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Business Model Risk

What is business model risk?

Experts define business model risk as "all risks within the business model [that] can endanger the profitability and sustainability of the business model or even company goals and value". For our purposes, business model risk pertains to the *financial viability* of the business and the prospects for *profitability* in the near-term.

Most startups struggle to become profitable in their first two years of operations, and end up going bankrupt before their business model can be proven and before they get enough traction to raise funding. Some businesses feature a more advantageous balance of cost and revenue streams, and are therefore better positioned to reach profitability while they still have runway from bootstrapping or seed funding. In contrast, others are more difficult to make profitable since margins are thinner or fixed costs are greater, and therefore face greater business model risk.

Even when business models are difficult, strong customer acquisition and month-on-month growth are good signals that the startup is on the right path and are, therefore, compelling data points for investors. In fact, investors are likely to be more impressed with hockey stick growth (rapid customer acquisition) than profitability in the early days. Some investors go as far as to say that growth matters more than profitability, especially if that growth can deliver access to low-cost venture capital. While some subscribe to this perspective, others qualify this approach noting that "this strategy may only benefit companies seeking to surpass the $100 million threshold in the short term". And other investors outright criticize this way of thinking, asserting that a "growth at all costs" model is flawed in the long run, especially in emerging markets.

In all, startups need to set growth objectives that fit their business model. For example, B2B companies may want to focus on fewer, bigger clients while others may find that rapid customer acquisition makes sense. No matter the approach, consistent usage rates as well as strong customer retention, consistent month on month revenue growth, and high customer lifetime value are important metrics to track for any startup seeking to validate their business model.

In addition, startups in emerging markets need to integrate the reality of operating in a tougher business environment into their model assumptions, such as a lack of infrastructure, limited connectivity, higher cost of data, the need to reach customers with a human touch. As Cochran says, "integrating this reality into positive unit economics is a critical step to long-term value – maybe not right away, but eventually".

As such, our suggestion for managing overall business model risk is to consider the balance of costs and revenue early on, keep a close eye to the most important metrics for the business, focus on retention and not just acquisition and strive for positive unit economics from the get go. To keep track of it all, we suggest startups invest in dashboards and other processes for facilitating analysis.

Key factors of business model risk

- Scale needed for profitability
- Current number of customers
- Month-on-month customer growth rate
- Churn rate
- Retention rate
- Months in operation
- Months of runway - cash on hand
- Monthly revenue
- Month-on-month revenue growth
- Recurring costs
- Fixed costs
- Variability of input costs
- Unit economics: CAC, LTV

Mitigation strategies

Develop a robust financial model, and reference it often

A helpful tool to address business model risk is to construct a robust financial model for your business, to thoroughly understand your cost and revenue levers, and to forecast your key metrics over time. The good news is there are many resources out there that can help you build a sound financial model. A quick search for "financial model template" produces dozens, if not hundreds, of Excel templates that you can use to start plugging in your fixed and variable costs, as well as expectations around customer acquisition and retention (see below for some suggestions). Of course, it's essential to plug in numbers based on valid assumptions depending on your product vertical, customer segment and market.

A financial model is not a magic bullet, but rather a way of naming and quantifying the factors or drivers that will determine the success of your business, thereby revealing which ones are the most important to your business' survival. The trick is to add enough detail to create sufficient accuracy, while preserving enough simplicity to keep the model usable and to reveal underlying relationships and dependencies between metrics. It is also important to allow for ranges of estimates, not just specific points. Many times, the model will reveal how sensitive your business is to something like customer acquisition costs, so pay careful attention to those numbers (this article might help).

Test assumptions frequently to inform your growth strategy

If your company is facing business model risks, a good financial model will also allow you to generate and test assumptions regarding the levers that may be impacting your growth and success, as well as to quantify your margin of error, given unknowable fluctuations, market shifts, and resource limitations. For example, a financial model can help you determine the impact of variation in key inputs -- like greater churn, the cost of a new hire, or an increase in input prices -- on your bottom line.

A model can also tell you what you need to grow, and when economies of scale may kick in. With these in hand, you can then plan targets and milestones for each quarter, thereby enabling your team to "live the model".

Create a core set of dashboards to embrace data-driven decision making

Once you get the hang of modeling, you will develop a sense for the key metrics in your business model. These metrics should be integrated into a core set of dashboards, including a financial dashboard along with your customer retention dashboard that you track with consistency. Seeing these metrics evolve over time will allow you to make data-informed business decisions and pinpoint the correct strategy for adjusting your model. For example, if costs are growing faster than revenue, then you need to reevaluate the marginal cost structure of your model. Embracing a data-driven approach to business will allow you to stay agile, refine your product offering, get clear market validation, adjust your model as you go, and be more resilient to unavoidable shocks.

