By Ramakrishna Velamuri and Michele Appendino

In the face of major price competition from eastern markets, internal innovation has become the key to growth in today's business world. Based on what some companies have achieved can successful models of entrepreneurship be enhanced within large corporations?

Entrepreneurship as a Core Competence in the Large Corporation

Large corporations in the mature US and Western European markets are finding it more and more difficult to grow organically. Although acquisition as a route to growth seems to be making a comeback in Europe judging from the recent large bids for O2 and Endesa, its track record is not very encouraging for the shareholders of the acquiring companies. The brutal price competition from Asian exporters (mainly Chinese) is driving margins downwards and will continue to do so. As a result, large corporations are beginning to realise the importance of promoting entrepreneurship and innovation within their ranks, as a way to ensure long-term corporate health.

The transition from a predominantly administrative culture, which places the emphasis on optimising returns from available resources, to an entrepreneurial one, where the focus is on the 'pursuit of opportunities beyond resources currently controlled', or the innovative recombination of existing resources to pursue new opportunities, is not an easy one to achieve. A first step in achieving this transition is to understand the nature of opportunities and the process by which they are recognised and pursued.

All new products, new services, and new firms can be traced to opportunities that were recognised at some point by enterprising individuals. Yet our understanding of how opportunities are recognised remains something of a mystery. Broadly speaking, there are at least three classifications of opportunities as they relate to individuals.

Economics textbooks equate opportunities with information that allows individuals to buy low and sell high. This class of opportunity is called arbitrage. According to this view, it does not really matter who the entrepreneur is, as it is assumed that any individual can potentially recognise any opportunity. Arbitrage opportunities do present themselves every now and then, but because they depend on information that is not tied to particular resources and skills or to particular individuals, they are not sustainable and therefore tend to disappear very quickly.

Current observation of actual products, services, and firms launched, highlights the fact that, in many cases, particular characteristics of individuals enable them to recognise particular opportunities. For example, it is no coincidence that DVM, an 'ethnobank' in Germany that caters to the investment needs of Turkish immigrants, was set up by an MBA graduate of Turkish origin who had grown up in Germany and had some years of banking experience. It also helped that he attended the Starting New Ventures course in a leading European business school. In this example, at least three variables link the entrepreneur to the opportunity - his Turkish origin, his experience of having grown up in Germany, and his experience of banking. We shall refer to these opportunities as related opportunities, because they are closely tied to the characteristics of the individuals who identify them.

There are several successful ventures founded by individuals with no prior experience in the corresponding business. For example, Stelios Haji-Ioannou, the founder of easyJet, a low-cost, no frills, point-to-point airline, had no prior experience in the airline business. Similarly, Richard Branson has repeatedly entered businesses in which he had no prior experience and has made several of them profitable. We shall refer to these opportunities as unrelated opportunities, in that there is no apparent link between the prior experience of the entrepreneurs and ventures they pursue.

What can we say about the attractiveness of related versus unrelated opportunities? From teaching entrepreneurship in business schools and from having funded several young firms, we have observed that younger, less experienced students have a greater tendency to pursue unrelated venture ideas than older, more experienced students. We

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can say that individuals with no prior work/entrepreneurial experience will by definition identify unrelated opportunities, whereas people with industry/work experience tend to recognise and pursue related opportunities.

Unrelated Opportunities

Ventures based on unrelated opportunities have generally lower success rates than related opportunities. This is because those who pursue unrelated opportunities often make the mistake of thinking that a business is more attractive than it really is. It generally takes a long time (years rather than months) to understand in depth the workings of a sector, and the profit potential in it. However, in the rare occasions that ventures based on unrelated opportunities succeed, they have the potential to grow tremendously, to generate above average profits, and even to revolutionise or open up new market segments. Some examples in this category are Bill Gates of Microsoft, Marc Andreessen (who co-authored Mosaic, the first web browser, which later became Netscape), Stelios Haji-Iannou of easyJet, Richard Branson of Virgin, Jeff Bezos of Amazon and Niklas Zennström of Skype.

