

EARLY-STAGE COMPANIES

THE DRIVERS
OF PROGRESS**ANTONIO DÁVILA**Professor of Entrepreneurship
and Accounting, IESE

Start-ups increasingly play a key role in transforming the way we live and in driving the overall economy, but starting a company from scratch is not for the faint-hearted or impatient.

Entrepreneurs are important drivers of social and economic progress and, increasingly, successful early-stage companies are changing society as they launch products and ideas that transform the way people live, work and play. Interestingly, in our study *Global Entrepreneurship and the Successful Strategies of Early-Stage Companies* we found that the similarities in early-stage companies around the globe are far greater than their differences. The people behind these new ventures also have much in common. Viewing the world through the perspective of proactive opportunity is part of the DNA of many successful entrepreneurs. Starting and building a new venture typically requires an enormous amount of optimism, stamina and ability to survive some very rocky seas.

**EIGHT GROWTH STRATEGIES
FOR NEW VENTURES**

● We succeeded in pinpointing eight growth strategies for new ventures, each of which has associated opportunity / risk factors. We also asked a range of executives to highlight what they believed were the key growth accelerators and growth challenges. We also asked them about their darkest hours of self-doubt, some of which are highlighted here.

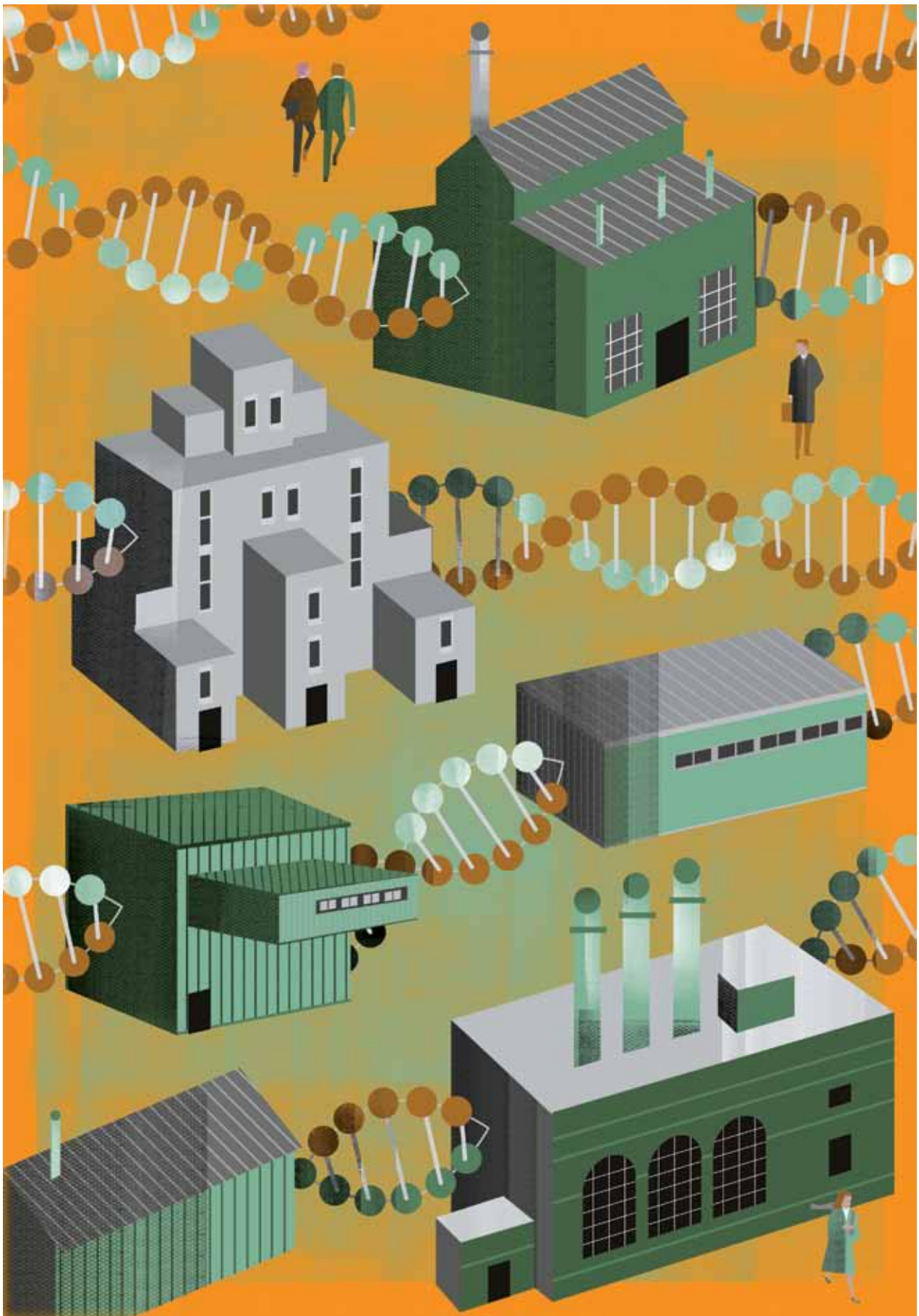
- Wave
- New product in a new category

- New product in an existing category
- Redesign of business value chain
- Research or discovery of knowledge
- Rollup (aggregation) of existing players
- Governmental, regulatory or political change
- Idea transfer or transplant

RIDING THE WAVE

● When it comes to waves, few companies manage to pull off the “triple play” in which they help to create a new business wave, play a major role in building the wave and continue to ride it. One such firm is Microsoft. Its founder Bill Gates says that they had a “focus on helping to build an entire industry around personal computing. We worked with a lot of software and PC companies to help them get off the ground. Building this ecosystem was critical to our success.”

The distinction between a new product in a new category and a new product in an existing category is one of degree. Almost all products labeled as belonging in a new category will have some features that are in existing products. New product companies can differ greatly in their ongoing product strategies. Some keep their first successful new product as a core and add ongoing features to it. Others build an ongoing new product pipeline where the aim is to develop a sequence of new products. New products can exploit short-