Additional resources

- Financial Modeling for Startups
- How to understand the financial levers in your business
- Long list of helpful articles and templates
- Startup financial model template
- Another startup financial model template
- SaaS financial modeling template
- EY Finance Navigator software
- EY Guide to financial modeling for startups (includes definitions for the types of data to include in a financial model)
- Step by step guide to create a bullet-proof financial model

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Customer Risk

What is customer risk?

Customer risk is high when your product is not delivering sufficient value to customers. At the heart of customer risk is *product market fit (PMF)*, and the extent to which a product solves a problem keenly felt by customers. Operationally, customer risk is evident when high proportions of customers churn and when customer acquisition is extremely costly and slow.

In these instances, startups have yet to achieve product market fit, and so find it difficult to attract customers and risk losing those they have acquired as they are not delivering enough value. This can happen for many reasons but typically it boils down to when users' needs and pain points are poorly understood, when the product has hiccups or inconsistencies in user experience, or when there is a gap in clear and consistent communication between the company and its users.

The most straightforward way to establish whether a startup has achieved product market fit and is delivering benefits to users is to ask the users directly (through a frictionless feedback loop and user research), to evaluate user data and determine where there may be drop off points, and to measure benefits to users via established impact methodologies. However, such impact assessments, even those leveraging lean data methods, are rarely (or only infrequently) feasible given the resources required.

As such, startups need more consistent internal methods to evaluate and monitor product market fit and assess if they are delivering value to customers thereby managing customer risk. There are a number of operational habits and methods that can help:

The first, **user research**, is perhaps the most important tool in beginning the product market fit journey - both to understand whether the product meets a user's needs and validate a company's value proposition as well as to understand where there may be challenges in the user's experience with the product once acquired.

The second, **data analysis**, entails careful monitoring of acquisition, usage, and retention metrics. These indicators can reveal the extent to which customers value the product and derive benefit from its use.

Finally, startups need to use the research and data to develop an **engagement strategy** that will enable them to improve communications with users and to maintain open channels for feedback, which can increase retention and customer lifetime value.

Key factors of customer risk

- Complex or unwieldy UI/UX
- Accessibility of payment methods
- User preferences not understood
- Low trust
- Poor customer support
- Price point outside of users willingness to pay
- Limited access to technology
- Customer connectivity
- Customer-centric product management processes
- Customer feedback process
- Communications challenges

Mitigation strategies

A number of product management approaches can help startups mitigate customer risks and move towards achieving product market fit, monitoring usage and retention over time.

Hire a product manager that puts customers at the heart of the product management

The most direct first step is to hire an accomplished product manager who knows your product space and your user base well. A good product manager who knows your market space -- and where the gaps are -- can provide the intuition and expertise that can serve as a foundation for achieving product market fit. If that person also knows your user base -- their access, preferences, and decision-making criteria -- then you have found someone who can effectively guide product development. In many cases, especially for pioneering startups introducing new products among unserved potential users, teams may struggle to find candidates that can both master the product development process and deeply empathize with the problems and realities faced by users. When this happens, startups can ensure their teams adopt customer-centric product management approaches, putting the needs of users first.

Engage in user research - early and often

User research should form the foundation of the product market fit search, whether you are developing a prototype, rolling out a new product, or refining features for an existing product. User research can take many forms: analyzing existing data to uncover needs and challenges with the current

user experience, administering a quantitative survey to better understand the population you are targeting, or getting into the field to speak directly with or observe users.

User research can make use of prototypes and minimal viable products, or just involve silent observation as a customer uses your product. Our Product Market Fit toolkit can help you pick which method is right for you at the moment and design your research.

Analyze user data, at each step along the customer journey

The second pillar of product market fit is data. Keeping track of users throughout the customer journey -- from awareness to acquisition to usage frequency and even referral -- will allow you see where customers are dropping off and where you should invest additional effort. The AARRR framework can be a useful approach for tracking the customer journey. Startups should start with an initial dashboard and then grow their data strategy as features and channels multiply. Data can also amplify user research, helping you to direct user research efforts towards certain segments or towards certain problems in the journey. For example, data may indicate that users of a certain age or in particular geography activate at lower rates, thereby targeting your attention to specific barriers to use.

The combination of user research and data can help you articulate the outstanding questions and hypotheses about what customers will find compelling and useful. Once you articulate the open questions, controlled experiments or pilots can be a powerful way to generate answers and evidence. Making such experiments a part of your business' culture and DNA can ensure that your team continuously improves and grows your product offering.

Develop a robust and consistent communications + engagement strategy

Together, the user research and data should inform a communications and engagement strategy that keeps the startup in touch with users, and motivates users to continue engage with the product and with the startup. The strategy should focus on identified touchpoints, set goals for each, and test methodologies for improving engagement and retention along the funnel.

