Startup Studio

An emerging Asset Class

mamazen

About Mamazen

Mamazen is a digital-focused Startup Studio that was created in Turin in March 2017 out of an idea of Farhad Alessandro Mohammadi. While Startup Studios are an established model in other countries, there are still very few Venture Builders in Italy to date.

In 2018, Mamazen developed a model for generating and validating ideas capable of improving and optimizing startup creation and launch processes.

The ultimate goal is to increase startups' success rate, making their business sustainable and capable of having a long-term positive impact.

Authors

Farhad Alessandro Mohammadi
CEO of Mamazen

Manuela Maiocco
Business Analyst at Mamazen

Editors

Mamazen
Studiohub

Contributors

Paolo Giolito
Senior Wealth Manager,
VP Italian Association Blockchain,
Business Angel

Barbara Avalle
COO at Doorway - Angel Investor

Melissa Sesana Grajales
Family Officer

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Investments in alternative assets

In 2021 there was a significant change in the allocation of assets within a portfolio. Investors and family offices were forced to adapt to markets where interest rates are almost zeroed or even negative, and returns from fixed-rate investments are expected to remain relatively low for some time.

According to the Global Family Office Report 2021, over the last few years portfolios have diversified their investments in various asset classes, including alternative investments: about one-third of portfolios (32%) have been allocated to equity, one-fifth (18%) to fixed-rate assets, another 18% to private equity, and 13% to real estate. 10% of portfolios has been invested in cash, and 6% in hedge funds; the remainder has been allocated to gold, precious metals, commodities, art and antiques.

Overall, **40% of portfolio investments are in alternative asset classes**, and more than half of family offices (51%) have stated they are looking for possible alternative diversifiers in such areas as hedge funds and private equity.

The change will be gradual; investors expect to reduce investments in fixed-rate assets in both developed and developing markets.

Fig.1: *Types of alternative investments*

As shown in Fig.2, according to SVB Capital the number of VC deals made by family offices has grown steadily over the past decade with a significant increase in 2021. At the same time, **an increase of 18% to 20% is expected in private equity and venture capital allocations**, which will mainly involve direct investments.

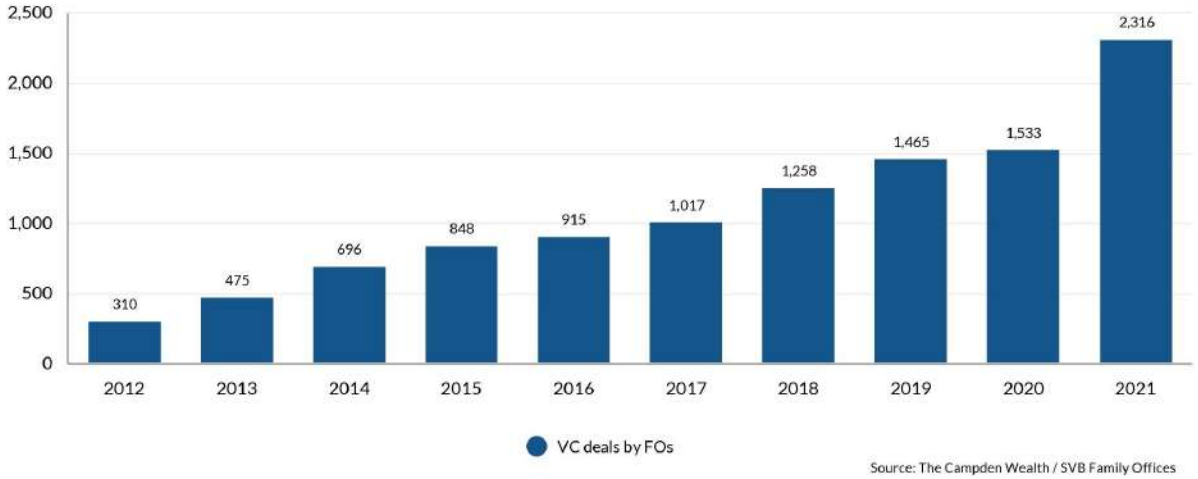

Fig. 2: *Number of venture deals with FO participation globally*

A Venture Capital Fund usually engages in that part of a startup's life cycle that begins with the pre-seed stage until the Series B round (and beyond), characterized by a progressive decrease in risk, and therefore also in returns, as phases follow one another.

However, **VCs do not cover the stage of a business's life cycle from the very beginning until the first pre-seed round**.

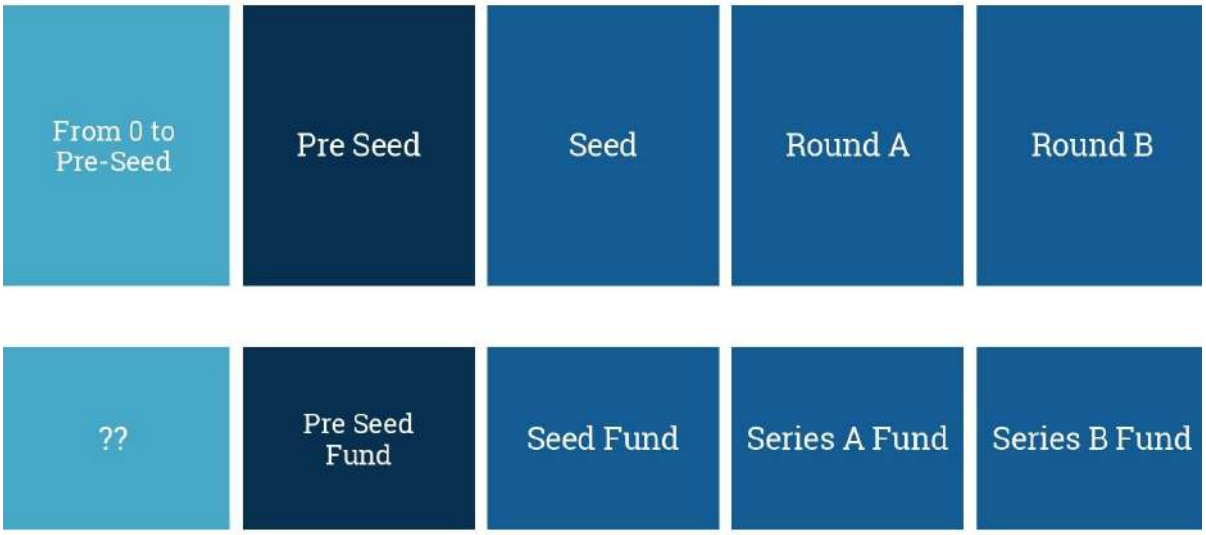

Fig. 3: *VC investment stages*

This is because newly-created startups still have to develop a good track record to demonstrate they are sound. Given the lack of historical data, the investment in an embryonic startup is directly connected with the idea and the project that the founders want to realize; The decision to invest is not based on economic and rational elements, as traditionally required, but rather, inevitably, on a subjective assessment of the team and project presented.
It is easy to understand that the **0 to the pre-seed stage** of a startup's life cycle is characterized by **high risk** and **high returns** for investors. In the first months, the startup's future is still uncertain and difficult to predict, the idea is still at an embryonic level and target customers and business models are still to be accurately defined and validated.