STARTING AND BUILDING A NEW VENTURE REQUIRES AN ENORMOUS AMOUNT OF OPTIMISM, STAMINA AND THE ABILITY TO SURVIVE SOME VERY ROCKY SEAS.

comings in existing markets, as the China Lodging Group did in regard to economy hotels.

VALUE CHAIN OPPORTUNITIES

- Value chain restructuring can
- take many forms and may be based around outsourcing of processes or research, IT expertise or restructuring to reduce activities that add no value. In the case of Net-a-Porter, its founder Natalie Massenet saw in the nascent Internet an opportunity to sell high fashion directly to customers. “I wasn’t trying to transform the store, I was trying to transform the magazine. I thought it would be amazing if you could tell readers what to buy and also to give it to them with one click,” Massenet says. In 10 years, Net-a-Porter’s revenues have grown to over \$100 million.

Discovery and research knowledge ventures tend to be in the field of life sciences or the extractive industries. Companies that seek to discover major product breakthroughs for medical conditions such as cancer or diabetes face daunting risks of success. New ventures that start at the very early stages of the discovery process face a long period before revenues come in. However, there can be a very large payoff if a successful new product is created.

In the extractive industries sector, in the early exploration stage companies face a very low probability of finding significant reserves for any one company but very high payoffs if that discovery is made. Commodity price fluctuation is a significant risk factor in this sector. For example, from 1990 to 2002 the price of uranium was below \$10 per pound, but between 2007-2009 the price ranged from \$40 to \$90 per pound.

ROLLUP OF EXISTING VENTURES

- Acquisitions, mergers and joint
- ventures are an important element in the growth strategies of both existing and new companies. How-

ever, a subset of new ventures (or restarted ventures) explicitly make acquisitions a core and major engine of their growth strategy, involving the rollup (aggregation) of existing players. The key risks in rollup ventures are overpaying for the company and the assets acquired and a heavy reliance on debt financing.

GOVERNMENT INCENTIVES

- The global telecommunica-
- tions industry has seen many start-ups that have benefited from government incentives or changes in regulatory systems. Suntech Power, which makes photovoltaic cells, took advantage of government incentives in Spain and Germany in order to grow the company. However, a change in Spanish government policy in 2008 dented its profitability.