The engagement strategy should also include clear and easy mechanisms to communicate with customers along the user journey (from acquisition to retention to revenue), with messaging that makes sense to the customer base. These should include opportunities for customer feedback and reprisal, which can also provide content for progressing towards product market fit. Customer support mechanisms like helplines and call centers can help you track where customers are hitting barriers or need assistance. Similarly, asking customers for feedback at regular intervals or after certain actions can also be a valuable source of intelligence. There are established industry tools for collecting this feedback such as Net Promoter Scores, KISSmetrics, and Flurry.

Additional resources

- CGAP Customer Centricity Guide
- Product testing toolkit

User Research

- UserTesting
- Validately
- Ask Your Target Market
- Qualaroo
- SurveyMonkey, Google Forms, Type Forms
- Join.me
- Screenleap
- Customer research surveys

Data Analysis

- Seven steps of data analysis. A walk-through of how to approach data analysis.
- Top Ten Tips for completing data analysis. A collection of tips and tricks for completing data analysis.
- Data Management Toolkit

Customer Segmentation

- CGAP Customer Segmentation Toolkit and Workbook
- Averages Lie: Using Smart Segmentation to Find Growth – McKinsey.
- Cluster Analysis and Segmentation – INSEAD Business School.
- The Many Faces of the Poor: Mass Market Segmentation - CGAP
- Mystery Shopping Infographic - CGAP
- Power of Micro-segmentation - CGAP
- Willingness to pay

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Execution Risk

What is execution risk?

Execution risk is high when a startup will not be able to deliver on its plans and promises, risking to lose customers, disappoint partners and investors, and ultimately fail. This is usually the result of insufficient resources (either financial or human) or poor planning and orchestration of the resources the business does have.

The first risk is easily identified, but not easily resolved: inadequate budget. In this case, the startup has committed to delivering a service or product, but finds that they lack the finances to purchase inputs, staff time, or other resources necessary to deliver on that commitment. Many startups, especially those at an early stage, have just a few months of financial runway or may still depend on the personal savings of the founder. In these instances, securing (or committing to) longer-term contracts may be difficult as there may be concerns about the durability of the business.

The second type of execution risk has to do with skills and abilities within the startup team. In this case, lack of expertise, or incomplete information about the market may cause the team to make decisions or take actions that cause the startup to fall short of customers' expectations. This often happens when the team does not have sufficient experience in the relevant market, or does not have the right mix of skill sets needed to execute on their vision t. Since startup teams are small, there may be holes in technical abilities or product expertise that cause execution to falater.

The third, related, risk has to do with leadership, management, and oversight. In these instances, the management team lacks processes to adequately plan the activities needed to execute, an lack oversight to supervise and motivate the team. This is often the case when startups have too many ideas going at once and are unable to maintain focus on what will really help the business succeed. This can also happen when the team grows too quickly and there are no processes in place to manage increased demand, or when there is insufficient alignment among its members, or when the team is not sufficiently motivated to deliver.

A fourth execution risk is mission drift. In this case, the team gets distracted by a big customer or an idea that causes it to slowly (or quickly) drift away from their mission, creating another sort of execution risk in which objectives are continuously changing.

Key factors of execution risk

- Insufficient technical skills
- Weak leadership abilities
- Poor local knowhow/expertise
- Limited financial runway
- Insufficient human resources
- Weak processes and structures
- Poor incentive structure
- Mission drift

Mitigation strategies

Build a thorough product roadmap

The first step to managing execution risk is to create a thorough product roadmap that illustrates how your offering will evolve over time, keeping in mind the resources available. Such a roadmap is central to your strategic planning process as it describes how resources and time are allocated against the various projects the team is developing to improve and expand the offering. Roadmaps often include a series of sprints to develop, test, and integrate refinements in additions. Once you have your overall roadmap in place, you can also start creating mini roadmaps for these dedicated sprints and experiments.

Not only do these tools create reasonable expectations, given available resources, they also help discipline the team by allocating resources proportionate to their importance. With a roadmap, leadership can help ensure that those things that really matter, get done. They also ensure that decisions are made at appropriate times, according to a schedule, once adequate evidence has been accumulated.

With the roadmap, leadership has an overview of the talent, expertise, and funding that the team needs to more ably deliver on the roadmap. It should serve as the basis for a plan for acquiring talent and building your team. It will be important to ensure you have adequate talent across the startup's verticals, including local expertise, which can often be overlooked.

