Startup studios emerge as a growing force

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Sparkling Partners
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Introduction

Since the 1990s, among a proliferation of start-ups, new technologies and fundraising, one indicator remains constant: nine out of ten start-ups fail. Over the same period, more than 2,000 start-up support structures have been created around the world, mainly accelerators and incubators. The mission of them all: to help start-ups to succeed.

Why did these thousands of start-up support structures not have any visible overall effect on the success of start-ups?

Let’s first dismiss a somewhat extreme explanation: these structures do not improve the success rate of start-ups because it is not possible. There will never be a "magic formula" to succeed; luck is a factor that plays too big a part? Of course, to create a start-up is by its nature an uncertain and risky decision, but start-ups are created by optimists, not by the unaware. To attempt to launch an entrepreneurial venture is not like playing the lottery, it is possible to plan, prepare, and get help.

Another possible explanation for this lack of visible results is the heterogeneity of support structures (their approach and size are highly variable) combined with the competition to attract start-ups. They are not encouraged to share practices and know-how, and this results in a high degree of fragmentation. They thus constitute a set of independent and uncoordinated approaches, some of which are real success stories, but whose overall effect is hardly perceptible.

But this fragmentation is not the main reason for their limited effectiveness, which, in our opinion, is based more in the very nature of these entities. These entities are mainly accelerators and incubators that provide start-ups with time, expertise and infrastructure. They often work closely with investors, such as venture capital funds (VCs) and business angels (BAs), who provide financial resources. This dual vision of support for start-ups - time on the one hand, money on the other - generates a discontinuous, incomplete and ultimately insufficiently effective offering for the needs of entrepreneurial projects. Our model of the start-up studio - "start-up factories" - which we detail in the following pages, seeks to fill exactly this space.
More than 200 start-up studios are currently registered. As shown in the previous graph, this number is rising sharply. From fewer than 1% in 2007, it now equates to about 8% of the number of accelerators and incubators. Even though the majority of these start-up studios are less than five years old (their first start-up investments are just beginning to mature), they are attracting growing interest from entrepreneurs and investors, thanks in particular to the very promising performances of pioneering start-up studios, such as Idealab or Betaworks.

Is this growing interest justified? Is the rise of start-up studios the latest fashion trend in the world of start-ups, or will it lead to an inflection point in the way of creating and developing innovative companies?

**What is a start-up studio?**

**Definition**
A start-up studio is a company that creates start-ups, repeatedly, by providing human and financial capital.

Let us look at each element of this definition:

- **COMPANY**
  A start-up studio is itself an entrepreneurial project, with a vision, founders, teams, know-how, capital ... and whose objective is to develop these assets. This notion also emphasises the independence and autonomy of start-up studios, not to be confused with the Innovation Department or internal studios of large groups.

- **CREATE START-UPS**
  the start-up studio is the originator of the ideas and projects it develops. It does not join entrepreneurs or existing projects, it starts from scratch: its job is to generate ideas and create innovative business models, then to develop start-ups it then entrusts to leaders it appoints.

- **REPEATEDLY**
  In order to be able to create and develop several start-ups each year, a start-up studio puts together sustainable assets: teams, methodologies, know-how, technologies ...

- **PROVIDING HUMAN AND FINANCIAL CAPITAL**
  As mentioned in the introduction, this is a fundamental characteristic of start-up studios: the provision of all that is necessary for an idea to come to life, especially the combination of human and financial resources.

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**Chart 2: Main types of support structures for start-ups**

- **Accelerators & Incubators**
- **Start-up studios**
- **Business Angels**
- **VCs & funds**

**Time & Staff Commitment**

**Financial Commitment**
Start-up studios are also called: “venture builders” or “start-up factories”. This industrial analogy - the “start-up factories” - makes it possible to specify the main objectives:

- **IMPROVE THE QUALITY OF PRODUCTION**
  A start-up studio aims at producing better start-ups, that is to say, by taking a strictly financial viewpoint, to generate high levels of holdings of highly-valued shareholdings