We would classify the successful unrelated ventures into two broad groups. The first is made up of ventures based on radically new ideas that entered emergent industries and successfully rode the growth wave. Interestingly, the one important factor that was common to these entrepreneurs - Apple’s Jobs and Wozniak, Gates, Andreessen and others - was their intrinsic passion for what they were doing. Making money was not their main goal when they started, and none of them could have foreseen that they would have such a major impact on the technology sector. It was thus not possible for them to plan ahead in any meaningful way. For this reason, it is unlikely that any of these ventures would have survived the scrutiny of the planning process in a large corporation, where the emphasis is on predictability. Therefore, this type of unrelated venture will tend to be launched by individual entrepreneurs working independently, as has been confirmed by research to date.

The second group of successful unrelated ventures was set up in mature industries (passenger airlines, book retailing, telecommunications, etc) with innovative business models that fundamentally redefined the value proposition for customers. In doing this, the entrepreneurs caught the incumbents off-guard. They leveraged technology to do away with entire segments of the value chains of these businesses. For example, Haji-Iannou followed the lead of Southwest Airlines by doing away with travel agents altogether, although this was only one of the innovations he introduced, the others being point-to-point travel, the use of a single model of aircraft (the Boeing 737), and no-frills service on board. Similarly, Bezos leveraged the internet to circumvent the need for expensive retail locations. Finally, Skype used the capabilities offered by broadband internet to radically redefine the value proposition for customers in voice communications. What this second set of examples indicates is that large corporations in mature industries must be sensitive to the threat of new entrants coming up with innovative business models and rendering their own obsolete.

It is worth asking why Barnes and Noble, the market leader in book retailing, was not the first to see an opportunity in using the internet to sell books online. Similarly, why did the large European carriers such as British Airways, Air France, Lufthansa, and KLM not proactively replicate the business model of Southwest Airlines in Europe, even after it had been proven in the US for many years? Indeed, why have the large telecoms operators been less than enthusiastic in embracing Voice over IP technology, even after it has been shown to be viable? We believe that the business models of these large, established companies, which are based on huge sunk investments, lock them into a particular pattern of thinking that make it very difficult for them to change course quickly. Further, the new business models involve cannibalising secure revenue and profit streams from established businesses. In other words, they have simply too much to lose by embracing the new business models.

For today’s managers it is becoming increasingly important to realise that there are as many threats as there are opportunities emanating from unrelated areas. This means that in an environment of pervasive innovations, threats (based on opportunities pursued by competitors) may originate from product-market areas beyond those considered as the traditional industrial boundaries of the firm. Barnes and Noble was surprised by Amazon's innovative use of the internet to develop a competing business model. Similarly, Charles Schwab creatively used the internet to open up a hitherto untapped segment of the stock brokerage market, thereby stealing a march over larger players such as Merrill Lynch.

Related Opportunities

Ventures based on related opportunities have a much higher probability of surviving and being successful, though they typically possess rather limited potential to introduce a revolutionary business model or to create a new market. What we do know is that most ventures are started in related areas. In fact, individuals leaving paid employment are the ones who start most new ventures. According to John Freeman, "Organisations create their own competition by providing the skills and background that provide credibility for the entrepreneur. They provide the knowledge of opportunity by placing that person in a position to know about unserved or badly served markets."

Some organisations, such as Fairchild Semiconductor, have spawned many new ventures including Intel and AMD. Recent research argues that employees of firms such as Fairchild (referred to as entrepreneurially prominent firms) benefit from access to high quality information and resources - above all, social capital - and the reputations of their employers at the time they start their own ventures.