Achieve team alignment via management tools (OKRs)

The second step to addressing execution risk is to build internal processes that align your team so that leadership can support and track efforts towards delivering on the roadmap. One powerful and proven approach to this alignment is to create Objectives and Key Results (OKRs) in which employees outline their major objectives in terms of measurable, quantifiable actions. These actions are grouped into buckets that align with the startup's overall goals. They should have a good balance of achievable goals (70%) and a few stretch goals (30%), and could be integrated into a dashboard that is easily trackable by leaders. OKRs are a powerful tool to make sure that everyone is working towards common goals, understands their contributions towards the bigger picture objectives of the company, and remains accountable to deliver on results on a quarterly basis. Establishing a company-wide OKRs tracking sheet can be a central place that anyone in the company can look at to stay in the know, ask clarifications, and contribute ideas. "With everyone operating off the same list of goals as everyone else, everyone can learn from everyone else, and that levels the playing field in astonishing ways, says one CEO.

Set incentives that work for your team

Part of building internal processes is to create adequate incentive schemes that motivate employees to meet and even exceed expectations. These incentive schemes should go beyond staff to include the broader sales and distribution team like agents and contractors. When financial resources are scarce, other motivating factors can include titles, vacation time, team retreats, other perks, or even stakes in the company.

Additional resources

- Intro to roadmaps
- Step by step elements of a roadmap
- Roadmap guide via an example
- Mind the Product's product roadmap resources
- Experiments template
- Product experiments worksheet
- How to make OKRS actually work at your startup
- How to implement OKRs as your startup
- MeasureWhatMatters
- Compensation strategies for cash-strapped startups

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Fundraising Risk

What is fundraising risk?

Many startup founders we meet say fundraising is the most painful part of leading a startup. They would rather be focused on their customers and their products, and not courting potential investors and funders. That said, when a startup needs funds, it is often urgent, so it is important that founders start building relationships with the right investors early - even when they're not raising. Otherwise, founders can waste a lot of time and energy chasing investment precisely when the business most needs their attention. In understanding fundraising risk, there are various levels to consider, from the leader's level of preparation to that of the business.

To be successful at fundraising, founders/CEOs need to have a complete and detailed understanding of their business. Leaders that are not conversant in the ins-and-outs of their business, especially the financial side, are unlikely to capture an investor's attention. This can happen when a CEO is overly focused on one side of the business and neglects another, or when the team is poorly integrated across various verticals. More commonly, this happens when startups lack the data and systems to substantiate their business. Startups are often moving so fast that they don't take the time to establish robust systems and may struggle to access data points reliably. For example, the distinction between active users and registered users is often an obstacle for early-stage startup founders. This kind of gap in information can be extremely detrimental when courting investors.

With this detailed knowledge in hand, leaders need to work on developing and telling the story of their startup. It takes skill and practice to craft the story or pitch in a way that communicates passion as well as intelligence, market understanding and toughness. Many investors tell us that they can judge a startup within minutes of meeting the founders. In fact, this is the basis for startup pitch competitions, which are popular all over the world. To get to this level of storytelling prowess, founders need to practice telling and refining their story, and should consider their fundraising potential a significant risk without such practice.

Finally, startup founders also need to invest energy building their networks and relationships throughout the startup and investor worlds. Often, the personal background of the founder can be a defining characteristic of this network, often to the exclusion of minority, local, or women founders. Nevertheless, founders tell us that the best time to meet investors is when you are not fundraising. This may mean taking time away from the business even when fundraising is not an urgent priority. Without building and cultivating such a network, fundraising risk will also be considered high.

Key factors of fundraising risk

- Data room development
- Density of investor network in region and sector
- Personal networks of founders
- Public speaking abilities of founder
- Refined story and pitch
- Access to pitch competitions and practice
- Integration in a startup community and hub
- Access to acceleration opportunities
- Access to innovation hubs

Mitigation strategies

*This primarily applies to pre-seed startups and first time founders.

Understand your fundraising landscape

Just as founders invest time engaging in desktop research and stakeholder interviews to understand their customers, they need to also map out the universe of investors to identify which ones have a mandate that matches their business. Most funds, and even angels, have specific mandates around sector, stage, geography, impact, technology used, customer served, current revenue run rate, type of revenue earned (recurring or one-off), and more. By comprehensively mapping the relevant investors, founders can approach them systematically and understand how to focus each conversation to appear relevant and tailored.

Mapping also allows founders to identify avenues for warm connections from within their networks who might have experience with these investors either as a co-investor, an investee, an LP, or a partner. These connections will not only serve to build trust with the investor but also share valuable initial feedback as to the founder's fit for that investor's mandate.

Ensure clarity of vision, immediate action and key risks

Building a pitch isn't just about a strong customer journey story or punchy, well designed slides; these are increasingly becoming normal practice. What sets great pitches apart from average ones is providing clarity in:

- illustrating the market gap (including evidence to validate)
- how the team will approach filling that gap (with the evidence the team has the capability, experience, resources and networks to do so), and a picture of how the world (or the ecosystem of directly-relevant stakeholders) could change as a result of success.