- **REDUCE MANUFACTURING COST**
  Specifically, around multi-disciplinary support provided close to teams and projects since the start-up studio model is naturally resource-consuming. However, it allows the generation of significant synergies, both in terms of market (start-ups of the same studio sharing their sectoral knowledge or their customers) in terms of cost (the pooling of teams, knowledge/experience and tools is at the heart of the operational model of the studios)

- **LIMIT MANUFACTURING DEFECTS**
  For a studio, a project is not pre-destined to become either a major success or a total failure. It may, for example, be limited in size but develop technology that may be used by other studio start-ups. This ability to adapt to each project and share resources between projects makes failures less binary and therefore less expensive

- **ENSURE RELIABLE PROCESSES**
  Being able to repeat the process of creating start-ups with the same level of quality is a central objective for studios that differentiates them from isolated approaches, such as business angels

- **INCREASE YIELD**
  This objective is not the main one; a start-up studio seeks first to ensure the quality of its creations before increasing the rhythm and the number. Most start-up studios set a regular goal of 3 to 5 start-up creations a year without any desire to increase this number

In summary, a start-up studio can be understood as the grouping together and networking, within the same organisation, of an investment vehicle, a prototyping workshop and an accelerator.

Billy Chasen, co-founders of Betaworks, a pioneering NYC start-up studio founded in 2007 explained:

“People have said ‘Are you an investor or an incubator?’ and we were neither. We were both. And we’d focus on one or the other depending on what was going on.”
Operating Principles

The start-up studios operate around a multidisciplinary and operational support system for the generation of ideas, the creation of start-ups and the development of their teams.

Chart 3: Operational support themes for start-up studios

From a practical point of view, for each of the support themes presented above, the way of operating of each start-up studio may differ by:

- **THE LEVEL OF SUPPORT**
  All the support themes are provided by all the start-up studios but, depending on their degree of specialisation, their resources and their network, the level of support varies from start-up studio to start-up studio. Some, for example, have a very strong technical know-how while others emphasise the effectiveness of their financial and back-office support.

- **THE DEGREE OF INTERNALISATION**
  To ensure the quality of their support, the start-up studios with internal teams provide certain levels of support while others are entrusted to partners in their network. For example, some employ a dedicated lawyer, others use a partner law firm. For the technical aspects too, some internalise the know-how of hardware prototyping for example, while other start-up studios rely on nearby design offices.
Start-up studios are distinctly different from other start-up support providers, in particular accelerators & incubators and venture capital funds, as summarised in the table below.

<table>
<thead>
<tr>
<th></th>
<th>Start-up Studio</th>
<th>Accelerator</th>
<th>VCs</th>
</tr>
</thead>
<tbody>
<tr>
<td># of start-ups / year</td>
<td>2 – 4</td>
<td>10 – 20 &amp; more</td>
<td>5 - 10</td>
</tr>
<tr>
<td>Maturity of projects</td>
<td>Idea</td>
<td>Development</td>
<td>Commercialization</td>
</tr>
<tr>
<td>Duration of relationship</td>
<td>3 – 7 y</td>
<td>3 - 12 months</td>
<td>2 – 3 y</td>
</tr>
<tr>
<td>Formatted programs</td>
<td>-</td>
<td>++</td>
<td>+</td>
</tr>
<tr>
<td>Level of staff support</td>
<td>++</td>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>Relationship with the managers</td>
<td>++</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Size of internal team</td>
<td>++</td>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>Ecosystem and network effect</td>
<td>++</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Average equity investment</td>
<td>100 – 600 k€</td>
<td>20 – 100 k€</td>
<td>&gt; 500 k€ -1M€</td>
</tr>
<tr>
<td>Initial level of capital ownership</td>
<td>++</td>
<td>-</td>
<td>+</td>
</tr>
<tr>
<td>Level of specialisation</td>
<td>Strong</td>
<td>Weak</td>
<td>Medium</td>
</tr>
</tbody>
</table>

Chart 4: Comparison between accelerators, start-up studios and venture capital funds