Precisely because results are unpredictable and depend on complex elements, this type of investment is a risky business, a sporadic event, or a gut-driven investor decision. It is not a matter of lack of interest or unwillingness or expected returns; **no tools** capable of turning investments at this stage into a **structured process** with **predictable and measurable results are available** for investors.

Investors must devote time and/or resources to analyzing a sufficiently large number of companies to identify countless companies, instead of just one, in which to invest. Therefore, for each company it would be necessary to analyze, among other things, the product, the market, the revenue generation model, and the validity of the assumptions on which growth expectations are based. These considerations are left in charge of funds for those companies already in the seed round, but this is not possible for early-stage (0 to seed) startups. Thoroughly analyzing a large number of startups would take too long.

However, the development of **Startup Studios** has brought about a **significant change in the investment landscape**.
Thanks to their structure and process, as shown in Fig. 4, **Startup Studios allows investors to make a structured investment in early-stage (from 0 to pre-seed) startup companies.**

Fig.4: *Startup Studios allows to make structured investments from 0 to pre-seed stage*

Startup Studios are a startup creation model designed to measure and **mitigate** a startup's typical **risks of failure**. A process that has always been characterized by unpredictability becomes **standardized** and **repeatable**, thus giving rise to a portfolio of companies whose expected return on capital is higher than that offered by a portfolio of "traditional" startups, with the investment stage being the same.

"I got to know the Startup Studio model abroad, and I believe that considering it for projects in Italy is crucial. Combining the typical approach of a Venture Capital fund with the interaction with the "factory" of the idea that will be developed generates investment opportunities that follow a very structured process informed by risk control and profitability parameters".

(Paolo Giolito - Senior Wealth Manager,
VP Italian Blockchain Association, Business Angel)

"Disruptive investment strategies and models are hard to come by and it is even more rare to be an early investor in an asset class or strategy before they are overcrowded; if venture capital is an important part of your existing portfolio, then venture studios deserve serious consideration."

(Douglas Beyer - Managing Director at Radianx Capital)

The main reasons for a startup's failure

Those who decide to invest in startups are aware that their investment is very risky: it has been estimated that 95% of startups fail within the first 4 years after being founded. The survey by CB Insight "Top reasons startup fails" has identified the 12 main reasons for a startup's failure. The most relevant ones are the followings:

- **Failure to raise new capital:** 38% of startups has declared they failed because they ran out of money; sales revenues were not enough to cover costs, and the startup company was unable to proceed with the subsequent round.
- **No validation**: the idea behind the startup was not validated in the market before the product was created and before raising the first round. According to the survey by CB Insight, 35% of startups fail precisely because instead of meeting a real market need, they simply offer a product that is just a nice-to-have for most people.
- **Untenable business model**: one of the most common reasons for a startup's failure is that the business model is not sound. Continuing with one single business channel with the result of generating insufficient revenues or failing to scale up represents one of the reasons for failure for 19% of surveyed companies.
- **Wrong team**: the management ability of team members is not objectively measurable at first glance. After a couple of meetings, investors cannot evaluate the team appropriately; in 14% of cases, it emerges too late that the team is not the right choice for the company.
- **Lack of harmony in the team**: the members of a startup's team have often never worked together and lack complementary skills. The inability to make decisions together and manage conflicts accounts for 7% of the reasons for a startup's failure.

- **Underestimation of legal and regulatory issues**: 10% of startups fail for having underestimated the legal and regulatory complexities arisen during the development of the initial idea or from a lack of long-term vision during negotiations.

The following paragraphs will describe and analyze the process through which a Studio succeeds in mitigating startup failure rates.

"One of the problems encountered by business angels in evaluating startups lies in the fact that startup's founders are in love with their idea but have failed to consider the market to understand whether or not their startup company is commercially attractive, whether or not the market recognizes the value of their idea, and whether or not someone would be willing to buy the product.
A Studio is never in love with the business idea to pursue it at all costs. The Startup Studio invests and creates the team when it has ensured a market need. It creates a team capable of developing that business idea, and it is not so much in love with the startup, so it does not fail to facilitate whatever is necessary to shorten exit times, which is a fundamental aspect for investors".

(Barbara Avalle - COO at Doorway, Angel Investor)

Startup Studios, a new model for creating startups

The title should not be misleading, the first Startup Studio was established in 1996, but it is only since 2015 that this model has started to develop on a large scale.
The term Startup Studio or Venture Builder refers to a structure designed to generate companies serially with a **standardized and repeatable process** aimed at **mitigating the risks of startup failure**.
With Startup Studios, **investing in startups in the 0 to pre-seed stage becomes a structured process**. As explained below, the typical risks of failure of an early-stage investment are mitigated and reduced.

When not in a Studio, a startup in the seed stage, according to data published by Crunchbase, has a failure rate of 86% and a cash-on-cash return of 1052%. In a Studio, for the same cash-on-cash return (that corresponds to the seed stage), the **failure rate** is that of a Series B round, namely **60%**.

Sure enough, according to research carried out by Crunchbase on a sample of 35,568 startups founded between 1990 and 2010, **the average success rate is 14%**.
Conversely, as emerging from data published by GSSN (Global Startup Studio Network) in 2020, considering a sample of 258 Studios out of a global population of 560, **the rate of success of startups founded by a Studio is equal to 40%**, i.e., almost 3 times that of traditional startups.

Traditional Startup	Seed Return: 10X	Success Rate: 14%
Startup created by Studios	Seed Return: 10X	Success Rate: 40%

Table 1: *Success rate and return compared*

The difference between a startup generated by a Studio and a traditional startup lies in the creation process. In a Studio, the first step involves the **analysis of market and investment trends** to elaborate a preliminary list of ideas.
The Studio makes an initial selection by applying several parameters, such as how easily the startup can be created, the time required for that, the necessary technology, and the adherence to the Studio's focus. All ideas that do not meet the required parameters are discarded. **Each selected idea is then analyzed and tested on the market** before releasing any prototype or MVP (Minimum Viable Product): an idea must always start from a problem, a real need.

The fundamental assumption is that **no solution is necessary when there is no need**, and therefore there is no point in creating a company. As a second step, it is necessary to investigate whether or not there are **target customers** and whether or not they are **aware of the problem** and actually **willing to buy the product**. Only those ideas that the market has warmly greeted are developed; conversely, **non-validated ideas are discarded** or set aside for a possible future "round" of evaluation (what does not make sense today may make sense tomorrow).

