A Start-Up Company: Opportunity or Just a Job?

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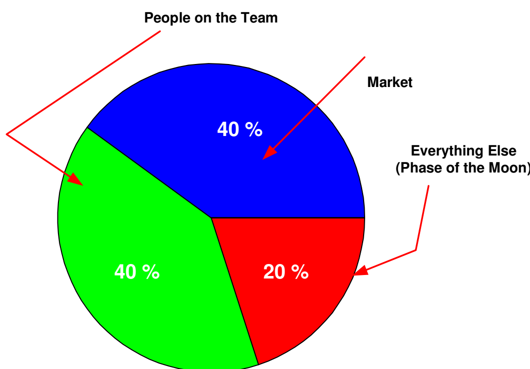
In previous years, the high-tech community was awash with new start-up company opportunities seemingly everywhere. Obviously, not every new venture is going to make it to the promised land, i.e., IPO, so what are some guidelines for choosing between genuine start-up ***opportunities*** versus (short-term) start-up ***jobs*** that after a couple of years don't amount to much? The following paragraphs offer some words for thoughtful consideration in this regard.

Which Start-Ups Should I Consider?

Venture capitalists use a rough "40-40 rule" which is best illustrated by the pie chart in Figure 1. In general, they assign the potential for a major return on their investment based upon (i) 40% the size and quality of the market, (ii) 40% the people in the start-up's lead team, and (iii) 20% everything else not already included. Furthermore, if the VC's don't believe that there is a market opportunity in a given area, almost no one on the planet will convince them otherwise! Therefore, the quality of the investors/VCs is a very key ingredient in deciding which start-ups have good potential because they have already weeded out the good ventures from the bad for themselves.

Figure 1 Investors' "40-40 Rule"



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The quality of the investors immediately lead to higher company valuations from the very beginning, and this fast-track valuation advantage normally stays with the start-up all the way through to IPO. Therefore, just who the investors in a start-up company are is a vital consideration for the venture's potential success and its future monetary valuation.

It is absolutely crucial that the investors' have a solid presence in the marketplace that the new venture is going to navigate in. Their access to market information, vendors, strategic partners, distribution chains, etc. is just as valuable if not more so than the capital that they bring to invest in the start-up. In today's explosive market, investment capital is not that difficult to come by, but strategic relationships, access to semiconductor foundries, etc. are in contrast, more difficult than ever to secure without the right connections.

One additional word is in order regarding investors. The investor profession is no different than any other profession; there are good investors and not-so-good investors. Good investors generally only work with other good investors. It is crucial that the company founders do their own due-diligence on their prospective investors and their track record! If an investor's win-loss record is on the dismal side and they are allowed to sit on your board of directors, their money could be the most expensive money that you ever take.

Is a Start-Up Company a Real Opportunity or Just Another Job?

This is an excellent question! There are many jobs available out there, but far fewer true opportunities. And normally chasing any opportunity that promises something bigger than life is just that. Technologists should be very cautious about start-up opportunities that appear to offer tremendous up-side, but are otherwise fuzzy when it comes to other important factors like:

- Opportunity to learn/ develop new technologies personally
- General opportunity for advancement
- Quality of and experience level of co-workers
- Quality of life features (i.e., is there already a cot located in your cubical?)

Statistically speaking, a lot of start-ups do not make it, so it is unwise to think that the start-up that you have

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chosen to jump on board with will automatically result in you becoming filthy rich and you retire to the southern coast of France. It is far better to join a company that offers a range of success that certainly includes the potential for top-notch financial reward, but otherwise advances your career in a desirable direction also.

Let no one fool you; start-up companies are not for everyone. The work load is generally higher than in more established companies, but if you are the type of individual who runs the race hard wherever your job is, you might as well stand to be more favorably rewarded by putting that effort in play within a start-up company where it will be eagerly accepted and rewarded.

When is the Best Time to Join a Start-Up?

Depending upon your station in life, the best return on your risk is when the company is small. Prior to first-round funding, risks are of course very high, but it is very difficult to even hear who these would-be start-up companies are unless you just happen to know one of the founders. Prior to first-round funding, most start-up companies are in "stealth-mode", and they do not have the budget to advertise. Adding to the difficulty in catching a budding start-up prior to first-round funding is the fact that the promising start-ups grow ***very fast***, and being at the right place at the right time to synchronize with their explosive plans is normally difficult.