Beyond this vision, founders also need to clearly articulate how funding will be used to accelerate growth by explaining how their immediate actions (with the cost of each tactics and strategies) will allow them to achieve the next milestones. Having a good set of clear, strategic milestones is key as they are your startup's launchpad to the next round of funding. Furthermore, a developed fundraising landscape analysis (as noted above) can help founders communicate how these milestones fit the criteria of specific investors who have been targeted for the startup's round.

Create a Series A data room for your Pre-seed fundraise

Detail and structure is everything when it comes to building a startup's investor data room! Even in early days, a startup should build and maintain financial statements with the same level of professionalism they would expect from themselves at their Series A raise.

Founders should ensure to comprehensively include all material contracts, registration and licensing documents, technical documents, marketing materials, partner pipeline, competitive research, team CVs, and other items in their data room; having them consistently formatted and labelled isa plus.

Why start so early? First, it is much easier to build these habits in your team's way of working from day one, and to begin building the systems needed to generate this level of documentation when complexity is still low. Once the business has grown and the number of transactions has skyrocketed, implementing such systems will be difficult. Second, having such systems demonstrates that your team has a firm grasp of the details of your business. Third, such systems leave less room for extrapolation and estimation work on the investor's end as information is readily available.

Engage early, regularly, genuinely

Just as relationships aren't built overnight, funding rounds aren't closed in a week. If founders are on mandate and impressive, many investors will be glad to begin engaging in exploratory conversations months or even a year before you intend to begin fundraising. Founders should establish early on how regularly the investor would prefer to discuss their startup and be genuinely direct in these conversations.

These conversations are a great opportunity to gather feedback, given investors' experience in the sector, and their networks. For example, founders would be wise to understand who investors turn to for additional insight and data. These could be advisors, venture partners, and LPs, but will also include founders of portfolio companies (past and present) who have relevant experience in the startup's space.

Make the ask

If the relationship is going well and founders feel that there is strong alignment on mandate, approach, and vision between the startup and the investor, it is smart to be explicit and make the ask. Don't be afraid to say: "We're planning to begin fundraising in three months and would love to have you on board".

Dedicate time

Founders need to drive business growth but they are also responsible for fundraising. Whether the team is actively fundraising or whether founders are just laying groundwork, founders must dedicate regular time to fundraising and commit a portion of each day towards this process, especially in the final two to three months of the process. There are many tasks a startup's leaders can delegate to the rest of the team but fundraising is one that needs to be led by the founders.

Roll with the punches

Founders need to be prepared to take rejections (a lot of them) and as with martial arts, it's all about how you fall.

The best response to these rejections is to take the time to understand why the investor was not a fit, and to ask for direct and honest feedback. Next, they could ask for referrals to other investors or advisors who could help bolster areas of weakness the investor identified. Most importantly, founders should never take it personally.

Resources

- Investment readiness check
- What to include in investor data room (list)
- Y Combinator's Series A program
- More investment readiness advice
- Pitch deck template

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Market Risk

What is market risk?

While many risk factors are internal to a startup, market risk is about the environment and context in which a startup is situated. In some cases, the fate of a startup is determined not by the business, but the regulatory and competitive circumstances that surround it. A well-functioning business and team with a good product may ultimately fail because of a competitor, a change in technology, or shift in regulation. While it is hard to control for big macroeconomic shifts, startups can at least focus on monitoring regulation and competition.

In terms of regulation, fintech startups often find themselves in grey areas, either between authoritative bodies or decrees, or else in sandboxes, designed precisely to take advantage of such grey areas. Even when fintech startups are clearly regulated, the space is particularly dynamic so startups need to stay attuned to regulatory trends and dynamics. Authorities may take action unexpectedly, especially as digital providers and financial technologies grow in reach and influence, so startups can expect that regulators will move toward greater oversight in the near term. After all, financial services are among the most regulated sectors in the economy so startups should be prepared for stringent reporting and compliance requirements as fintech grows in size.

Beyond regulation, another key area of market risk is competition, both from existing players and from new ones. For example, a large player entering from an adjacent market could completely transform the landscape for a startup. Similarly, among competitors of equals, if one partners with a dominant distributor or receives a large investment, prospects for your startup could be significantly dim. This risk is particularly acute in smaller emerging markets that larger players from other markets might see as easy pickings.

Other areas of market risk are more difficult to anticipate. They could include advances in technology or shifts in device availability or changes in consumer preferences, or bigger macroeconomic or geopolitical shifts,each of which could alter the face of the market in unexpected ways. While these changes are difficult to anticipate, they may be determining for startups, yet there is little control a startup could have on them.