Once the validation process is completed, a founder is selected and an MVP is constructed. **The founder acquires shares in the startup** and equity is allocated partly to the Studio and partly to the founder; according to best practices, about 30% goes to the Studio and 70% to the founder(s). Moreover, **the Studio also provides the startup with its team and funding** form a related fund (if any), which intervenes in the first round of investment.

The process described above and the Studio's structure thus make it possible to create a portfolio of startups that, besides having a **lower-than-average failure rate**, are also characterised by a **0-to-Exit time that is nearly halved** compared to startup average (4.3 years *versus* 8 years). These results are possible thanks to a Studio's typical characteristics - as described in the following paragraphs - which significantly mitigate the above-mentioned main factors leading to startup failure.

“The fact that a Startup Studio can mitigate the risk is very attractive to an investor because the resulting portfolio is one in which the product-market fit has been thoroughly studied and the team has been carefully selected. Given these premises, companies are bound to succeed, in that all elements that may divert from success have been eliminated. In this model, we, as family offices, can invest in early-stage startups with mitigated risks”.

(Melissa Sesana Grajales, Family Officer)

Predicting and mitigating risk

Creating a startup within a Studio allows mitigation of the risk by acting on the main reasons a startup usually fails. When a structured process, a team of proven experience and a network of investors and advisers come into play, **a startup in the 0-to-pre-seed stage has a risk of failure comparable to that of a startup company raising the B round.**

Non-validated *vs* Validated Product

The process of creating a traditional startup often involves a phase aimed at raising the first round of investment, which is followed by the development of the product and its launch before testing the idea in the market.

The two processes are compared in the Fig. 5 below. In a Studio, **the analysis and validation of ideas is the first step** to creating a startup; the purpose is to identify the right product/service to be developed before developing it.

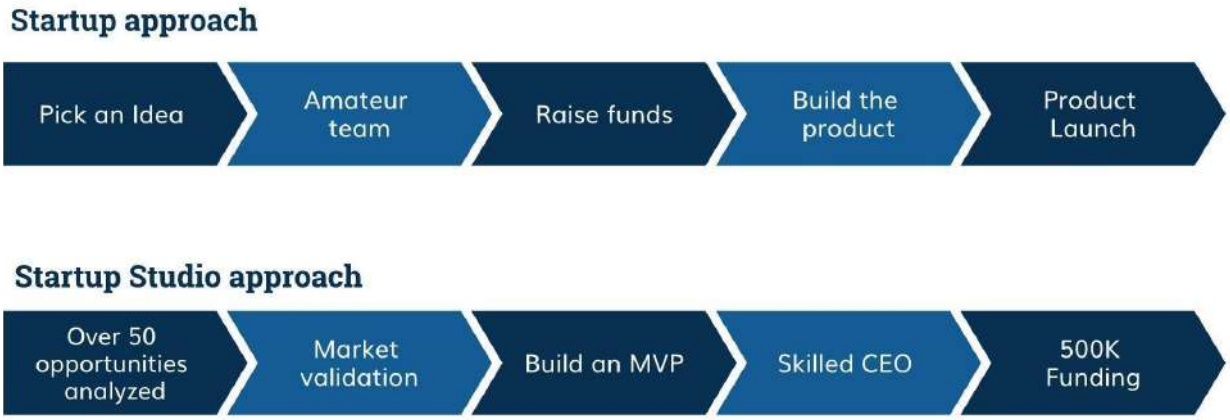

Fig.5: *Startup and Startup Studio approaches compared*

Validation is a systematic and planned process that involves the implementation of a number of techniques aimed at **collecting specific metrics for the development of an idea, product or service that does not exist yet**. Tests are performed and feedback is gathered from the target public without having to launch the final product on the market.

Thanks to this process, the idea is confronted with the real world, and it is thus validated or discarded through several tests whose main purpose is to **understand**

whether or not there is a market for that. If no sufficient feedback supports the idea, this is abandoned as soon as possible to minimize the time and money invested in the project.

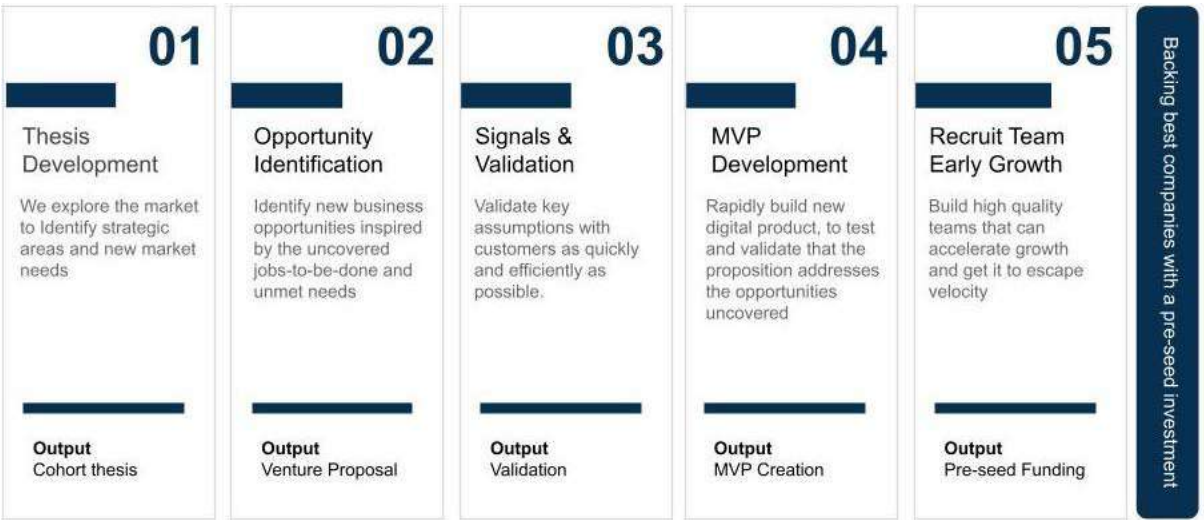

Fig.6: *Startup Studio process, from thesis development to pre-seed funding*

There are many **validation methods**, two of which are worth mentioning: the Mechanical Turk and the fake door, also known as the smoke test.

The **Mechanical Turk** is named after the Mechanical Turk automaton, a machine built to play chess in the late 1800s. The public was made to believe that the Turk was an automaton programmed to play chess, but inside the machine's cabinet there was a skilled player who moved and manipulated the automaton. The Mechanical Turk technique is the ideal solution for **replacing costly, complex or yet-to-be-developed technology with a human being** that can perform the same functions as those of our product/service *in lieu* of the technology to be tested. It is a low-cost solution that allows one to actually understand how many people would use the product and the main problems customers would encounter when confronted with the product. Therefore, the Mechanical Turk can be used to test future products that do not exist yet. Well-known case studies include an automated text dictation service, a calculator or a digital assistant behind which, when testing, a person performs work manually rather than using real technology.