Among these characteristics above, some are strong markers of the studio start-up model:

- **DURATION OF RELATIONSHIP**
  the duration is long for a studio, often several years from the origination of the idea to the profitable commercial development of the start-up

- **LEVEL OF SPECIALISATION**
  To guarantee the performance and efficiency of their operational teams, the majority of start-up studios specialise in creating several start-ups by sectoral focus, some even focusing on a single sector

- **INITIAL LEVEL OF CAPITAL OWNERSHIP**
  As a creator of ideas and start-ups, a start-up studio "starts" with 100% of an idea rather than an accelerator or a fund which "starts" with 0% of a start-up when it joins

- **RELATIONSHIP WITH THE MANAGERS**
  The multidisciplinary and operational support provided by start-up studios implies a very close relationship with the managers. Start-up studios are also sometimes called the "third founder" by reference to the typical structure of a start-up founded by a pair of founders
Start with the idea and find the right team, or don’t worry about the team and instead validate the idea? This simple reformulation of the difference between start-up studios and accelerators highlights another feature specific to studios: the need to recruit entrepreneurs. This statement is sometimes considered as an oxymoron: can we recruit and keep an entrepreneur; an individual by nature free and independent? Most start-up studios can show the difficulty of regularly recruiting entrepreneurs to take the reins of start-up companies. But many observe the emergence of a generation of entrepreneurs attracted by the studio start-up model because they are open to the opportunity and efficiency of building and running a start-up “from the launch”. This problem of recruiting entrepreneurs is at the heart of the model of start-up studios for two reasons: on the one hand attracting these types conditions the success of each company and, on the other hand, it constitutes an important growth driver for studios seeking to evolve successful entrepreneurs into partner roles within the studio.

Finally, to conclude this presentation of the main characteristics of start-up studios, it is important to review the measurement of their performance. How can we say when a start-up studio is a success? In quantitative terms, the criterion most often used is the "gross multiple" (called TVPI - Total Value to Paid In or "Gross Multiple"). It is calculated as the ratio between the total value created and all resources committed. This indicator is well adapted to the model of the start-up studio because:

- It takes into account all the value created, already realised (exits, dividends ...) or not yet recorded (the value of the portfolio)
- It combines investments in the studio’s internal teams and direct investments in start-ups (the former creating value in the second)
- Finally, it integrates the concept of synergies by aggregating all the resources of the studio

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**Start-up studios of today**

**The recent rise of start-up studios**

The start-up studio model was born in the United States where Idealab, created in 1996, is considered as the first true start-up studio. Betaworks in 2007 is the first studio created in the "digital era". Rocket Internet, launched the same year, has largely contributed to the spread of the model to a wider audience (although its "copycat" model is a little different as mentioned below). Also, among the pioneers, efounders introduced this model in France in 2011.
The number of start-up studios has increased sharply since 2013. This increase is very recent for two main reasons:

- **THE GRADUAL “UPSTREAM” MOVE OF INNOVATION SUPPORT PRACTICES**
  Support structures for start-ups during the seed, development and growth phases are well established, both from a financial and operational point of view. Extending this support, upstream, closer to ideas, is much more recent and is the *raison d’être* for being a start-up studio. This corresponds with the need to validate the economic model and the qualities of a start-up as soon as possible, in order to maximise the chances of success and avoid wasting time and resources.

- **THE MATURITY OF PROTOTYPING TECHNOLOGIES AND DIGITAL TOOLS**
  In terms of technologies and processes, several recent developments have made the start-up studio model possible and competitive, especially rapid prototyping technologies (hardware and software), hosting and data processing (cloud) and digital marketing tools. These elements are essential to be able to operate a studio start-up at a controlled cost.

For an overview of start-up studios, we can refer in particular to the GSSN - Global Startup Studio Network - which studies and promotes the model by leading a global network of start-up studios. Some of the best known internationally include Idealab, Betaworks, Atomic, Pioneer Square Labs, Rocket Internet, GoKart Labs, Prehype, High Alpha, Science Inc., Boulder Bits, Expa, Polymath Ventures, Madrona Venture Labs, Barefoot, Hanse Ventures ... In France, the main ones are efounders, Axeleo, Matters, Redpill, Techno Founders or Sparkling Partners.