There are many ways that governments can promote new ventures in green technologies and other environmental causes. Tesla Motors, a United States start-up, was founded in 2003 by Silicon Valley entrepreneurs to explore the potential of electric cars. The U.S. Department of Energy has provided Tesla with \$45 million in advanced technology loans to help the U.S. to be competitive in battery technology.

Great ideas can arise anywhere and often do so simultaneously, but alert entrepreneurs who use an idea transfer approach can be early movers in taking already proven ideas to other parts of the world. For example, **Robin Li** observed the early success of Google and then replicated it in China in the form of Baidu. “We recognized that Internet search in Chinese was an under-served market,” says **Li**. “During my time on Wall Street and in Silicon Valley I had thought deeply about how searches could be vastly improved for the Chinese.”

Niklas Zennström, who co-founded Skype in 2003 set out to solve a market pain point – the monthly phone bill, by creating a free telecommunications network. “Hundreds of millions of people

would be interested in this idea,” he said. “My belief was that if you could successfully address this basic idea, you could probably create a good business out of it.” Two years later, eBay (a 1995 start-up) paid \$3 billion for Skype.

VALLEY OF DESTRUCTION

● Early-stage companies are rightfully heralded as a vibrant and important source of growth. Statistics on the revenue or jobs created are often quoted. What is given much less publicity is the simultaneous and sizeable amount of revenues and jobs destroyed in the early-stage sector of the economy. We characterize these as the “mountain of creation” and the “valley of destruction,” two concepts that highlight how the net revenue and net job creation that we report for this early-stage sector mask the larger gross creation by some companies and simultaneous large destruction by other companies (who were the creators in prior years).

Our research also shows that in the first five years, an early-stage business will almost certainly experience one year of losses. For example, 42 percent of companies have a pattern of two positive revenue growth years and one negative growth year in their Year 2 to Year 5. These are among the “dark moments” that put the firm’s strategy to the test as well as testing the nerve of those running the firm. Start-ups are not for the faint-hearted. It takes imagination and vision, but also plenty of grit and a tough-minded entrepreneurial spirit of the sort embodied by **Martin Sorrell**, CEO of the communications company WPP, who said that when everyone claimed the business was bankrupt and over-leveraged, “even in those dark moments I never ever thought that we were going to go down. Not even for one second.”

MORE INFORMATION:

Global Entrepreneurship and the Successful Strategies of Early-Stage Companies. Foster, George; Dávila, Antonio; Haemmig, Martin; Xiaobin He; Ning Jia; von Bismarck, Max; Wellman, Kerry. World Economic Forum. 2011

ROBIN LI

CHIEF EXECUTIVE OF BAIDU
CHINA'S LEADING SEARCH ENGINE



“ After the Internet bubble burst, mainstream websites no longer wanted to invest in search technology. In the summer of 2001, we decided that it was time for Baidu to undergo a major transformation. I recall being in a conference room in Shenzhen taking calls from members of the board of directors. *I knew right then that consensus would not be achieved through logical reasoning but through a demonstration of the founder's fierce determination.* Later on, one of the directors told me that the board was not moved by my theories or reasoning, but by my attitude.”

MARTIN SORRELL

WPP, MARKETING COMMUNICATIONS COMPANY

WPP

“ The period from 1990 to 1992 presented the biggest challenge when people would say we nearly went bankrupt, we were over-leveraged. The market always goes one way and another and in dark moments, it always goes too far one way or the other. But the darkest moment was then. On the other hand, intellectually, whilst it was a challenging time, it was a very interesting time. *The biggest test of companies, people, individuals, families and countries is in their darkest moments, in their toughest moments.* It's not the easy times that are the true test, it's the difficult times. In those dark moments in 1991 and 1992 I never ever thought that we were going to go down. Not even for one second.”

PIERRE OMIKYAR

FOUNDER OF EBAY



“ In the early days of eBay, my view was that as long as it was legal, we could sell it on eBay. One of the few times we made a decision to limit legal items was when a member of our board became very upset about Nazi paraphernalia being sold on the site. It was a tense time and there were lots of discussions – you could argue that some of these items hold significant historical value despite the fact that they offend many of us (myself included). *The community had key input in these discussions and helped us to figure out how to proceed. In the end I think we made the right decision to prohibit those items from being sold on eBay.* Since then, we've also limited other items that promote hate and racism.”