Another validation method is the **Fake Door**. Based on this method, **it is possible to test an idea and collect data by showing users a functionality, product or**

service that is not available yet. A fake structure is developed (this can be a website, a brochure, a physical store, a landing page..) to make the product appear existent and working; metrics showing the interest of customers, such as mouse clicks, waiting lists, and orders, are collected and, based on such data, a decision is made to develop the product or abandon the idea.
For example, it is possible to purchase advertising space in a magazine to sponsor and sell a non-existent product. In truth, the product presented is still to be realized; it will be so only in the case that enough orders are placed otherwise the company will give the money back to paying customers and the product will not be created.
Another example of applying this technique is the development of multilevel video games: developing a game with multiple levels is time-consuming and requires much programming. Therefore, before developing a complete video game, some static screenshots are created and a short description is provided for each level. Players are encouraged to register for the game and leave their email address to receive a discount they can use when it is ready. It is thus possible to gather data on the level to be developed and the order in which it should be developed, according to the interest shown by players.

The Mechanic Turk and the Fake Door are just some techniques that may be used to validate a product. Other techniques include, for example, Pinocchio, Façade, One-Night Stand, Infiltrator (an example is available at this link) and Relabel, which are illustrated in The Right It, a book by Alberto Savoia (2019). These techniques represent useful tools by which it is possible to collect metrics and validate an idea without realizing the final product for each of them.

Non-professional team *vs* experienced team

As we have seen in the previous paragraphs, the most common reasons for startup failure include an inexperienced team, a lack of network, as well as the fact that people's skills are neither diverse nor complementary.
A well-balanced team is characterized by variedly skilled people, namely, people specializing in product, marketing, development and other activities. A group of

developers only is not helpful to the company's growth, whereas a team with diversified abilities gives better chances of success.

For this reason, the Studio devotes time and resources to search not only for a founder with the right experience and abilities but also for the first members of the startup's "dream team". A Studio's goal is to have a **heterogeneous team** with the **right mix of skills and experience**.

Amateur CEO *vs* experienced CEO

A startup is more likely to succeed when it is led by a founder with experience as an entrepreneur is familiar with the industry, and has a vertical network or a network of investors. In order to reduce the likelihood that a company will fail due to an inexperienced team, a Studio carefully selects the founders of its startups: the fundamental requirements to be a founder include **experience in competitive environments**, a track record of **experience as an entrepreneur** or **experience in the startup's industry**.

A founder who has already created a company of their own, who has made it grow and scale, is already aware of the mistakes that must be avoided; they know the industry very well and have their network built up during their previous experience. A good founder also has vision, is ambitious and tenacious.

Data show that most of the **founders selected by Studios are people aged 35-50**. The underlying rationale is to take all the background knowledge and experience gained in the previous company into the startup; this allows a founder to avoid the mistakes made in the past, and the startup will thus be more likely to succeed. As illustrated in Fig.7, the graph realized based on research carried out by Pierre Azoulay (2018) shows the relationship between the

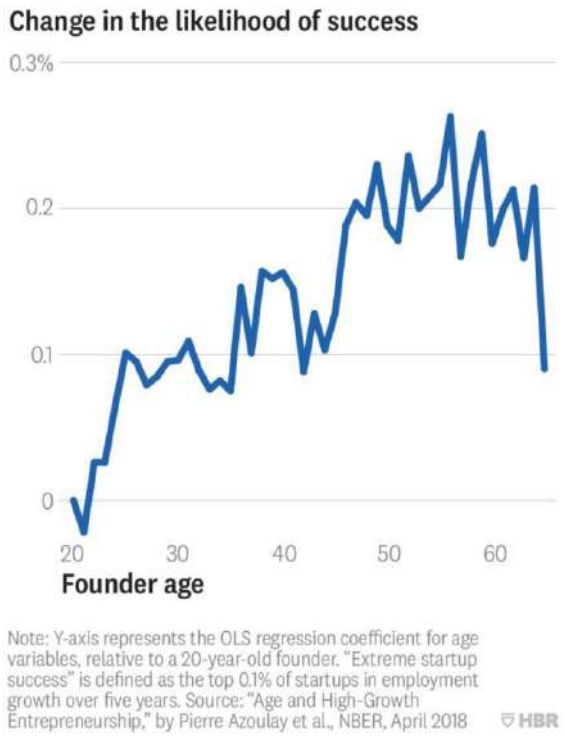

Fig.7: *Relationship between the founder'sage and the likelihood of success.*

founder's age and the company's likelihood of success. It emerges that a **startup company is more likely to succeed as the founder's age increases**, at least until 50. It also emerges that the likelihood of success is low when founders are around 20, then it increases considerably with founders aged until 30, and continues to rise with founders aged until 50. Therefore, Studios select the founders for their startups from amongst candidates in the age range in which the likelihood of success is higher.

First step: product creation *vs* MVP made after validation only

Investors are well aware that the deck prepared for them will surely include a slide showing that a percentage of the round raised will be allocated to the development of a platform/product. This happens because the product is usually constructed in traditional startups, thanks to the funds raised in the first round of financing, without any prior validation of the idea. Traditional startups test finished products directly on the market, so if the product fails to meet market expectations, it is too late to realize that the investment has been in vain.

The Studio model proposes an alternative scenario: the first step for developing an idea is to analyze and validate the idea itself. **An MVP is developed only when data unequivocally show that the product/service satisfies a real market need** and some customers have already shown an interest in buying the product.

Fundraising problems *vs* Efficient fundraising through a Fund or dedicated Holding

The validity of the idea and the founders' skills are not a 100% guarantee of success in the first round of financing, and there may be countless reasons for this: the selected team's network of investors is not large enough, or the team fails to correctly identify target investors, or fails to raise funds in time thus running out of cash.

Unlike traditional startups, startups created within a Studio are more likely to successfully raise the first round and do it more quickly - **the time to the seed round decreases from 36 to 10 months for startups in a Studio**. This is possible

thanks to the **presence of a Fund or dedicated Holding that invests in startups** as soon as they are ready and show good metrics. It is not only the time to reach the seed round but also the **time necessary for the next rounds decreases**.
A Studio typically relies on a network of investors and VC funds. A traditional startup will face a seed round, a Series A, Series B round and so on only once throughout its life cycle, whereas a **Studio will have to manage startups in that stage repeatedly**, which means that it is possible to realize **scale economies** and invest time and resources to build up a network of long-lasting relationships with Venture Capital funds, of which all startups in the Studio may take advantage.

Thanks to the processes mentioned above, a Studio can mitigate and reduce the risk of startup failure. On the one hand, founders have the chance to work alongside a Studio on a validated project, and on the other hand, investors in a Studio have access to a portfolio of startups characterized by a lower risk of failure.