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**Different types of start-up studios**

How to understand and differentiate the respective positions of the hundreds of start-up studios mentioned in the previous paragraph?

A simple typology of start-up studios can be established by segmenting them on the one hand according to the rigidity of the framework in which they make ideas emerge and on the other hand according to the balance between their financial and human resources, as is illustrated in the graph below.
Regarding the level of collaboration or autonomy during the generation of ideas, the start-up studio is, in most cases, the source of ideas through its teams, experience and network. For the majority of the studios, these ideas, which can be very varied at the beginning, but as they mature, focus around one or more specialisations in order to be more efficient in the use of the studio’s resources. Some start-up studios operate in a different way by being more driven from the generation of the idea because they are close to industrial groups or universities that submit specific innovation themes to them.

In terms of the balance between financial resources and operational resources, we have seen that the ability to commit both time and capital is the main characteristic that defines a start-up studio. However, the level of commitment of each type of resource can vary, mainly in relation to the level of funding of the studio.

Other parameters allow more refined differentiation of start-up studios, in particular:

- Level of specialisation and internalisation of the support themes (already mentioned in the first part) related to the quality of their network and teams
- Location, essential for understanding the scope of the ecosystem and networks of a studio. For example, Pioneer Square Labs is well-known in Seattle while Betaworks is based in New York
- The culture and history of the founders that directly affects the studio’s strategy and goals, as well as their relationships with entrepreneurs
• The ability to surround themselves with partners for the financing of start-ups in the long term (we will come back to this essential point in the following section)

The development of start-up studios

The promises of the model

The recent development of the start-up studio model allows it to benefit from the feedback and experience of the proliferation of incubators, accelerators and venture capital funds over the last twenty years. This rich history makes it possible to study the sources and causes of start-up failures and their support systems. Without pretending to summarise here the numerous studies of the subject, we can underline four known limits of accelerators, incubators and VCs, that the start-up studio model makes it possible to avoid:

• ALIGNMENT WITH START-UP EXECUTIVES
  The start-up studio, behind the projects and the "third co-founder" is, by its nature, totally invested alongside the leaders in the success of each start-up

• THE VARIATION IN START-UPS
  Much more flexible than an accelerator or a fund, a studio, while aiming for rapid success for each project, adjusts its support for each start-up, both in terms of duration and ambition

• ABILITY TO SHARE KNOW-HOW BETWEEN START-UPS
  Competition, individualism, need to differentiate, competition for financing ... the reasons that prevent a start-up creator from sharing with his peers are numerous. By embodying a third party also interested in the success of several start-ups, the start-up studio organises and encourages this sharing, which are major gains of time and prevents errors by the entrepreneurs

• INSUFFICIENT AND FRAGMENTED RESOURCES
  The start-up studio is a one-stop-shop approach providing projects with the majority of the skills, unified contractors and resources they need
In terms of financial performance, the studio start-up model is receiving a great deal of attention and hope since it has achieved some remarkable results. Note that the evaluation of the results obtained by a start-up studio is a complex concept, on the one hand because the indicators used are numerous and more or less convergent (IRR, TVPI, time-to-market, failure rate ... ), and secondly because the available data are rare, recent and often unverifiable.

While keeping these precautions in mind, the first studies of the performance delivered by the start-up studios underlines the effectiveness of this "manufacturing" approach to start-ups, according to two key indicators. Exit rate first; it is higher in studios (~ 35%) than in accelerators (~ 20%) which seems to confirm that a start-up created by a studio fails less often than any other start up. Next the creation of value, with multiples obtained by the studios that are generally superior to those obtained by a VC. This is mainly due to a higher capital weight at the time of the exit combined with amounts invested often being lower. According to the GSSN, a studio start-up can achieve TVPIs of 10.

