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You've been pitched!
Is that AI startup the real deal?

Beena Ammanath
A report by the Deloitte AI Institute

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You’ve been pitched! Is that AI startup the real deal?

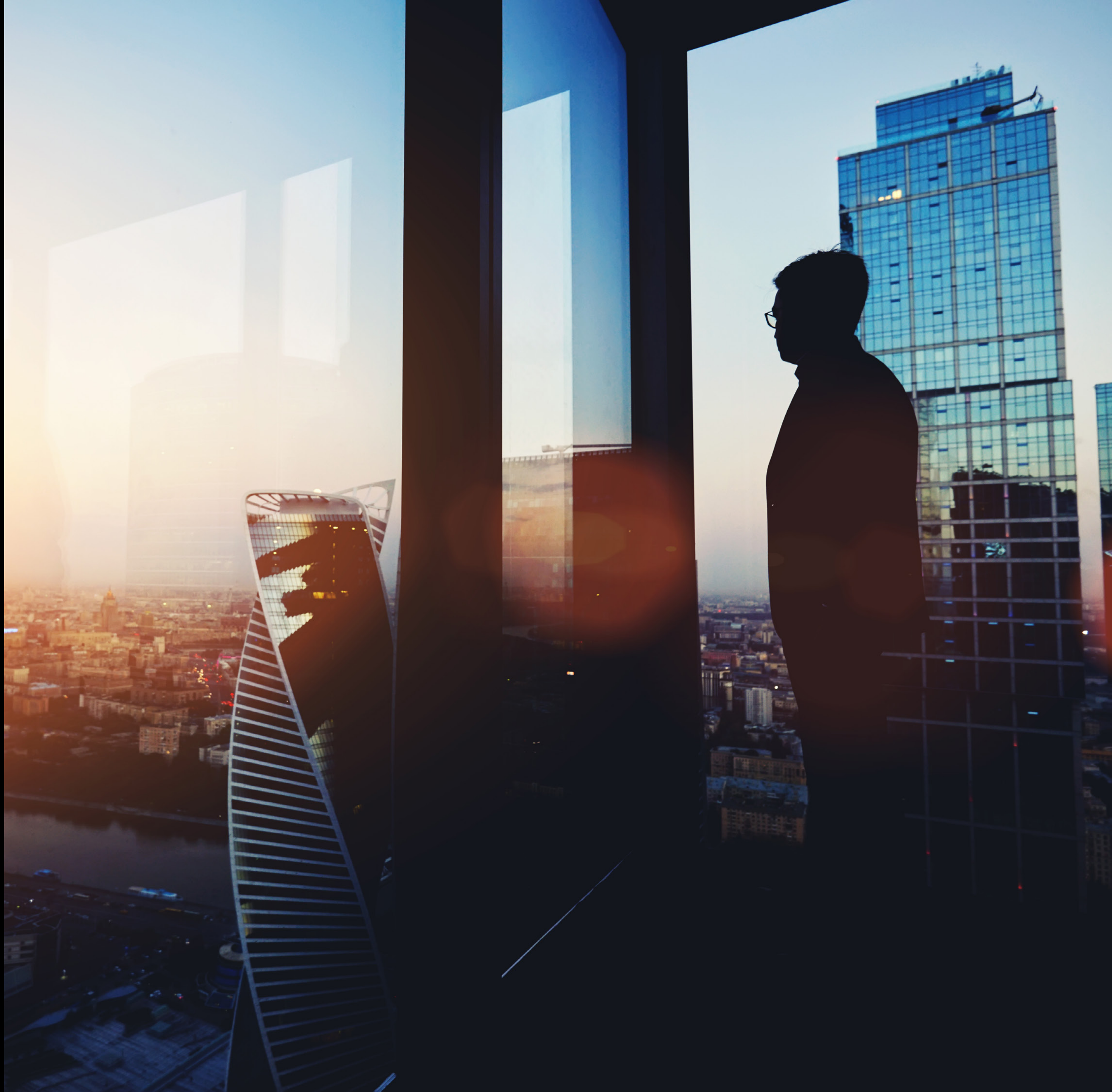
You’ve just received an interesting, fantastic pitch: A brand-new artificial intelligence (AI) company has promised to set the world on fire. In fact, they promise to set your business on fire, their solution is so good.