Based on the research of the Inc. 500 companies in the United States conducted by Amar Bhidé, we can see that even related opportunities can be stepping stones to high growth organisations. The companies listed in the Inc. 500 ranking are a compilation of the fastest-growing privately held companies in the US. The firms studied by Bhidé boosted their revenues from an average of US$1 million in 1984 to about US$15 million in 1988. In the same time period, the average amount of employees rose from 20 to 135. Over this period the average sales growth was 1,407%. Bhidé interviewed a sample of 100 founders of these companies and concluded that the Inc. founders tended to imitate the ideas they were exposed to during their previous job. The results of the interviews showed further that the typical Inc. company starts with products or services that are quite similar (at least in their tangible attributes) to the products or services offered by other companies. He reports that in a survey of all Inc. 500 companies, undertaken from 1982 to 1989, only 12% of the founders attributed the success of their companies to "an unusual or extraordinary idea", and 88% saw their success to be the result of the "exceptional execution of an ordinary idea". The innovations that led to their high growth typically happened several years later.

Interestingly, most of the high growth ventures were started with very modest capital. The Census Bureau's 1987 survey of businesses in the US showed that 30% of all companies were started with less than US$5,000 and only one-third had more than US$50,000. This is confirmed even in Bhidé's sample of 100 founders of high growth companies, with the results showing that 26% started with less than US$5,000 of initial funding and only 21% raised more than US$50,000. This would indicate that lack of capital is usually not a constraint to fund a high growth company.

For an established corporation, there might be some merit in allowing new ventures to be started by its employees with very limited resources, even if these ventures do not, at the outset, offer the potential of very high growth.

Opportunity Recognition and Pursuit in Large Corporations

In conclusion, we can say that opportunity recognition - whether related or unrelated - has become one of the most crucial capabilities a firm needs to develop to survive in today's business world. There are several measures that enhance the capability for opportunity recognition and pursuit in established firms - promoting a culture that tolerates failure, encouraging experimentation with new ideas, introducing monetary and non-monetary incentives for innovation, and promoting diversity in the workforce (some of the world's most innovative firms are also the most diverse in terms of gender, race, nationality, and educational background). Firms can also encourage their managers to interact with

those from other industries, through open enrolment executive education programmes, and membership in horizontal organisations, such as Associations of Finance Managers, Purchasing Managers, etc.
However, these measures to enhance entrepreneurial capabilities are by no means easy, and are particularly difficult to harmonise with the efficient exploitation of the firm's current businesses. This difficulty was articulated by Peter Drucker as early as 1974: "The search for innovation needs to be organisationally separate and outside of the ongoing managerial business. Innovative organisations realise that one cannot simultaneously create the new and take care of what one already has. They realise that maintenance of the present business is far too big a task for people in it to have much time for creating the new, the different business of tomorrow. They also realise that taking care of tomorrow is far too big and difficult a task to be diluted with concern for today. Both tasks have to be done. But they are different. Innovative organisations, therefore, put the new into separate organisational components concerned with the creation of the new."
Since Drucker made his pronouncement, several venturing models have emerged to tackle this tricky problem: as a general rule, the more unrelated the opportunity is to a firm's core business, the more compelling is the case for it to be organisationally separate. This separation between core and new venturing activities defines one end of the spectrum. The separated units can either be funded internally on an ad hoc basis, or can be organised within a Corporate Venture Capital (CVC) organisation. Again, there are different CVC models: pooled vs. dedicated, and centralised vs. decentralised. The choice of model is a function of the venturing strategy adopted. At the other end of the spectrum are the entrepreneurial organisations, i.e. those that have defined entrepreneurship and innovation as their raison d'être. Examples of entrepreneurial organisations are 3M and Apple, where innovation is deeply ingrained in every activity. Between these two extremes, there are a number of hybrid models.
Wherever on the spectrum a firm positions itself, it is clear that entrepreneurship- the recognition and pursuit of entrepreneurial opportunities- will need to become a core competence (if not the core competence) in large corporations if their managements are to deliver the long-term revenue growth demanded by their stakeholders

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