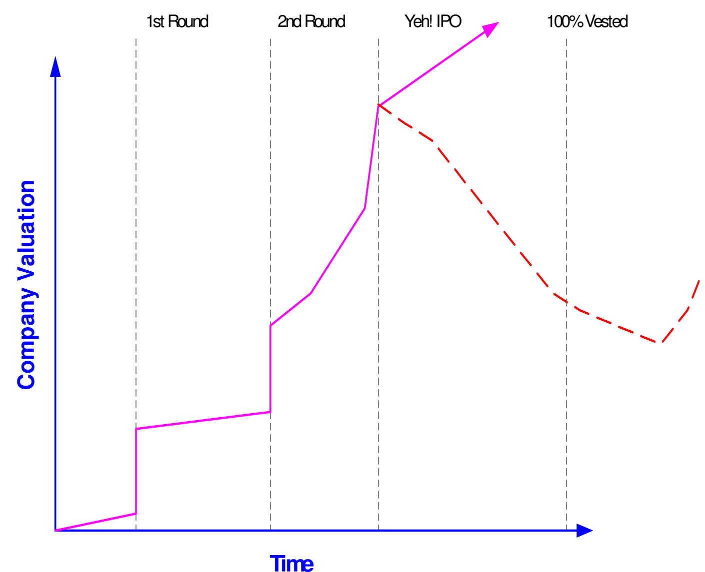
If an individual has a dream to one-day roll their own start-up company, getting on board a start-up opportunity early with a team of people who have ***done it before*** is an invaluable learning opportunity. It also demonstrates mettle to future would-be investors who you will need to fund your own venture in the future.

The company's potential exit plans should be of concern also. The things that really matter are (i) stock value and (ii) your personal vesting schedule (see Figure 2). If a person joins the company just before IPO for instance, even if the IPO is successful, this person will not normally be even 50% vested for another 2 years! A lot of things can happen to a company 3 years after IPO while this person is waiting to get 75% vested, and not everything is good. The company's focus can change dramatically thereby affecting the nature of the technical projects the company tackles, etc. In general, the most excellent time to join a start-up company is soon after the first-round of funding has been taken. In this context, the following statements apply:

- Stock options are still reasonably low-priced and therefore very attractive;
- Individual will be probably at least 50% vested by the time the company comes out with its first products, the company is acquired, or the company has the opportunity to consider an IPO;
- Individual has an excellent opportunity to make significant technical and organizational contributions to the company;

As suggested in Figure 2, timing is a very key element in maximizing the return on risk in the context of ***vested stock options*** and the ability to actually redeem any of them for hard cash. And as suggested in Figure 2, no one has a crystal ball so that they can see very far into the company's future, but on the other hand, every resource available to the company and its investors will seek to maximize the company's valuation just prior to IPO, so it is a good idea to be as well vested as possible near the company's planned IPO date.

Figure 2 Company Valuation & Stock Versus Time



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Are There Any Competitors on the Horizon?

You better hope that there are! If not, it is very very doubtful that this start-up venture in question has discovered a multi-billion dollar market opportunity that has missed everyone else's eyes on the entire planet! Ever hear about cold-fusion?

Large market opportunities draw large attention. The presence of market competition is normally good evidence that opportunities are lurking.

How Will the Company Make Money?

Unless you really liked the Kevin Costner movie "Field of Dreams", and you want to try the "build it and (see if) they will come" with your own start-up path, this part of the picture should be very straight-forward. If the story behind the company really turning a profit is complicated and convoluted, beware. A number of start-up companies have also assembled large design teams, positioning them for just an acquisition by another larger company with no real intent to ever really build a product-company. So if the company vision is murky, be advised.

The "dot-com" companies have suffered greatly in this regard because all of the market hype and posturing has led to less than prudent business practices being followed. Many companies grew much faster than their cash burn rate and near-future earnings could ever justify, and when the market forces became uncertain, their house of cards quickly fell through.

What is the Company's Exit Plan?

Having an idea about the company's exit plans is synonymous with understanding how your

stock options can be eventually turned into cash. The recent "dot-com" company scenarios of recent times stood conventional wisdom on its ear…for a time, but making money the old fashioned way has seen a genuine resurgence.

In order to be viable, the company should have a number of different exit-plan options available to itself. If the company talks about going IPO, there should be some evidence of Wall Street connections from the very beginning. Investment bankers are no different than other suitors in that they are going to play the dating game with any would-be future IPO candidate long before they go and get married.

Who are the Investors?

This question is very important because while their money is as green as anyone else's money is, track records of performance on their other investments can range dramatically! If the investor's record with other start-up companies is less than golden, don't take their money in the first place! All too often when things get difficult with the venture, these same investors (who now probably have board of director positions with your firm) will be directing the future for your entire company.

