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Speed, Power and Flow: Use Surf Criteria to Rate Start-ups

A novel method to predict start-up success.

In the start-up world, traditional formulas for calculating financial value often fail investors. Several classic models, such as discounted cash flow, multiples, the sum of parts or net asset value, could hardly anticipate that Amazon's strategy of burning capital for years would yield so much value. Indeed, could such conventional models justify WhatsApp's purchase price of more than US$19 billion? Could they have foreseen the lack of value behind WeWork? The answer is no.

To measure the value of a company, traditional valuation models look at certain variables, which tend to be quite objective and concrete, such as traditional assets or at least some mature state of revenues or cash flow. They use discounted present data to forecast future value, or extrapolate it based on one or two facets of an organisation. While some models are more complex than others, most of them rely heavily on assumptions and some level of acceptable and shared semi-rational delusion regarding what value truly means.

However, start-ups are in a different world. Not the world that is, but rather in a world that may be. Valuing them sometimes seems more an exercise in imagination or gambling. Some investors can claim to be prescient. Most others – angels, venture capitalists, private equity firms, corporations or institutional investors – have crashed and failed too many times to assert confidently that their successes boil down to anything other than luck.

With so much uncertainty, we may be better off just leaving all this valuation nonsense behind and go to the beach. As we watch competitive surfers tumble and roll under the water, a realisation comes to mind: Judging a surf competition and assessing start-ups have a lot in common. Beyond the difficulty or innovativeness of a surfer's manoeuvres, judges look at a triad of elements when scoring waves: speed, power and flow.

The surfing analogy

How does surf relate to start-ups? In our analogy, the speed-power-flow criteria of surfing competitions can help us evaluate three fundamental dimensions of start-up competitiveness and success.

Flow

Flow relates to the start-up's ability to reduce customer pain or friction, i.e. address a market imperfection or an unmet need. In other words, flow relates to how well the start-up business model can generate or improve customers' lives. Is it proposing a solution that will bring superior benefit to consumers? Will it increase their flow? Is that flow important for customers and are they willing to pay for it?

Flow can thus be classified and valued based on the size and frequency of the pain it addresses, as well as how well it diminishes or extinguishes it altogether. In measuring such pain, we need to look at the size of the market and the frequency at which the start-up product or service will be sought. In sum, the goal is to measure how much flow or value potential a start-up is likely to generate.

Some examples of start-ups that immediately had great flow are Amazon and Uber. They may have begun with small-value transactions, but they did so in ways that reduced friction and simplified customer's lives. Soon they serviced huge markets with frequent transactions.

Speed

Speed measures the execution and operational quality of the entrepreneurs as they attempt to convert their flow into a profitable and sustainable reality. Speed is not about rushing to acquire market share or even revenues, because this motivation could lead to teams cutting corners, window dressing and other non-sustainable or even value-destroying ways to reach visible KPIs.

In other words, speed refers to a team's ability to create sustainable value and transform the company into a going concern. It is not about creating a growth story, but a well-structured company that can continuously deliver superior value as it grows.

Signalling the sustainability and resilience of the start-up, speed can be measured by how well the team:

- Delivers on and leverages its flow
- Learns and adjusts to changes in flow, or even creates new flows
- Overcomes bumps in the road and continues to deliver.

When WhatsApp was founded in 2009, despite its small team and several failed versions, it was able to develop a messaging solution that outcompeted larger and more established competitors. Several companies were pursuing the same great flow of mobile messaging, but WhatsApp had the superior speed to deliver on it to the point that Facebook gave up competing and paid US$19.3 billion to acquire it.

Power

Power relates to the start-up's capacity to differentiate itself, conquer and maintain a dominant, sustainable and profitable market position over time. Many start-ups believe that a first-mover advantage, or a large war chest, will give them power. However, the example of WhatsApp shows that having more money, as its competitors had, is no guarantee of success or power.

Similarly, Uber's great flow and first-mover advantage have not given it power over Lyft in the United States, Grab in Southeast Asia, or other ride sharing firms now springing up around the world. Power relates more to market dominance, innovation, competitive advantages and other ways a start-up can reduce the threat of losing its market position to copycats.

Many start-ups have fantastic ideas and flow, they may even put a good team together and develop great speed, but ultimately fail to build a business that also has great power. In the internet era, power is key as challengers may enjoy an abundance of venture capital and quality entrepreneurs, which, together with the ease of setting up a new online business, can easily disrupt an industry.

Amazon has its share of copycats that mimic its e-commerce platform features, namely Alibaba, Lazada, Zalando, etc. However, in the US, Amazon developed at great cost an extremely efficient, speedy and reliable distribution network that other online or brick-and-mortar stores struggle to copy. Amazon has become so powerful that some blame it, even if unreasonably so, for the American "**retail apocalypse**". That power is likely to increase if its IoT adoption continues to grow and create an even more convenient and protected channel to reach its customers.

Quality, not quantity

The speed-power-flow triad provides a quick, yet reliable way to assess the go/no-go value of a start-up, as well as more comprehensive valuation of its potential. It amalgamates the wisdom of several frameworks to measure start-up value, using three simple variables. It sees beyond the overreliance on existing assets and allows our imagination to capture more accurately a likely future that goes beyond a projection of what exists today.

Investors do not have infinite resources or risk tolerance to invest in any or all start-ups. They have to spot, accurately and correctly, the best quality start-ups within each wave. Similarly, competitive surfers have to choose their waves wisely within their limited allotted time. They do not win championships based on the quantity of waves they catch but rather on their quality measured by a wave's potential to help the surfer generate maximum speed, power and flow over those surfed by their competitors. Investors can also profit from the speed-power-flow framework to select and invest their assets in quality start-ups with a high probability of success.

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