A healthy dose of skepticism is in order. On the other hand: What if they really have created the exact AI solution you need? You’ll never know the answer to this question without two words that should be your guiding star: due diligence.

Going beyond the hype

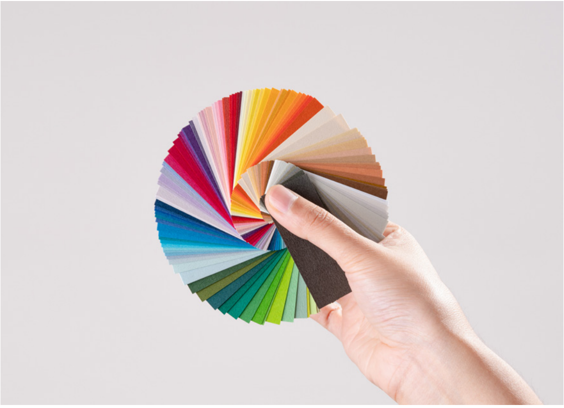
In the past several years, interest in AI has surged. Venture capital investments in companies developing and commercializing AI-related products and technology have exceeded $2 billion since 2011.[1] Technology companies have invested billions more acquiring AI startups. Press coverage of the topic has been breathless, fueled by the huge investments and by pundits asserting all sorts of disruption.[2]

Looking into AI startup companies and solutions can be a tricky business. For a corporate customer, the big questions to consider include: Is it a good match for the slate of problems that your business is focusing on? Can it scale into new opportunities for the business? Does it have the capability to actually do what it says it can do? And, can your business tolerate the risk of dependence on a startup?



Choosing smart

Startups, including AI companies, fail for all sorts of reasons: failure to attract enough funding, bad management, inexperience, poor product, no market fit, underestimating the competition, or all of the above. When they fail, their customers can suffer. To avoid the prospect of picking the wrong startup for an AI solution for your company, it's critical to consider a lot of questions.



Not all startups are equal as far as their maturity—a startup is a company in the first stages of operations; it can be three months old or three years old. For some, the business model may not be fully developed, their funding may not be robust, and they often have fewer employees and a limited roster of clients. On the other hand, the founders can have a brilliant focus on innovation and a vision for a solution that is spot-on. Perhaps this entrepreneurial founder has built other successful companies. Choosing smart can start with asking specific questions:

- **Can the solution adapt?** Are the company's solutions that worked so well for one client's problems applicable for what you're trying to solve? Keep in mind that many companies ask for a "custom" AI solution for their particular business circumstances. If the product was built specifically for another client, it may need additional changes to work for you. Dedicating the extra financial and management resources to get what you really need from a "one size fits all" offering of a startup isn't an ideal situation, unless it's stated upfront.
- **Is the company stable enough—from a financial and a management perspective—to not just survive, but thrive?** The founders/executives will likely still be spending much of their time trying to secure additional funding, a distraction from running the company and providing high-touch service to customers. In addition, is the company adept enough to respond to a Black Swan event like a pandemic?
- **Can the company scale the way you need it to?** This is perhaps the most important question. Often, promising AI startups manage to have an interesting pilot project with one customer but fail to understand the difficulty to scale up to multiple large companies. It's a conundrum, because typically only with a scalable product comes the big revenue needed to keep the startup on firm footing.