"Including a Studio in a portfolio is interesting because investors are thus given a chance to invest in a phase of the startup's life cycle that requires a great capacity to evaluate pros and cons. Moreover, this type of investment already offers a diversified portfolio – the investment is not in one single project but rather in several projects – elaborated by experts who support the startup's team in developing the business idea, the revenue model, and the go-to-market strategy. There is also a higher exit multiple, namely, investing in a seed round with a lower value, with a reduced risk of failure and in shorter timeframes."

(Barbara Avalle - COO at Doorway, Angel Investor)

Background to a Studio's process

Interviews with some of the best Studios worldwide have revealed that these Studios have some characteristics in common. Such features are listed below by way of example because they may not include all factors that are crucial to the good performance of a Studio.

- **The Studio's team**: the critical element to a Studio's success is the team; not only must the team be capable of creating a company, they should also standardize and make the entire process repeatable. Creating a startup in a Studio is no longer an exceptional moment; instead, it becomes a defined and predictable process. The entrepreneurial experience of team members, the knowledge of the industry in which the Studio engages, and the network of people and investors that team members bring are essential to this process.
- **Validation process:** All Studios with high performance have a systematic and planned validation process in place. Each Studio develops its own method for validating ideas, but all methods consider market data and need validation before proceeding with the product's construction, and are characterized by orderliness and several predefined intermediate steps. It is only thanks to correct planning that the Studio can create startups systematically and at a regular pace.
- **Studio and Investors' interests aligned**: To ensure its interests are in line with its investors', the Studio recoups the investment only after having repaid investors; the Studio will thus tend to achieve an Exit with the highest possible value. However, suppose the Studio recoups its investment in the startup before its investors. In that case, it has no interest in increasing the value to be distributed since it has already recovered its investment.

  A Studio whose goals include achieving a positive EBITDA before its Portfolio Companies achieve an Exit does not have the right incentives to produce quality startups.

- **The Studio's focus**: the industrialization of business creation is a complex process. Startup Studios, especially those that have been active for a short time, do not have the expertise to do all activities (corporate venture building and classic venture building, consulting, accelerator programs, and other activities). To be successful, Startup Studios must focus on a type of process only, so as not to waste the team's energies and encourage the development of vertical skills. The best option is to choose the activity that gives the greatest return and offers greater long-term benefits with lower costs.
- **Portfolio focus:** some Studios have declared that the sector in which they operate is not relevant, which means that they are willing to build anything with a product-market fit and sound business model. However, data show that a Studio's approach is winning when the Studio focuses on a specific niche, which may be represented by a specific technology, a specific business model, a specific industry, or a specific market, as the case may be, and that a combination of different elements refines the focus and give even better results. The underlying rationale here is that being the best in a specific industry is better than struggling on all fronts and risking poor results. When a Studio focuses on a specific field, it can create a team of high-level experts in that field. Moreover, relying on such experts attracts potential founders who intend to join a Studio.
- **Equity split:** the majority of the stakes in the startups created in a Studio must be held by the founders for two fundamental reasons. The first is that a startup must be VC Ready - no VC would invest in a startup in which the team that has to take it to Exit does not hold a majority stake; the second reason is that the team must remain motivated. According to best practices, 30% of the equity should be allocated to the Studio and 70% to the founder(s).
- **Capitalization:** creating startups is costly. According to a report published by GSSN, the average annual budget is $2.3 million for an experienced Studio and $800,000 for an emerging Studio (Startup Studio Industry Report 2021, Studiohub). It should be taken into account that the Studio will have no returns for at least five years (the minimum time it takes for a new Studio to achieve the Exit for the startups it has created, without considering the learning curve).

This means that the Studio must be well-capitalized to sustain the costs for the generation of quality startups; stopping production periodically to focus on fundraising makes the process highly inefficient.

- **Caring for the Studio's image:** in a world dominated by content, it is essential to be able to answer all times questions such as "what is a Startup Studio", "what is the difference between Studios, accelerators and incubators", "how does it work" and so on. This contributes to the spread of the model and helps potential founders and investors understand how it works. The Studio is thus able to tell the stories of founders and how new startups are created and also describes its processes, success - and failure - stories. A good presence both online and offline is critical to building a network for creating successful startups.
- **Sound funding structure:** a Studio needs to rely on a sound funding structure. There are three main funding models for a Startup Studio: the Single Studio Model, the Startup Studio Fund, and the Dual Entity Model (cf. *Investing in a Startup Studio*, Mamazen, 2021).

  The Dual Entity Model has by now finally become a best practice because it is the model that best succeeds in aligning the interests of all parties, i.e., Studio's investors, Studio, startup's founders, and Startup Studio's founders . The following chapter deals specifically with the Dual Entity structure.

The Dual Entity Model

The model involves the **combination of a Venture Builder and a VC fund** (or an Investment Holding Company), so two different operating models come together and operate symbiotically, generating benefits for both parties.

The fund's first investment is in the Studio and aims to finance the creation of startups and thus cover the operational costs of production. The fund acquires stakes in the Studio and, indirectly, stakes in each startup created by the Studio itself. Moreover, the fund directly invests in the startups created by the Studio year after year, choosing only the best among them.

The reasons for bringing the two models together

A VC fund usually spends time and resources to select and search for the best startups on the market and carry out due diligence activities to identify those startups in which it is worth investing. In this process, a VC fund has to share the market with other VC funds to get the best deals on which there is often competition.

In some cases, competition may cause upward movements of purchase prices and investment terms.

Conversely, a Studio needs to raise money to finance the production of startups and raise funds to finance the startups it has created. These activities take time and resources and the Studio is thus forced to interrupt the flow of its operations to focus on fundraising, thus losing ground and part of the competitive advantage gained up to that point.

The Fund/Studio combination, namely, the Dual Entity Model, creates a mutually advantageous "relationship" in which both players enjoy the benefits analyzed below.

Benefits for the fund

The fund first invests in the Studio, in which it acquires a minority stake (ranging from 10% to 30%); this allows the fund (or Holding Company) to **diversify its portfolio** with one single investment. In fact, by investing in the Studio, the fund indirectly acquires stakes in all the startups that will be created, and this is the first benefit.

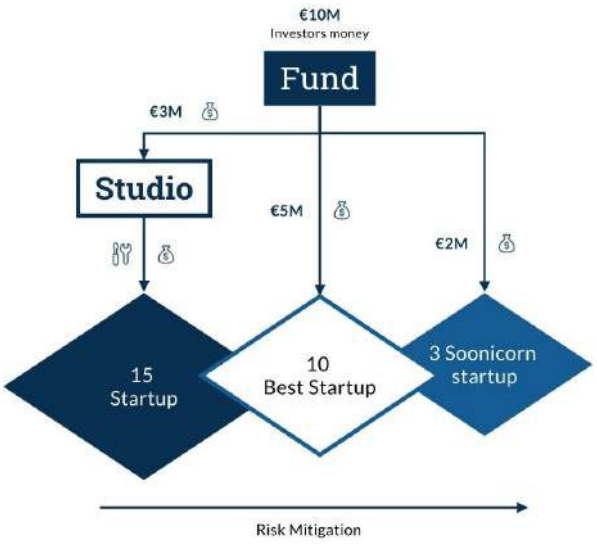

Fig.8: *Dual Entity Model*

The second is that the **startups generated by the Studio have a lower failure rate than the market average** (40%, just as those in the Series B round). The fund also has an exclusive **pre-emption right to invest in every startup** created by the Studio **upon advantageous and predefined terms and price**.

