because they underestimate the difficulty. The frantic and scattered startup must evolve into a scalable organization.

Below are a few of the key areas where entrepreneurs and startups face difficulty in the scale and growth phase.

- Recognizing Change. Most entrepreneurs are successful, because they are confident and self-assured (which make them believe that they can change the world). While these personality traits have served them well throughout their career, entrepreneurs must recognize that the game has changed. The entrepreneur needs to start over in the learning process. They need to recognize that new skills are required to be successful. This is what investors call “coachable” entrepreneurs. Without the ability to adapt, entrepreneurs will make key mistakes that could doom the startup during this important transition phase.
- Management Skills. The CEO entrepreneur needs to learn management skills. They can’t continue to do it all by themselves. Other people need to drive the continued development and sell of the product. The CEO will always be involved, but the CEO can’t drive every decision. Additionally, the CEO needs to learn how to help others be successful by training, teaching, and managing. The CEO should not micro-manage, but must empower the team to execute on the corporate strategy.
- Corporate Strategy. The CEO needs to develop a corporate strategy. The startup will face new distractions, as it hires new people and builds out the different functional organizations (sales, finance, HR, etc.). The corporate strategy should clearly define the vision, and how the company will execute on this vision. The strategy doesn’t need to be a complicated and long document;

instead, the strategy needs to succinct and sufficiently clear so that everyone in the organization knows what to do. Outlining the strategy will also set priorities for the company, and enable the CEO to monitor progress. Without a clear corporate strategy, the company will haphazardly execute of different activities, and will hope these are the right activities to make the company successful.

- Exponential Revenue Growth. The CEO needs to drive exponential revenue growth. While the sales organization creates processes to scale (make coin operated) the customer selling process, the CEO needs to focus on exponential growth where the company's efforts are multiplicative, not addition. Exponential growth begins with understanding the company's ecosystem and potential partnership options. The CEO needs to develop a strategy for targeting the best partners, including how to incentivize the partners and what sustained activities are necessary to develop the partnerships. After building a relationship with the partner, the CEO usually reaches out to a licensing lawyer to help structure the deal and drive the agreement to completion. Finally, the CEO must execute on the partnership and naturally transition the relationship to the sales or business development organization.
- Competitive Positioning. After landing the initial customers and selling to mainstream customers, a startup realizes that it is no longer flying underneath the radar. The competition has prepared customer materials comparing products and explaining why their product is better. The startup needs to take a new look at its competitive positioning, and develop materials for the mainstream customers. Often, this task is given to the new marketing team. However, the CEO needs to own this strategy development, as it provides key insights into the overall corporate strategy.
- International Expansion. Chasing all possible revenue

opportunities, the startup begins contemplating international expansion. This is an area where startups usually fail to have a coherent strategy, and often, startups rely on the same selling tactics in their home country. Startups often will hire individual sales people to cover one country or an entire region. This is called the “seal team six” approach, where an extraordinarily talented sales person could win some battles, but they never seem to win the war. They are left to fend for themselves with predictable results. The startup usually needs help understanding the different strategies for international expansion and help with execution.
- Buy-side M&A. With additional investor funds (Series B or Series C) in the bank, the startup begins to contemplate acquisitions. The normal M&A strategies may include technology tuck-ins, acqui-hires, or new product acquisitions to diversify or to fill a feature gap. The entrepreneur CEO usually underestimates the complexity of and the diversion created by M&A. Most startups lack the bench strength to handle an M&A transaction and need to bring it outside experts to help with this process. M&A is an effective means to scale and grow the business, but only if managed correctly.

The entrepreneur usually has the talent and adaptability to meet the “grow and scale” challenge. However, the entrepreneur needs to understand that new skills are required and must learn the new skills and seek help when necessary to transfer the startup into an emerging company.

What is Business Development?

There has always been a lot of confusion around “what is business development?”. I recall a Venture Hack event in the past where a speaker remarked, “there is no such thing as business development”. While the speaker was making the statement for shock value, it does illustrate the confusion around business development.

Historically, with startups, confusion reigned because no one wanted to be called “sales”. Apparently, this didn’t sound executive enough or there was some perceived negative connotation with being a sales person (these people obviously have never seen the pay check of top sales people). To avoid the term sales, people called themselves “business development”. In the last few years, this positioning has evolved even further. Now, startup sales people call themselves Chief Revenue Officer (CRO) or some equivalent.

To unravel the confusion, it is necessary to start with the conceptual difference between sales and business development. Sales people should be focused on customers, and driving quarterly revenue. Sales people are paid on commission for driving revenue, and will instinctively avoid “time sucks” where short-term revenue possibilities don’t exist. Also, a well-run sales organization is supposed to be “coin operated” with standardized sales materials, pricing models, etc. The more efficient the process, the more success you will have with selling.

On the other hand, business development is focused on strategic partners who are not customers, and is less focused on driving short-term sales. Business development requires latitude for building a long-term relationship where revenue might take time to develop. Business development is also a different skill set. The relationship between the companies and deal structure needs to be defined. There might be a

revenue model or only coordinated sales efforts, or there might be only interoperability between the parties.

