FINANCIAL POST

Is your business open or closed?

Brad Cherniak, Financial Post · Monday, Dec. 13, 2010

There is plenty of talk about a new paradigm of openness and collaboration in business, with companies such as Apple, Google and Wikipedia being held out to typify this new world of "open business." This is a world in which there is no room for being proprietary; where ideas are free-flowing and unencumbered by arbitrary corporate borders.

But this openness is a dangerous presumption for small businesses to operate under. As a rule, whether you are looking to finance your company or sell it, there is a higher premium than ever before on being proprietary. And, when it counts, no one is more proprietary than the leading technology companies.

However, the meaning of "proprietary" has evolved. Many technologies and production processes are rendered commodities quickly in their life cycle. For these, "open-sourcing" and "crowd-sourcing" have become valid tools on which to tack new features and develop end-user markets. There is no economic incentive to make these investments under a proprietary or "closed" model, because the payoff is shared among everyone who copies and incorporates it into their offering.

That's not to say open or technology-based service businesses aren't great businesses. They can be successfully financed or sold, but often at very different multiples of cash flow or profit than "closed" businesses.

It is the smaller players who are struggling to adjust their expectations and, accordingly, their business models.

Venture capitalists are also struggling with this paradigm, with many of their investments having been acquired and valued under a closed model, but which now operate under an open one. Microfinancing and Super Angels, which represent an extension of the traditional angel model, are a result of this change.

Super Angels commonly invest in technology-based service companies -- the laundromats, hardware stores and gas stations, or even indie films of today. Consider the gaming and app companies being formed prodigiously to pile into the various online app stores. That's not to say traditional angels are not active here, too.

You can't invest more than a few hundred thousand dollars in these companies, because the economics of the investment don't support doing so. And this paradigm is extending into the software world.

The rest of the business world still works with the alligator-filled moats and high walls: with non-disclosure and non-compete agreements, patents and trademarks and other protective strategies. These companies still collaborate actively, as always, but still very carefully. They disclose as little as possible to get business done. And this is not likely to change any time soon.

Any company, large or small, may operate under both open and closed models simultaneously, but it could complicate valuing and financing these companies.

For small business owners, my advice is, don't try to be both. The business models, infrastructure requirements, marketing strategy, capital requirements and financing strategy, and valuation methodologies are very different for each.

Companies that try to do both risk turning off prospective investors or acquirers.

Bryan Watson, executive director of the National Angel Capital Organization, says open companies are accessible to angels and Super Angels because of their reduced infrastructure requirement which requires less capital.

In the case of "closed" companies, he cautions that the presence of a large IP portfolio does not guarantee stellar returns, nor does the lack of one mean a company is relegated to meager, commodity-like returns.

However, he says having an IP portfolio can support the valuation of your company, particularly in a sale scenario, as can more intangible assets such as a customer base.

Read more: http://www.financialpost.com/your+business+open+closed/3967340/story.html#ixzz17zzrB21R

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