Funds and Studios share the same management: a fund's management has **access to first-hand information** and metrics on startup performance and can thus evaluate the startup correctly and efficiently. The decision to invest is therefore based not only on precise data, but also on direct observation of the work carried out by the entrepreneur until that time. This also dramatically simplifies legal and business due diligence.

Moreover, as the Studio does not have the funds to finance startups in the subsequent rounds, it **assigns the pro-rata rights** in the stakes held in startups t**o the fund**, thus ensuring greater strength for the fund in the case of double down.

Benefits for the Studio

Thanks to the investment received, the Studio can promptly fund startup generation, covering the operational costs for remaining active with **no time wasted in raising the necessary funds**.

Benefits for the founders of the startups created

Given good results and good metrics, startups' founders have **access to almost immediate funding** subject to previously agreed conditions. They thus avoid losing time in a lengthy fundraising process that would require 6 to 12 months of intensive work.

Like in any winning relationship, in this relationship, too there are safeguards. To encourage the Studio to continue to focus on greater Exits, the VC fund relies on the **liquidation preference on the investment made in the Studio** itself. This is an incentive for the Studio to stay focused on startups that can generate a significant return in a short time.

"The idea of having two separate entities is engaging. The rules are clear: on the one hand, steps are taken to reduce the degree of risk of failure of startups through the increase of the average quality levels of the startups produced; on the other hand, investments are made in a measured way, on the most promising projects only, not like a waterfall".

(Paolo Giolito, Senior Wealth Manager,
VP Italian Blockchain Association, Business Angel)

"The Startup or Venture Studio is an interesting asset class for investors looking to maximize their odds of success in accessing very early stage ventures. In addition, the Dual entity setup helps accelerate scalability through fast and efficient capital allocation on startups that show traction. This becomes a very disciplined and data-driven process that helps minimize investment risk. I can only see Startup Studios becoming a more common asset class in the future."

(Mirko Lagattolla, VP Management for Beyond Beer)

Startup Studio: Startup Studio Benchmark

The Startup Studio model was first developed in the US in 1996 with the founding of Idealab. However, the model has spread considerably over the last few years: as shown in the chart below, **the number of Startup Studios has increased exponentially worldwide** (there were 560 active Studios in 2019). Moreover, the interest in Studios has grown over the years, just as the number of investors and funds that have invested in Studios.

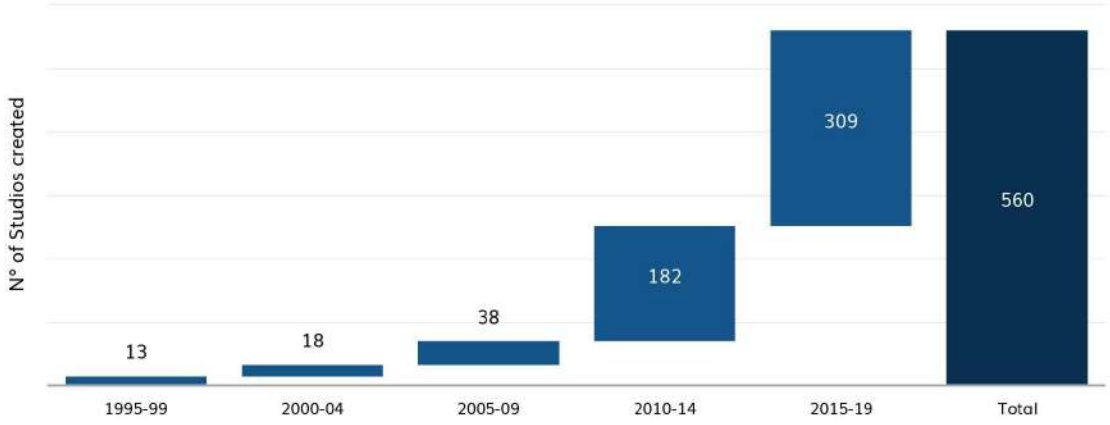

Fig.9: *Startup Studio presence*

Although the term Startup Studio is not widespread yet, most people in the industry certainly know the names of the startups they have created and their success. The most notable startups that have been in a Studio include companies such as **Dollar Shave Club** (from Science - 1 billion Exit), Lyft (13 to 24 billion IPO), **Zalando** (Rocket Internet - 6.8 billion IPO), **Snowflake** (Sutter Hill Ventures - 33 billion IPO), **Hellofresh** (Rocket Internet - 1.9 billion), **Him and Hers** (Atomic Ventures - 1.6 billion) and **Clubhouse** (coming from Alpha Exploration - 4 billion) and many others.

In addition, many important funds such as **Foundry Group**, **Bezos Expedition**, **Sherpa Capital**, and many other funds have begun to invest in Studios. Furthermore, some funds of funds have recently developed, their main focus is the investment in Startup Studios. These include **Vault Fund** by Sarah Adams Anderson.

Data published in Disrupting the Venture Landscape, released by GSSN (Global Startup Studio Network) in 2020, show that the startups produced by a Studio perform better than traditional startups, not only in terms of success rate, but also in terms of the time it takes to raise funds and thus achieve the Exit. The sample of startups analyzed shows that t**he average time lapsing from startup founding to Exit is 4.3 years** for a startup created by a Studio, as opposed to 8 years for a traditional startup.

Going more into detail, the time lapsing from founding to the first round is 36 months for a traditional startup. With a Studio, the **time to reach the seed round diminishes from 36 to 10.7 months**; this is possible not only because a fund works alongside the Studio and covers the startups' first round of financing but also because of the reduced time needed for testing and validating ideas. Moreover, these two elements also positively impact the average time lapsing between the **Seed Round and Series A Round**, which **decreases from 20 to 14.5 months**. In addition, the reduced amount of time needed to raise the first two rounds, which totals 30.8 months, or 2.5 years, is one of the key factors in lowering the Exit time from 8 to 4.3 years for startups within a Studio.