Although this point was made earlier, it is repeated here again with purpose in mind. If you will be one of the principals in the start-up venture, the board can be one of your best assets, or it can become your worst nightmare.

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Now that You Have a Job Offer In-Hand…

So What Percentage of the Company Am I Getting?

This is a rather obvious first-question that often comes up if a candidate lands an offer from a budding start-up company. This question alone sheds little insight into the monetary value of the stock at some point in the future however. The following questions underscore this point further.

Question #1: Would you be more inclined to join a start-up company founded by Bill Gates, or by Joe Fuddyduddy?

Obviously Bill Gates. The likelihood of the company's success is tremendously affected by the character, business relationships, access to capital, etc. of the founders. Even 10% of Joe Fuddyduddy's company would not come close to stacking up to 0.1% of a new company founded by Bill Gates.

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Question #2: How many people in the company right now are at this same percentage level?

The answer here depends dramatically upon whether the new company is going to be a "one-man show", or whether its vision requires a comprehensive many-disciplined team of experts. Normally, the company that necessarily attracts a reasonably good sized team of experts will have an equally larger vision and correspondingly higher future company valuation. With high levels of system integration being the more compelling value proposition, it is better to look for an opportunity that has a need for depth and breadth in its staff.

Question #3: But 0.15% seems so small!

But 0.15% of Broadcom or Microsoft is incredibly valuable in terms of US greenbacks! It is called capitalism. It generally takes very serious capital to launch a company that will itself become very substantial sometime in the future, and for that the investors' demand a healthy stake of the company; very understandable. If the investors' portion of the company is too small and risks mount, the inclination to cut and run is obviously much higher.

Question #4: How many rounds of financing have occurred, and how many future rounds are planned?

In a poorly run start-up, this may seem like a meaningful question, but if the answer is not a small integer, you will have far more serious problems to worry about than dilution! On the other hand for example, if adding an additional round of funding permits the company to grow its overall valuation to $5B rather than $1B with a net additional dilution of only 10%, obviously the company and every stock holder benefits from pursuing an additional financing round.

Question #5: If my percentage is small, shouldn't I be irritated that the investors are apparently holding most of the stock for themselves?

Quality investors full-well understand that the fuel that makes a start-up run consists of a number of key ingredients, including employee stock-options. Good investors require the employee stock-option pool to be maintained at a minimum specific percentage amount. In short, the venture must be a win-win for all parties involved in order to be successful. It should be clear that if the investors' portion of the company is too small a percentage, they may well write-off the venture as a loss more quickly if difficulties arise because they are looking carefully at their reward/risk ratio also. Balance is the key word.

***Question #6:* When I pushed on my offer for more stock, the company gave in. Should I keep pushing to get more?**

Companies like individuals are going to be reluctant to give away what they prize most. Some companies will prize cash over stock for example, or visa versa. So, if a company is a push-over for more stock, one should question just how valuable the stock really is. Similar concerns apply if the company is willing to offer "almost anything" in terms of salary. High-flying companies like AMCC will generally tolerate only one major iteration to the terms of the offer before they withdraw it all together.

Be advised that there are many "creative" ways to effectively redistribute stock value within a company pre-IPO thereby making the integrity of the company's management and investors key to your real stock position at IPO.

Finally, if the company allows you to push them into an excessive high stock and salary position, you may well be walking into a troubled company which is quite frankly desperate. The final terms need to be a "win-win" for all parties involved.

How Long Until the Company Goes IPO?

As suggested earlier, the company's planned IPO date should ideally match well with the point in time at which you will be at least 50% vested.

Just How Valuable is My Offer?

There are many factors that affect the value of the job offer that you have received. Some of these have already been discussed earlier. The most important factors apply to business elements which require some effort to research, including the following:

- Total market size
- Company customers, partners
- Entry time (hire date versus IPO date)
- Patent positions

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- Superior technology
- Position in the overall product / distribution food-chain

Comments Now in December 2003

Where are those good old days of 1999? Wow!

Recent economic times as well as looking back on now 4+ years of my own start-up company have again proven the need for some of the practical comments made earlier. In brief,

- Whatever one pursues must have genuine worth and merit. The pursuit of just the big-bucks can fade oh so fast (Sounds like a Proverb, right? It is.)
- You have to have fun along the way, not just upon reaching the destination.
- Take care of your family, your health and your friends. They last a lifetime but the start-up company may well not (That's a Proverb too.) Johnny and Karen are 3 years older now, and so am I ☺.

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