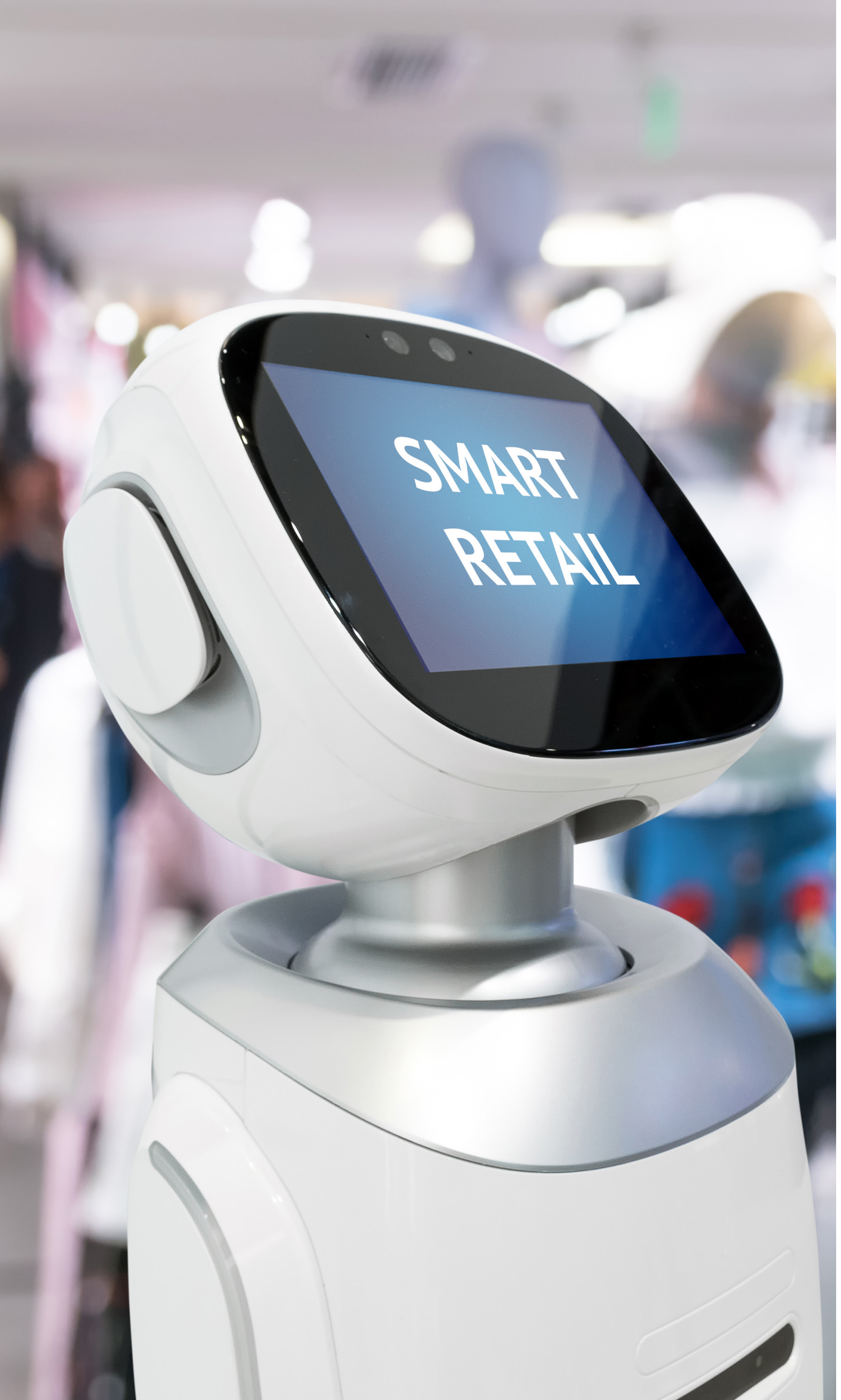
So how do you choose smart? Success comes in managing potential risks and making up for any weaknesses. Any analysis of a startup should look at the following three aspects closely: The visionaries, the vision, and the viability.

The visionaries: Management teams and their track records

First and foremost, team experience is critically important. Sometimes the founder, or visionary, of a startup is truly mercurial and charismatic. Sometimes the founder or team of founders are accomplished, serious, previous executives. Many AI startups are founded by those with extreme technical competence—but has this person previously built a successful company? Unlike with investments, for which past performance is not an indicator of future success, a startup founder's past experience is often the leading predictor of future success. Unfortunately, however, in some cases, even the most skilled executive can't deliver an extraordinary product if the business model fails.

When you consider whether the startup is built and run by 20-somethings or by industry-experienced people like a 20-year seasoned chief technology officer, don't assume one is better than the other, but do account for mitigating different risks based on the management team makeup. Be clear-eyed about the fact that "visionary" founders are usually entrepreneurs at heart—some may simply lack the interest in running a bigger, more complex company as it grows, not to mention lacking the necessary skills.

There's no question that the strength of the founder is likely a strength of the company, but it may be a strength that serves a particular phase well and may or may not translate into strength at a later phase. If they are a finance expert, they may do really well at managing the books but may lack the ability to raise capital. If they are a sales expert, they may be able to raise capital but lack the leadership skills to effectively create a highly technical AI product. And consider whether the founder has previous experience in managing the process of getting to scale, an often turbulent time in the process of moving from true startup mode to established business. In addition, test whether the founder has been able to attract and secure the talent needed to make that kind of shift for a solid, long-term future.