Different variations on business development:

–GTM Partners (Outbound Sales):
–GTM Alliances:
–Technology Alliance (or strategic alliances)
–Inbound partners

Do startups need business development? Driving sales is the most important thing. The sales/business development/CRO person needs to do what it takes to drive sales. One argument is that startups should outsource business development, because it is not a core competency for a startup. On the other hand, one trap for startups is to neglect proper business development, because they have a sales person called "business development". These are distinctly different activities. The startup will not scale or achieve exponential growth without proper business development activities.

Integrating Business Development with Exit Strategy

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objectives.

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In the best-case scenario, when your company receives its first unsolicited M&A offer, you want to reach out to other potential buyers to solicit competing bids. When companies

aren’t prepared, they are forced to pay millions to advisors to find other potential buyers. However, if you have done your planning in advance, you should already know who the other potential bidders are and can save significant fees. Additionally, the window for obtaining other bids is often short and other potential buyers are in reactionary mode. The internal process for potential buyers takes time. Many potential buyers can’t respond quickly enough to make a serious competing bid.

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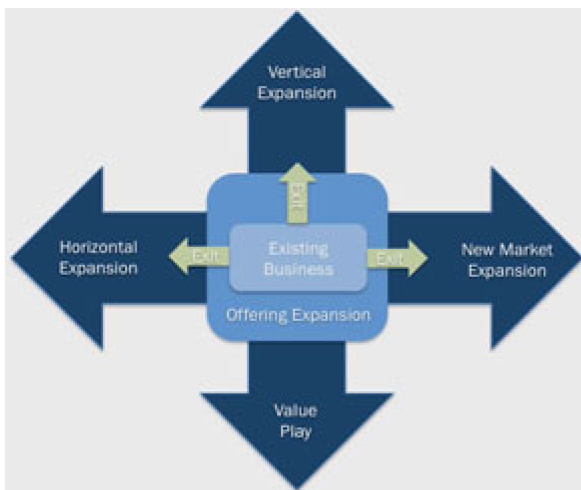
1 http://techcrunch.com/2013/11/02/welcome-to-the-unicorn-club/
2 The Venture Capital Cycle, 2nd edition, 2006.

Growth Strategy

Companies inevitably face the question: how to grow the business outside your existing market? Emerging companies as well as established companies face this question. When a company is started, the best strategy is to focus on a single product and a single market to marshal all your resources towards winning that market. After a few years, you realize that the growth rates of this market and your own growth rates begin to slow.

The chart below provides a high-level framework for thinking about your growth options. Of course, the hardest part about strategy is choosing the best strategy with the highest possible return and the highest probability for your success. Additionally, no strategy is effective unless you know how to effectively execute on the strategy. That said, the first step is to understand the potential growth options.



Offering Expansion
For product companies, the natural growth option is offering expansion, such as adding support, consulting and other professional services. When adding services, there are a number of considerations. From a financial perspective, services have a different margin profile and business model, and may impact your financial model. From an operational perspective, this requires adding a services organization and

usually requires changing internal processes to accommodate the new business model.

Another growth option is to add tangential products and move towards a solution offering, adding different hardware and software. The different solution offerings are usually third party products. Although this can increase revenue, the growth is incremental and doesn't open up new market opportunities. Additionally, this can have different margin and logistical impacts for the internal organization.

Vertical Expansion
With vertical expansion, companies acquire different partners in the ecosystem or decide to directly compete with these partners. The two most common vertical plays are expanding into the go-to-market (GTM) area and supply chain area.

With GTM, this often happens in foreign markets where you utilize local partners to build a country/regional market presence for your products. You need to decide whether you want to directly enter the market with your own sales force or acquire the local partner. With the supply chain, this often happens when a supplier has high margins and you see the opportunity to reduce your costs by making a competing product or acquiring the partner.

New Market Expansion
With new market expansion, you are looking for new markets to enter that are unrelated to your existing business. Usually, you enter new markets with high growth potential to increase your growth opportunities or to prevent disruption of your core business from an emerging market.

When diversifying into new markets, choosing the best market is always a difficult task. Questions arise around whether the diversification strategy should drive the best market opportunity, the company's core competency or other factors.

Horizontal Expansion

With horizontal expansion, you are looking for a strategic move in your existing market. Usually, you are acquiring new users through international expansion, for example, or through consolidating the market by acquiring competitors.

Growth in your existing market is usually the best and easiest place to begin growth discussions. Until you are a solid #1 or #2 in your market, expanding into new markets may leave you exposed to competitors if the diversification move distracts you from your core business.

Value Play

Another important consideration in deciding on a growth strategy is to be patient and wait for the right opportunity. You may not have the resources or the market conditions may not be right. You can consider becoming a “value play,” reducing costs and increasing margins while you wait for the right opportunities. The goal is to preserve cash for now and wait for the right opportunities.

Exit Strategy

After reviewing the different growth strategies, many companies decide that exit is the best strategy. Your partners or competitors may be better positioned to grow and expand the business. Understanding the market and competitive dynamics may lead to the conclusion that it is time to exit the business.

Once you understand the different options, it is easier to evaluate each option individually and in comparison to the others. One strategy is not necessarily better than the other. Certain strategies will involve higher execution risk, and should be deprioritized. Additionally, when choosing a strategy, you should remember that the best strategy in the world doesn’t matter if your organization can’t execute on the strategy.