Key factors of market risk

- Degree of competition
- Regulatory concern about your product space
- Supervisory attention
- Strong regional players
- New market entrants

Mitigation strategies

Since market risk is not internal to a startup, the best a team can do is to stay on top of the various dynamics that determine these risks. A few practices and routines can help your organization keep track of these risks and to mitigate them where possible.

Landscape analysis

The first is to regularly update a competitive analysis of the landscape that allows you to quickly understand the options your customers see, and how your services compare among them. To build a competitive landscape, a first step is to understand the comprehensive list of your competitors, including how your current (and potential) customers view those competitors. Next, you should list the advantages and disadvantages of your competitors' offerings relative to your own. Finally, you can use this analysis to fortify the strengths of your offer. These three steps involve research, analysis, as well as strategy, and will present a comprehensive picture of your position in the market. Not only will this picture allow you to play to (and further develop) your strengths and is a powerful addition to your pitch deck.

Regulatory risk assessments

The second practice for mitigating market risk is to regularly conduct regulatory and supervisory assessments. This means keeping tabs on where regulators are turning their attention and how their attitude toward fintech is evolving. For example, particular areas that authorities seem to be pursuing today include consumer protection, data protection, and KYC (know your customer) procedures. Fintech startups around the world would do well to keep these issues top of mind as they develop their products, especially the backend.

Resources

- Mapping your competitive position
- Market mapping and landscape analysis (for NGOs)
- How to conduct and prepare a competitive analysis (includes templates and exhaustive list of questions)
- Handbook on Consumer Protection for Inclusive Fintech
- Survey of financial authorities
- Complex Regulatory Landscape for FinTech
- Global Fintech Regulation and Supervision Practices
- From FinTech to BigTech: an evolving regulatory response
- FinTech and RegTech in a Nutshell, and the Future in a Sandbox

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Team Risk

What is team risk?

Given that early-stage startups have such small teams, the nature of the startup leaders,the dynamic between them, and how they build a team around them, can be a determining factor in their success. Moreover, the charisma, control, and abilities of the founders of a company are a clear determining factor when it comes to securing funding, as many investors say they bet on the founders, not the business (as the business models of early-stage startups tend to evolve quite quickly).

Skill sets and leadership abilities

The first risk is that leaders do not have the requisite skills or abilities to run and grow a startup. Given the dynamic, unpredictable nature of startup life, founders need to be able to roll with punches and be flexible as conditions evolve, even as they stay true to their vision and passion. In these small teams, founders must wear multiple hats, be able to move seamlessly between running the show and getting into the weeds to fill in wherever there is a need, and must be able to lead and inspire a fast-growing and dynamic team.

Temperamentally, a startup founder also needs to be able to rally a team. They need to be able to motivate the group and create buy-in for a vision that may be intensely personal to their own experience and may be difficult to articulate, especially for the most pioneering models. Turnover within a small team can be incredibly disruptive, so creating a positive environment and instilling commitment to the business is critical to successfully leading a team.

Some of these skills and abilities can be assumed if the founder has started a company previously, or if he/she has been trained at particular schools or companies that are known for instilling such skills. These indicators are good proxies for such abilities but are not a guarantee the founder is up to the challenge. Moreover, such assumptions can often lead to discrimination against local, young, or women founders who may not have equal access to such work or education opportunities.

Teamwork and communication

Beyond the founder, an additional team risk has to do with the interpersonal relationships between team members, especially between founders (if there are two or more). A strong leadership team means that there is open, healthy conversation between the members that is grounded in respect for and balance between each other's skills. Either too much disagreement or none at all suggests that ideas and decisions may not be getting considered deeply enough.

The same goes for team members across departments. If different teams work in silos, don't communicate with one another, or feel an unhealthy sense of competition this can lead to lack of productivity and, often, turnover. For instance, there should always be a communication channel and feedback loop

between customer service and sales teams who interact with customers on a daily basis, and the founders, product managers and tech teams who should consistently incorporate feedback coming from customers into their strategies.

A good dynamic between founders and other team leads can serve as a good foundation for ensuring strong interpersonal relationships between team members and an overall good company culture. Teams need to have adequate room to discuss and voice opinions, without damaging the feeling of trust and loyalty between its members. This means investing in team building as well as finding the appropriate balance between friendliness and collegiality. Startup cultures are created first and foremost by the startup founders, so it's important to spend time defining a set of values the company will live by and defining internal processes and team activities accordingly.

As well, consistent and clear communication, and a sense of transparency coming from leadership can go a long way toward building internal trust and camaraderie among members of the team. Even junior members should feel they have a voice and an understanding of how the company is doing and where it's headed.