The vision: AI products and services capabilities

The next thing to do when looking into an AI startup is to scrutinize the product or service. Does this product do what the company says it will do? It certainly may—for a particular company or industry. But what about your company or industry? An AI "solution" is only attractive if it's solving a real-world problem and providing a good return on investment.

Critical criteria include quality control, the ability to customize, the ability to support a solution, the product's speed to market, and the potential to scale up. As noted above, this last criterion can be extremely important—and it isn't just about scaling up to satisfy your company's needs. It's about the scale needed to serve many large companies and realize the long-term revenue needed to make and keep the startup stable. Accuracy is also a leading criterion: Not only should the AI startup's visionary be able to describe how accurate its solutions are but also how this accuracy leads to a desired business outcome.

It (almost) goes without saying that you should make sure the "AI" company is really offering AI—and not just data analytics to orchestrate applications and workflows. In that situation, the technology doesn't get more intelligent over time, and it never reaches the level of autonomy of bona fide AI. True AI systems are iterative—in other words, they get smarter over time and become increasingly autonomous.[3]

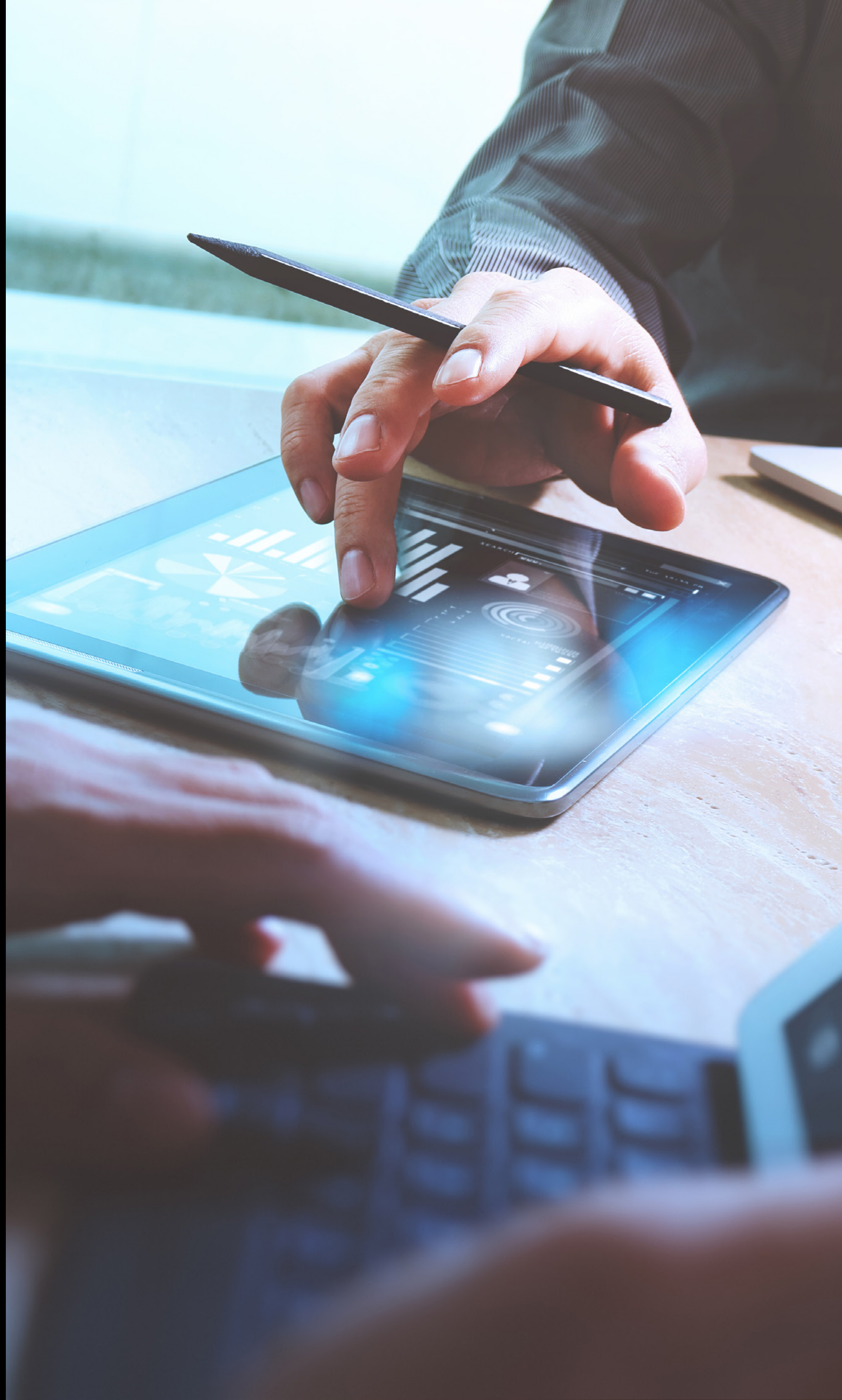
You will also want to make sure the AI company you're evaluating is staying abreast of current and potential regulation. AI is attracting greater regulatory scrutiny now that it's becoming more pervasive. Some regulators have concerns about AI's implications for fairness, bias, discrimination, diversity, and privacy. For example, the fundamental tool behind today's AI is machine learning, which has received significant scrutiny from regulators and others for potential social bias.[4]

