Contrary to popular belief, startups are not SMEs

They may look similar but are two different animals, each with its own policy and strategy

By Jacquelyn Cheok

STARTUPS are not SMEs (small and medium enterprises). It's time organisations and individuals stop confusing the two, now that startups are - in their own right - recognised as critical to Singapore's economic future.

A startup is a newly-established business, while an SME is (according to enterprise development agency Spring Singapore) a company with an annual sales turnover of not more than S$100 million or employment size of not more than 200 workers.

The former has become a buzzword, a term increasingly brandished around in the corporate world by chief innovation officers, digitilisation heads and fund managers, and in the public sector by politicians and government agencies - out of a wish to spur risk-taking and innovation.

An SME, on the other hand, is a household term. It is well known that Singapore's over 180,000 SMEs form 99 per cent of all enterprises and contribute to nearly half of the country's gross domestic product while employing 70 per cent of the workforce.

Fundamentally dissimilar

But more often than not, startups are lumped together with SMEs as a single concept. While both are critical to the economy and deserve support, and may look similar in that they are both built by entrepreneurs and are small in revenue and staffing, there is a meaningful difference between the two, especially where policy and strategy are concerned.

Founders who look to build a startup are looking to do something fundamentally different from those who look to build an SME, according to AOL co-founder Steve Case. He says: "Startup is a term reserved for companies that can scale quickly and that can disrupt an existing category."

Steve Blank, founder of the Lean Startup movement, goes further to say that startups are "temporary organisations" designed to "search" for a repeatable, scalable business model. That is, a startup's product, value proposition and revenue framework are constantly evolving.

To grow into the large disruptive entities they want to become, startups typically seek funding by way of diluted equity, sharing profits with venture investors who see multiple returns on their investment. SMEs, on the contrary, prefer to retain 100 per cent control over the company.

So SMEs are generally funded with debt financing - a small business loan from a local bank - and their aim is to grow reliably over time. They aspire to have a "steady" number of employees, customers and revenues over a long period, says Mr Case.

SMEs also tend not to be dominant in their fields, generally selling known products to known customers in known local markets. A startup, however, seeks to disrupt established markets, in the name of reform. It may even create a new market with its first-of-a-kind offering.

It is not unusual for startups to be unprofitable or non-revenue-making in their first years, as many tend to focus on building a user-base and an appreciation of their offerings. Venture funding is seen as a validation of their work, and their exit strategy is usually either a listing or a trade sale.

Alex Chua, founder of homegrown web development agency Akimi Technologies (which identifies itself as an SME), puts it this way: "The bosses of a startup treat the company like a product they can sell. The bosses of an SME see the company as an ATM, a vehicle organised for profit and to earn money through something they like to do. Selling the company is usually not on their minds."

Going by the above definitions, startups in Singapore include mobile marketplace Carousell, ride-hailing service Grab and HPV vaccine maker PathoVax, while SMEs include fast casual restaurant chain 4 Fingers, bicycle maker Aleoca and nursing home operator Orange Valley.

If a country wants to spur new job creation, it should focus on "making it easier for startups to succeed". AOL's Mr Case explains that it is not SMEs but startups that account for nearly all of net new job creation in the US, of which 40 per cent comes from just the top one per cent of startups.

If a large enterprise opts to engage startups to drive corporate innovation, it must seek to have its systems questioned and disrupted, to pilot new solutions and potentially bring more value to customers. If a corporate venture capital fund invests in startups, it can't expect quick results.

SMEs slow in response

If SMEs are slow to respond to calls for greater innovation and productivity, it is because they are founded as structured organisations focused on delivering known value to known customers. An SME feels it has little need to change. Neither is it structured to change rapidly, unlike a startup.

If a government agency states that its "startups grants" are for first-time entrepreneurs with unique, differentiated business ideas, it should not be rejecting a biotech founder and holding out for "kopitiam" operator aspirants (ie, an SME owner), much less because the biotech is "too advanced".

If a service provider targets both startups and SMEs as customers, it must offer a range of price points, for SMEs have more purchasing power than startups. The exception is outstandingly venture-backed startups, such as Uber, which can and will pay for prime real estate, for example.

Finally, if individuals discuss startups and SMEs, they could be more sensitive to the differences between the two. Despite popular belief, they are not exactly interchangeable.