As examples, the following results have been reported recently:

- Betaworks reports a TVPI greater than 5 versus an average of around 2 for VCs
- Atomic announces that it has launched more than 10 start-ups in 5 years, with initial financing of $20M. This highly valued portfolio has already generated an exit to repay the initial investors
- Efounders announced in 2018 a number of significant fundraising rounds and a first exit

A start-up studio faces several challenges specific to its job as a start-up creator principal among which is funding. The operational model of a studio is, by its nature, a consumer of numerous resources (multidisciplinary teams) and over long periods (7 years is a term often cited for the maturity of a start-up).

As illustrated in the following diagram, this funding need culminates during the simultaneous ramp-up phase of the first creations and studio teams, usually after 2 to 3 years of activity. This funding concerns the start-up studio itself in order to hire and develop its teams and the start-ups that it creates then develops. These start-ups require initial investment and, more often than not, "bridges" or additional fundraising for growth that the start-up studio may need or want to participate in. By way of illustration, most start-up studios mention a rhythm...
of 3 to 4 start-up creations per year, consuming up to €1 million for each, including more than half in direct investment.

Graph 6: development and financing cycle of a studio start-up

To meet this funding challenge, several complementary approaches can be observed:

- **DIRECT FUNDING OF THE STUDIO**
  Significant up-front funding is required to launch and operate a studio. A few of the bigger examples confirm this: Pioneer Square Labs raised a cumulative $27.5M for its studio of twenty-five people; High Alpha $10M and Betaworks $7.9M at its creation. This initial funding often comes from previous exits of one or more of the founders of the studio, themselves entrepreneurs.

- **BALANCING THE P&L**
  The studio teams develop essential know-how to develop innovative ideas and projects. Some studios enhance this know-how externally by providing services to third parties. This approach has the advantage of reducing the need for financing and keeping the teams at the top of the market in their field. However, it presents the risk of conflict between commitments to third parties and the needs of internal start-ups.

- **GROUPING PARTNERS TO FINANCE START-UPS**
  Several start-up studios are "clubs" of investors to which they are close and to which they present their start-ups when these require additional financing. These clubs, more or less formal, often include private investors, BAs and Family Offices, and rarely, venture capital funds that, in general, don’t recognise the role of the studio as "third co-founder". Efounders has announced that it has brought together over a hundred individual investors to finance several of its start-ups.

- **CREATE A VENTURE CAPITAL FUND ATTACHED TO THE STUDIO**
These funds, most often, invest in start-ups of the studio’s creations as well as in external start-ups. Beta Ventures was created in 2016 and has raised a total of $50M; Pioneer Square Labs, which recently announced the launch of PSL Ventures with $80M, or Axeleo Capital in France which launched in 2018. The creation of such a fund requires the establishment of very clear rules such as the distribution of roles. Conflicts of interest are a constant problem with these schemes leading to negotiated valuations of start-ups in the studio and the fund (PSL Ventures is forbidden for example to be "Lead" on the financing of start-ups from the studio)
Conclusion

It is tempting, in conclusion, to predict a bright future for start-up studios. More and more (re) known in the world of start-ups and in digital, they are starting to show promising results. The model is an innovative business creation approach that has learned from the recent but rich history of thousands of incubators and accelerators in order to stand out with more effective methods, resources, approaches and specific cultures.

But one of the first things we learn when developing a start-up studio is not to make predictions! Let us conclude by stressing the importance for start-up studios not to remain a sum of independent initiatives but to seek to become a sector that is structured and developed. Many of them already communicate regularly about their work, their successes or their strategic thoughts because they are not in direct competition with each other, on the same start-ups or the same deals. It is in this spirit that we have written this document.

By sharing their experiences and become more professional themselves, start-up studios will confirm the relevance of their model by multiplying, on a large scale and around the world, successful start-up creations.
Sparkling Partners is a start-up studio created in Lille in 2014. To date, it has created and financed some twenty start-ups which it supports in the retail, health, food and beverage sectors and in industrial IoT. Sparkling Partners brings together a team of around fifteen people particularly in an electronics studio, a software development team and a digital marketing agency.

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