The viability: Financial and operational

Finally, make sure the startup is viable. Will customers buy? If the AI startup isn't asking this question of their own company, you certainly should be. While it's obvious to make sure the startup's product is right for your company, it's less so to make sure there's a healthy demand for the startup's product by other companies. This is a key factor in answering the question: Will this company be viable tomorrow, next year, next decade? A great product is the cost of admission for the startup. A great product that is noticed, vetted, and purchased is the cost of long-term staying power. It should have good customer momentum and control of its message. Its messages shouldn't flow with the wind upon every customer request.

Funding, of course, is what helps keep the startup's wheels greased while it moves forward. How well funded it is, and by whom, can have a direct impact on how flexible it can and will be. You want companies to either grow or get acquired. While there's risk for customers in either scenario, the biggest risk is the startup going out of business. A solid financial footing also helps the startup attract top talent, which feeds on itself: top talent often attracts more top talent. Evaluate the company's level of professionalism and experience across a few of its departments. A startup may have a strong technology team but a weak legal team. Understand what kind of capacity it really has.

What about the startup's culture? Established companies typically have well-defined cultures, clear goals, measurable performance expectations, and refined training processes that maximize employee skills and optimize performance. Unless the company is lucky enough to have experienced leadership, startups often begin their journey without a definitive culture, which often leads to internal challenges, conflicts, disappointments, and employee turnover and can significantly impact its long-term viability.[5]



Mitigating the risks

Because there's an inherent risk in hiring a startup, examine your capacity to mitigate risks that may crop up. Be sure to examine whether its technology is built on a system compatible with yours, whether it has successfully navigated the growing pains that come along with an expanding customer base, and whether it has strong cybersecurity measures in place. Be sure you can accommodate if the startup is weak in a certain area, such as product customization. And remember that dotted line the startup wants you to sign? You'll serve your company well if your legal team takes a thorough and exhaustive look through the contract, focusing on your protection if the startup fails to deliver.

Ultimately, it's about what your company's appetite and tolerance for risk is. If other criteria identified appear to be a green light, consider moving forward. Teaming with an AI startup has significant benefits: It may save you development time, could help create a competitive advantage, and may result in an outstanding return on investment by solving your company's real problems. Those benefits rest on thorough analysis of multiple factors. But don't forget that elusive "X factor." While hard to define, a company's X factor could be what pushes you into the arms of the startup you're considering. It can be part culture, part people, part product, part possibilities, part "can't put my finger on it." And it may be exactly what you need.

Contact Us

Beena Ammanath
Executive Director of the Global Deloitte AI Institute
Deloitte Consulting LLP
Email: bammanath@deloitte.com

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1. David Schatsky, Craig Muraskin, and Ragu Gurumurthy, Demystifying artificial intelligence, Deloitte, 2014.
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3. Arif Janmohamed, “Most ‘AI’ companies are not AI companies. Here’s how to tell,” Fortune, July 3, 2018.
4. Duncan Stewart et al., “AIs wide shut: AI regulation gets (even more) serious,” Deloitte Insights, December 1, 2021.
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