Phase 2: Potential

Does this project have the potential to be a success?

Startups want to grow to become large. Potential describes the size the company could one day reach, if everything goes according to plan and the founders also have the luck that they need.

A startup's potential is very important to investors, because it helps them to evaluate it; the larger the company, the more valuable it is for a buyer. But potential is also relevant for government programs, because they have the goal of creating positive economic effects via startup funding. Therefore, founders must be able to explain the potential of their startup convincingly in a pitch to investors or an awards committee.

> *What investors are looking for when they invest in a startup is the possibility that it could become a giant.*
>
> Paul Graham

Size Matters

Potential distinguishes startups from other young companies: a newly founded sandwich shop on the corner is not a startup, but a newly founded sandwich shop franchise like Subway that one day will have more than 20,000 franchises under contract around the world could well be.

The news regularly contains reports about startups that have just received a million-dollar investment or that have just been sold for a nine-figure sum or more. It is the huge potential of these startups that leads to valuations of this magnitude.

In most cases, founders must realize that their business idea does not have the potential to become a startup. However, that doesn't mean that their idea is bad or that they should not go ahead with their plan – after all, the vast majority of companies are not startups. If the founders can solve a customer problem well with their idea, then founding a company can still be the right thing for them to do.

Factors that Contribute to Potential

Phase 2 is concerned with four topics that determine a startup's potential.

If it wants to become very large, a startup ...

- must have a large market with weak competition

- must have a unique and innovative offer
- that provides an increased customer benefit compared to what was previously available.

The size of the market determines the sales volume or the number of users the startup can theoretically reach. The strength of the competition determines what share of the market the startup can obtain. For example, in 2016, the e-commerce market in USA was about 450 Bn$, of which Amazon had a share of about 43%.

The second and third factors are needed so that prospective customers notice the product and buy it. If a product is not unique, it is hard for it to gain attention and to occupy a clear market position. If the customer benefits are not superior, then there is no reason for prospective customers to buy it. Twitter, Snapchat and Pinterest are all examples of innovative products that offered their users new possibilities.

The fourth factor that contributes to a startup's potential is the founders' imagination and self-confidence to define an ambitious goal for their startup and to see it through. Already in 1978, Bill Gates and Paul Allen, the founders of Microsoft, dreamed of there being a "computer on every desk and in every home".

Content of Phase 2

The four chapters of Phase 2 are:

2.1 *Customer Benefits*. What customer benefits are provided by the product and how large are they?

2.2 *Market Analysis*. How large is the market for the product and how strong is the competition?

2.3 *Key Features*. What features are absolutely necessary for the product and how is it different from the alternatives?

2.4 *Founders' Vision*. What are the founders' long-term goals for their company?

Market Analysis (Chapter 2.2) corresponds to Level 2 of Steve Blank's Investment Readiness Level.

Customer Benefits (Chapter 2.1) and Key Features (Chapter 2.3) are important aspects of Product-Market Fit – the most important milestone in the life of a startup and Level 5 of the Investment Readiness Level.

Link

- Phase 2 at founders-playbook.de:
  founders-playbook.de/potential/