Key factors of team risk

- Teamwork
- Consistent communication
- Leadership skills
- Previous startup experience
- Positive culture
- Clear values
- Skill level
- Balanced skill sets

Mitigation strategies

Upskill the leadership

The first mitigation strategy is to ensure startup leaders are adequately skilled and have the right attitude, either by nature, or acquired via training or mentorship. There are a number of training, incubation, and bootcamp opportunities for founders to develop their abilities as well as their perspectives on how to lead. Similarly, some masters programs are known for their ability to help entrepreneurs build skills and better lead a startup. Utilizing such resources or joining such programs to build the leaders' skills can be a good strategy for avoiding problems with leadership approaches. Startup founders can also benefit from setting up a Board of Directors or Advisors that can guide them as they build their team, or even investing time in having a personal leadership coach.

Set your HR policies early

Startups often worry about the HR and management challenges of building a team too late. There is established human resource and team-building literature on how to build teams and create loyalty between the members early in a company journey, and the pay-off is greater than the upfront time investment. There should be clear, established HR policies from very early on, especially when it comes to onboarding, promotions, performance improvement plans, bonuses, and other areas of management that may become areas of competition and discontent between team members. These policies should be as consistent as possible for all employees to ensure fairness and transparency in decision-making. This should also include measures and channels for feedback and complaints that allow team members to report discomfort and problems without having to approach their direct manager, to protect them from repercussions.

Define areas of responsibility to create a culture of accountability

Another mitigation strategy to ensure that teams work well together is to build a clear, well-structured organigram in which each member (and particularly each founder) has clear tasks and areas of responsibility. When responsibilities and skill sets are overlapping, it can be a recipe for discontent and disagreement, and lack of accountability for shortcomings. Building accountability and motivating team members to deliver is extremely important to mitigate execution risks as well.

Create a well-defined internal communications strategy

Especially in the early days, the team should hear from leadership often and should feel comfortable approaching them with challenges or feedback. Setting up a regular town hall, internal newsletter, all hands meeting, or other form of company-wide communications platform can keep everyone feeling included, informed and part of a cohesive team.

Resources

- What makes a successful startup team
- Y Combinator's Startup School
- Startup Course
- Foundr
- Founder Institute
- Startup Leadership Program
- Build a team that won't sink
- How to build a company culture
- Onboarding new hires - a Practical Starter Guide
- Set up a strong internal communications strategy
- Employee Engagement Surveys
- Performance management
- Hiring best practices
- Startup employee stock options

Tech risk

What is tech risk?

Fintech startups are powered by tech, but that tech can either be a source of strength or a weakness. When the tech is built according to best practice and makes efficient use of other platforms, then it can provide a foundation for achieving product market fit and beyond. However, tech can also be a hamstring for startups if it does not allow for quick iterations or integrations.

A common situation (in maybe 1 out of every 5 startups we meet) is a distinct **lack of tech**. This can take place when none of the co-founders has a technological background. In these instances, the startup has been built on Excel sheets and relies on manual operations for data entry and analysis. Spreadsheets are great solutions, and they can take you farther than you think, but startups can outgrow them fairly quickly. They are ideal for early days, when the team is still validating the problem. However, once the team has a working solution, it will struggle to scale without upgrading the tech.

Lack of tech can also be the diagnosis if a startup's tech stack has largely been bought from software vendors or if the startup is using someone else's platform. In these instances, the tech solution tends to be very rigid, and is not customizable. Most often, the data is also inaccessible. Furthermore, such solutions have very low defensibility since the architecture isn't owned by the startup and can be sold to other providers.

On the other side of the spectrum, are startups that "**do it all**", meaning that the team develops code for everything and bypasses established tools like Hubspot (for customer relationships management) or Metabase (for dashboards). This means they will not have tech resources to develop solutions to users' problems or create valuable intellectual property for the startup. In many instances, such startups code more solutions than are needed, putting the tech before users' needs. As a result, they end up with a solution saturated with tech -- USSD, SMS, mobile apps, web app, and a Whatsapp bot all at once. The result is a constellation of solutions and channels without even knowing how the tech is being used.

In the middle of the spectrum are startups with **low quality tech** when the engineers do not know how to develop software according best practice using advanced tools, storage solutions, data privacy standards, and dashboards. High-quality tech teams should maintain clear documentation, version control, and avoid duplication.

In contrast to low quality, another tech risk is **over architecting** or trying to make use of advanced technologies before there is a real need. We understand this strategy is considered an investment for the future, intended to position the startup for scale, but in early days, simpler solutions that are easier to adopt and adjust will allow for greater speed towards product-market-fit. For example, we have recently been seeing more startups make use of NoSQL databases like MongoDB or Firebase, which give the tech team good flexibility for designing data schemes and also allows for extensive storage. This solution makes sense when your business requires massive amounts of data, but for early-stage startups, this type of database makes data difficult to access and extract. Startups often fall prey to this risk when startups are overly seduced by **hyped technologies and buzz words** like AI/ML or using an .ai domain.