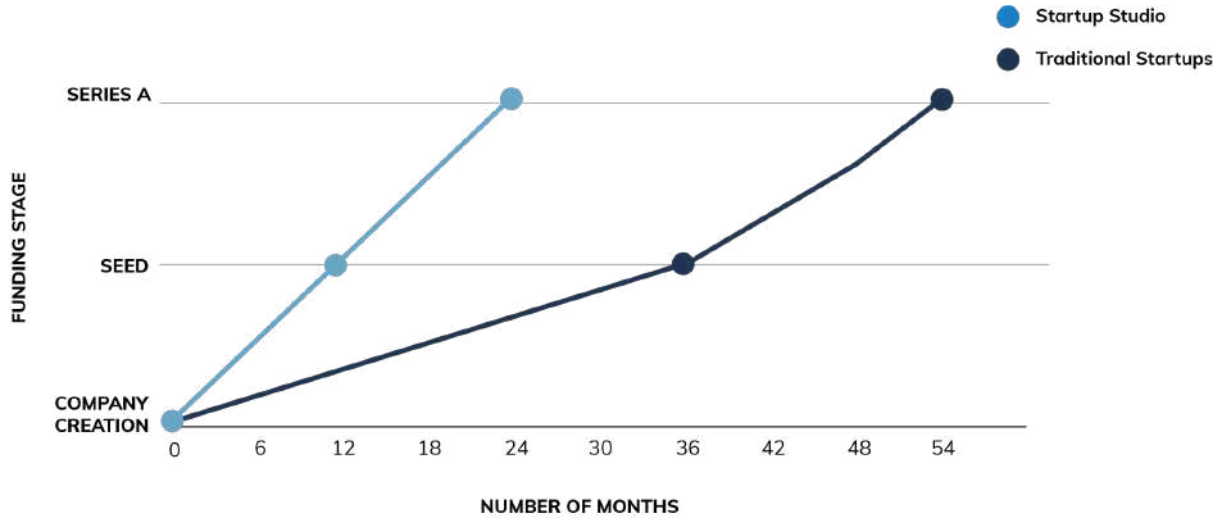

Fig.10: *Growth comparision between Studio startups and Traditional startups*

The same research shows that **84% of all startups produced by a Studio reach the seed round** and 72% of those startups reach the Series A round.
Overall, **60% of all startups in a Studio achieve an A round**, with 30% better results than traditional startups.

Apart from the fact that a Studio's creation process can generate startups with a lower rate of failure and a shorter time to raise capital, the startups developed in a Startup Studio also have an **IRR** of **53%** as opposed to 21.3% of traditional startups. In terms of Exit value, the startups produced by a Studio have an average value of 74 million compared to 50 million of traditional startups.

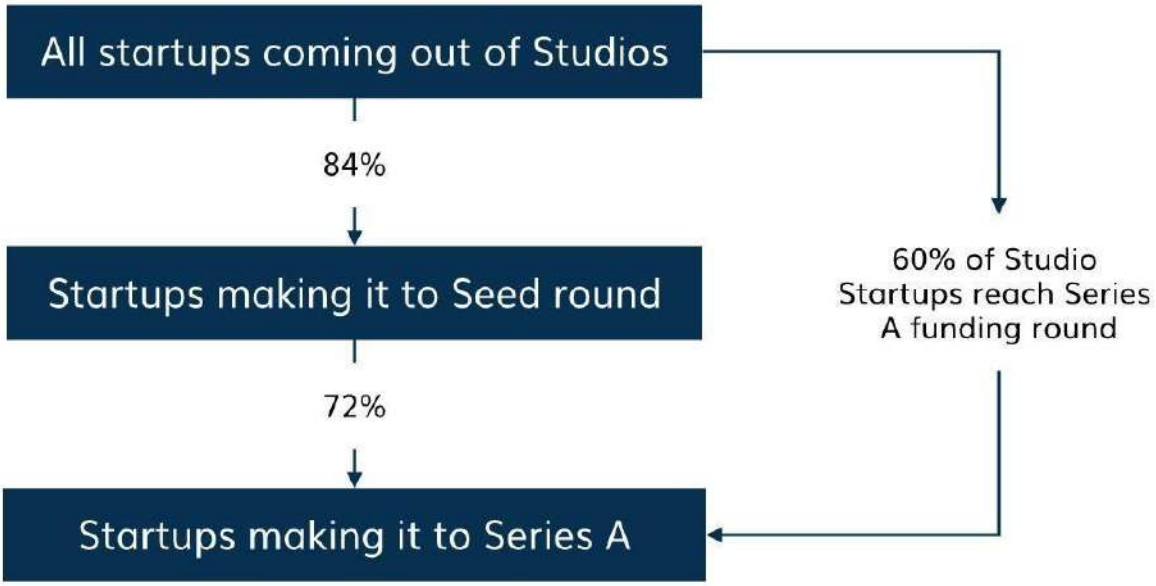

Fig.11: *Graduation rate for Studio startups*

An emerging asset class

Startup Studios are startup **factories capable of generating value in a serial and measurable way, whilst mitigating risk**. Studios create startups that meet real needs and provide the resources and means necessary for these startups to be ready to scale up.

The spread of Startup Studios and their successful results have attracted the interest of many investors over the last few years. **Studios are increasingly included in the investment portfolios of Business Angels, Family Officers, and Wealth Managers**.

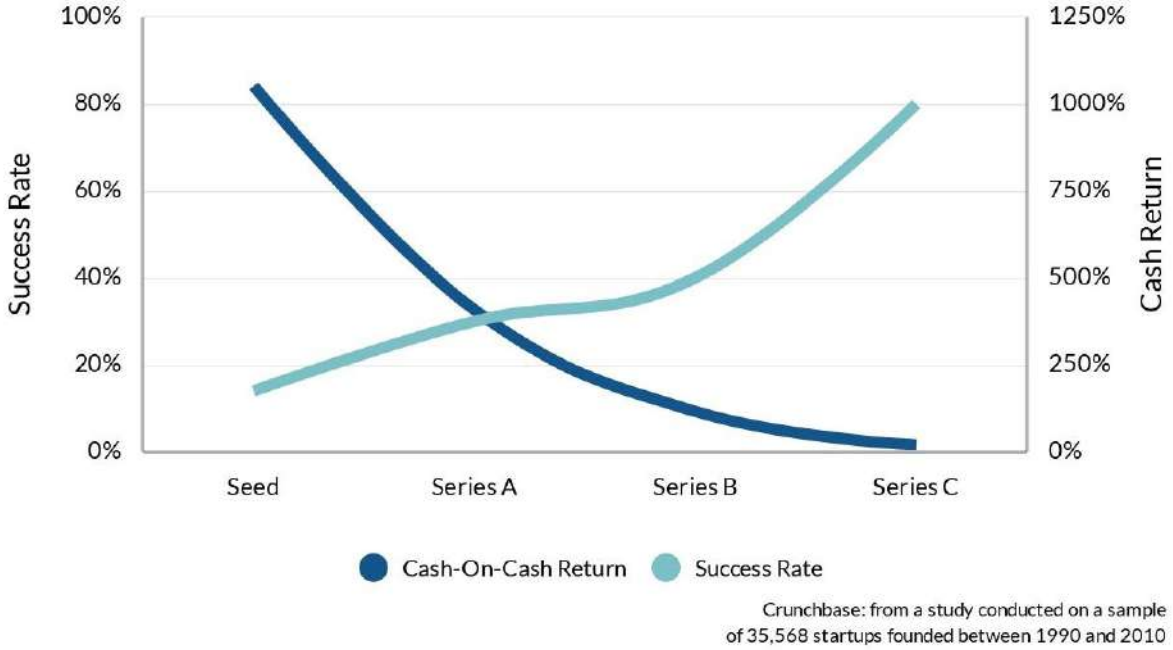

Fig. 12: *Cash return and success rate in each startup stage*

The main reasons investors are increasingly interested in Startup Studios are explained in the previous paragraphs. The first reason is their **success rate**: for traditional startups, the likelihood of success increases as rounds progress, but the return for investors decreases as the startup grows. As shown earlier in this document, a Startup Studio mitigates risk by producing startups that have, in their seed round, the same rate of success and stability of a startup that has already reached a B round.