Key factors of tech risk

- Database type
- Control over solution
- Extent of customization
- Hosting solution (PaaS vs IaaS)
- Approach to data analytics
- Solution ownership (proprietary vs. outsourced)
- Defensibility of solution v competitors
- Scalability of solution

Mitigation strategies

Depending on the diagnosis that best describes your startup's current status, you should adopt mitigation strategies that set your organization up for scale and success.

Still get the most out of excel sheets with off-the-shelf solutions

For example, if your startup relies heavily on spreadsheets and manual entry data, platforms like using AppSheets (as did Catalyst Fund portfolio company Spoon) or Glide can allow you to get the most out of them by creating custom apps on top of sheets. These apps could be used for internal teams, field teams, or agent networks as well as other stakeholders. These types of custom apps can also be connected to other platforms like accounting systems, customer relationship manager programs, payment gateways, and more via Zapier (see this example with Paygo Energy).

It will be important to consider the pricing models of these platforms to project future costs as your team and transactions growth. These solutions will allow you to grow your business to the next step, but costs may also go up. In this case, it is important to understand when it is right to invest in larger and more complex architectures.

One caveat is that these apps are not ideal for customer-facing interactions, particularly if your users are not very digitally savvy. To integrate digital methods into customer interactions, your team will need to consider the balance between tech and touch.

Build vs Buy

When considering the balance between what to build and what to buy, there isn't a straightforward approach. Some of the factors to consider in making the decision is (summarized from here):

	Build	Buy
Value proposition	Is the element core to your value proposition?	Is the element core to your value proposition?
Budget	Does your team have the requisite time and skill?	What is the cost of purchasing, especially as the business grows?
Timing	Do you have enough time to for team to build a solution?	How valuable is it to get the solution quickly?
ROI	Could you monetize the solution in some way to increase the ROI?	Could you invest the time and resources in a better way to improve returns?
Data integrity	Could you maintain better control and quality of data with a custom solution?	Would a bought solution be as helpful in maintaining data accessibility?
Integration	How extensively does the solution need to integrate with other, custom parts of your system?	Would off-the-shelf solutions easily integrate with your existing solution.
Level of control	Would a custom solution help you to access and analyze better?	Would a bought solution be as helpful in maintaining data accessibility and analysis?
Support	Is support for future customizations easily available?	Could an external contractor provide superior support for future needs?

Have a hiring strategy to form your tech team

If your business requires a considerable level of scalability, and there is a gap on the technical knowledge normally because none of the co-founders come from a technological background, you would need to form a hiring strategy. You could either start with a talented junior engineer and grow and skill them up, or you can look for a more senior position or even a co-founder. Your strategy would depend on the funding allocation for this. In the internship, you can also use a freelancer service and contract them as needed. It's important that you think and define a plan for this strategy ahead of time, before it's too late on the journey.

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Implement software development best practices

It is important to establish an internal culture of excelling on your tech team so that they care about the quality of the software before it's too late. We have seen many tech teams that have had to re-build their entire platform from scratch because they were more concerned about speed than quality during the early days. Implementing some key best practices can help you avoid this fate; they include:

- Have a member of the team responsible for quality assurance (QA). This could also be a rotational role.
- Have well-defined dev environments for development, testing, production, etc.
- Have a CI/CD (continuous integration/continuous development) processes and tools to be able to run tests and deploy new versions smoothly
- Implements code reviews and pair programming so that team members can support each other
- Develop unit test as well as integration testing
- Plan for the release of new app updates that includes a group of beta testers so you can gather early feedback and catch software bugs
- Test your app against a massive collection of physical devices using services like AWS Device Farm
- Monitor important technical metrics such as app crashes, server downtime, etc. and make your tech team accountable for these metrics

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Scalable architecture design

Although startups start small, they need to build their tech architecture with scale in mind, upgrading on a just in time basis by anticipating business growth. One critical method for anticipating upgrades is to track service speed and to figure out what is slowing it down. The solution, described in depth here, probably includes:

- Horizontal Scaling
- Caching
- Duplication

- Create subsets
- Splitting functionality
- A combination of the above

This design mindset is needed when your application is hosted in a Infrastructure as a Service (IaaS) platform, meaning you ned to run load and performance testing to understand your systems breaking points and benchmark system performance.Alternatively, you can make use of a Platform as a Service (PaaS) that would "allow you to develop, run, and manage applications without the complexity of building and maintaining the infrastructure typically associated with developing and launching an app".

Additional resources

Google for startups

- Data insight tools
- Tools to build a product