Investors can access a **lower-risk portfolio compared to investing in traditional early-stage startups with a lower ticket**. As emerging from the above analysis, **Exit times are shorte**r and the return on investment is faster, which results in a **higher IRR**.

Finally, investing in Startup Studios gives access to a portfolio of startups in their **0-to-seed stage**, making the investment more comprehensive than VC funds, which invest in later-stage startups.

Based on these premises, entrepreneurs and investors are expected to become more interested in the opportunities offered by Startup Studios. More and more Business Angels, Family Officers, and investors will be interested in considering and including a Startup Studio in their portfolios.

"To me, venture studios seem like an obvious investment. Investors constantly need to be looking for the next return generators for their portfolios. That being said, investors really need to dig in and understand the nuances and complexities of a venture studio before investing. At the root of a venture studio there are people and the entrepreneurial spirit – studios are platforms to help build and create companies."

(Douglas Beyer - Managing Director at Radianx Capital)

Glossary

Accelerators

Accelerators are programs that accelerate the development of startups and early-stage companies. Accelerators provide strategic consultancy professional services free of charge or for a small share. Such services range from the definition of the revenue model to team creation, from fundraising to the management of pivots, if any, to the launch of the product on the market.

Business Angels

Individuals ((also known as “informal investors”) who finance companies in a high-risk stage which, however, also has high prospects of development. Business Angels acquire stakes in startups with their personal assets and contribute not only capital but also managerial know-how and networks of connections. While venture capitalists substantially aim to obtain a high return by investing in high-risk activities, business angels may decide to invest not only for economic-financial reasons but also for other purposes, for example, because they have a personal interest in particular sectors or because they wish to contribute to the development of their community.

Equity

The company’s own capital expressed in quotas or shares.

Exit

A startup’s exit is when the startup and investors sell their shares in an IPO (Initial Public Offering) in the context of an acquisition or merger. Exits are the main way for investors to realize a return on investment.

Failure rate

The failure rate is the percentage of companies in a portfolio that cease business without reaching an Exit. Given that failure results in little or no return on investment, the failure rate is an important parameter for measuring the initial performance of a

portfolio. In the context of venture capital, most returns come from a few above-average exits, so the initial failure rate may not reflect the final ROI of a portfolio.

Founders

In general, in the context of a Studio, the term “founders” means the founders of the portfolio companies, it does not mean the Studio’s founders.

Incubator

Incubators provide startups with initial funding, space to work, and professional and mentoring support to help them go through the initial process for the validation of the business project. Startups usually remain in the incubator for a predefined amount of time.

IRR

The Internal Rate of Return (IRR) is a metric used in financial analysis to estimate the profitability of potential investments.

Mvp (Minimum viable product)

This is the product's first version, which serves both the purpose of testing functionalities and gathering initial feedback from initial users.

Private equity

The term “private equity” is used to define, in general, an investor’s activity in venture capital, with specific reference to investment in those stages of a company’s life cycle that follow the initial one.

Seed

Investment in the very early stage of business idea testing, when the technical viability of the product or service is yet to be demonstrated.

Series A, B, C investment rounds.

The various funding rounds follow the FFF (Family, Friends and Fools), pre-seed and seed stages. Each new round to raise capital is named with the above-mentioned letters to emphasize the startup's ability to find investors and thus its path of growth and development.

Success rate

Success rate is the percentage of successful startups in a portfolio. Success can be measured in several ways, for example, the number of startups still active after a certain number of years after their foundation.

Venture Capital

Venture capital is the capital, or money, invested in a project in which there is a substantial element of risk, typically a new or expanding business.

0 to Pre-Seed

The startup is at 0 to Pre-Seed stage when it is validating the product or service with its first customers/early adopters and is bootstrapped by the Studio.

Appendix

Understanding the difference between Startup Studios, Accelerators and Incubators

Incubators

In most cases, the purpose is to get a company ready to enter the market. Efforts focus on a continuous redevelopment of the prototype of a product or service as new information about customers and their preferences is found out. Incubators retain a negligible stake in a company, or do not retain anything at all. Many incubators are funded by public entities (such as universities and research centers) and therefore do not need to provide their services in exchange for equity. They adopt a hands-off approach and the value they provide is to fill the gap in terms of economic-financial knowledge (for example, being able to draw up a business plan). Their approach is mainly based on mentoring.

Accelerators

Accelerators focus on having the company grow rapidly so that it can reach a sufficient stage of maturity to complete the first round of funding. Accelerators invest in exchange for equity. The investment is about tens of thousands of dollars. In this case too, a hands-off approach is adopted. Efforts are made to stimulate growth through so-called “accelerator programs” with workshops, pitching events and demo-days. Accelerators differ from incubators in terms of the duration of the programs, which typically last three to six months.

Startup Studios

The ultimate goal of Startup Studios is the same as that of Venture Capital funds: achieving an exit and basing their revenue model on the exits made from their portfolio. Every company is founded further to the identification of specific market demand. The aim is to make the new company operationally and financially viable until it becomes an independent entity and then liquidate the investment through an

M&A transaction or a listing. Since startups are founded by Startup Studios, these latter normally hold significant stakes in the companies they launch. Startup Studios raise funds from General Partners and private investors such as business angels, family offices, and venture capital funds. If the company fails, the assets held in that may be used for other businesses. Startup Studios are not “early-stage” investors, they are real founders. Their approach is called “parallel entrepreneurship”. It starts from market research and continues with idea generation and testing. Those ideas that make it through the process turn into startups and enter the market.

Comparison between the 3 models

	Accelerator	Incubator	Startup Studio
Main goal	Fast growth to get the first funding round	Get ready to market	Get the startup to Exit
Source of the idea	Selection among startup candidates	Selection among startup candidates	Ideas based on real market needs
Duration	2-6 months	12-24 months	4 years
Management Approach	Hands-off	Hands-off	Hands-on
Equity	Between 5% and 10%	No/Low equity taken	Between 30% and 70%

Table 2: *Comparison between Accelerator, Incubator and Startup Studio*

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