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SEVEN STRATEGY LESSONS FROM TOP ENTREPRENEURS

Can you recall what the business world was like before Microsoft, Arcelor Mittal, or Ryanair? Such world-changing companies, created by intrepid entrepreneurs, can teach us key lessons about strategic vision. And Peter Cohan and U. Srinivasa Rangan say that corporate managers should pay special attention.
Entrepreneurs seem to win against the odds. Whether the story is about Bill Gates, Richard Branson or any other legendary entrepreneur, that story usually ends with the word “success”. But how do the best entrepreneurs manage to succeed so often and so convincingly? We’ve found that the entrepreneurial mind employs the following seven principles of strategic decision-making:

- Exploiting confirmatory bias
- Letting a thousand flowers bloom
- Expanding through beachhead acquisitions
- Selective stealing
- Changing the rules of the game
- Using paranoia, and
- Avoiding head-on competition

These strategy lessons are as valuable to managers in established companies as they are to entrepreneurs; the key is to understand the power of each strategic weapon.

Exploiting confirmatory bias

Confirmatory bias is a decision-maker’s tendency to lap up information that reinforces the decision-makers’ beliefs about the world and to ignore information at odds with them. IBM’s confirmatory bias – based on decades of dominance of business computing technology waves from desk calculators to mainframes to data storage – was that its entry into the PC market would confer it instant legitimacy. Moreover, IBM believed that its heritage of marketing excellence would let it prevail over any PC rivals.

In 1980, when IBM decided to enter the PC business, it wanted in fast. So instead of building a closed system for which IBM would supply all the hardware, software, and peripherals; IBM forged an open one to encourage other companies to develop operating system (OS) software, microprocessors, displays, printers, and other parts.

IBM’s search for an OS took it to Seattle where IBM met with Bill Gates, founder of Microsoft, which had developed BASIC programming software for small hobbyist computers such as the Altair. Unfortunately, Gates had no OS available for IBM, but was quick to perceive the huge opportunity with IBM. Gates searched around and discovered an OS, called Quick and Dirty Operating System (QDOS), from Seattle Computer Products – which he licensed for $50,000. (In so doing, Gates neglected to mention the IBM licensing deal to Seattle Computer Products.) Gates sold IBM the rights to the OS for use on IBM PCs for a pittance. He just asked for one thing: unfettered rights to license the OS to potential clones of the IBM PC. IBM, assuming that no PC-clone market would emerge quickly, was happy to grant Gates’ wish. IBM had convinced itself that Gates was naive about the emergence of PC clones. If Gates was right, IBM reasoned, then IBM was no longer the marketing powerhouse it believed itself to be.

IBM was initially correct about its decision. Between 1981 when it introduced its first PC and 1983, IBM’s market share climbed to 42 per cent. But by setting the standard in this rapidly growing market, IBM attracted competitors like Compaq – whose low-priced portable clones enabled it in 1982 to reach $100 million in sales during its first year, making it the fastest growing company in US history. Dell entered the market in 1984 and Hewlett Packard shifted from a proprietary architecture to IBM’s standard. By 1985, IBM’s share had fallen to 37 per cent; four years later, IBM controlled a mere 16.9 per cent of the PC market. Finally, in 2005, IBM sold its money-losing PC business to Lenovo Group.

Gates succeeded because he exploited IBM’s confirmatory bias. The entrepreneurial mind seeks to understand an incumbent’s confirmatory biases because they represent strategic blind spots that may present a rich source of profitable new business. Microsoft’s performance shows just how rich those new markets can be.

Letting a thousand flowers bloom

Uncertainty is often perceived as an enemy by corporate managers. Entrepreneurs, however, embrace it since they have developed ways to take advantage of it. Successful start-up CEOs, such as the ones running Google, for example, believe that, while the future is so difficult to predict, experimentation will allow them to make sense of it. They find it more productive to let their employees try many different new product ideas, accept that many will fail, and exploit happy accidents to build new businesses.

While Google has one line of business, search advertising, that accounts for almost all of its...
revenues; it encourages its employees to spend 20 per cent of their time on projects of their own choosing. The result of all these independent projects is the emergence of 83 new services ranging from Gmail to Google Earth (the service that lets users view detailed geographic photos from around the world), which so far have generated negligible revenues.

The story of Google Earth suggests that unexpected outcomes can generate new revenues. Google co-founder Sergey Brin was testing US satellite-imaging software from Keyhole before acquiring the company in 2004. At a staff meeting, Brin put Keyhole on a projector and began to show people their houses. Brin soon asked, “Why can’t you look at the whole world at once?” By 2006, Google Earth had integrated advertisements – such as searching for pizza while visiting a neighbourhood. And by requesting that users who download Google Earth (100 million as of September 2006) also download a search toolbar, odds have increased that more people will click on an advertiser’s ads, further boosting Google’s top line.

Google also has a surprisingly tolerant attitude towards failure. For example, Sheryl Sandberg, a vice president of its automated advertising system business, committed an error that cost Google several million dollars. When Sandberg realized how big her mistake was she walked to the office of Google co-founder, Larry Page, to apologize. Page accepted her apology but told her: “I’m so glad you made this mistake because I want to run a company where we are moving too quickly and doing too much, not being too cautious and doing too little. If we don’t have any of these mistakes, we’re just not taking enough risk.”

Google’s approach suggests a refreshing intellectual humility in the face of the vast uncertainties regarding how to create future growth. Will its approach lead to new revenue sources? That remains to be seen. Contrast this with the way many established firms deal with efforts aimed at innovations; they often stifle them with inappropriate metrics that discourage experimentation.

Expanding through beachhead acquisitions
Numerous studies suggest that most mergers destroy shareholder wealth. However, many successful entrepreneurs have achieved extraordinary outcomes when they expanded their competitive scope through beachhead acquisitions. Cisco Systems, a $29-billion leader in network equipment, recognized early in its development that acquisitions of small companies with a foothold in an emerging market could generate attractive returns. To make such an acquisition work, however, the target needed to pass two tests:

- It made a product in a new category that corporate customers were eagerly purchasing; and
- It was weak in selling and marketing to large corporations – an activity at which Cisco excelled.

Under these conditions, the acquisition was likely to work due to a very strong mutual dependency between Cisco and the target. (Cisco needed its product, and the target needed Cisco’s sales force.) This was the case with Cisco’s acquisition of Crescendo Communications from which one of Cisco’s largest customers, Boeing, intended to purchase switches. Cisco was concerned at the time that Crescendo’s switches could cannibalize Cisco’s core technology, the router. But Cisco overcame this concern and acquired Crescendo for $95 million. It was a smart decision: by 1999 switches accounted for $4 billion in Cisco sales.

By not overpaying for companies in new markets that could benefit from its strengths, Cisco tapped the profit-generating power of beachhead acquisitions. Contrast this with the traditional large company CEO’s penchant for large blockbuster acquisitions with the attendant high risk of failure.

Selective stealing
Successful entrepreneurs are shameless in stealing ideas from others if it serves their purpose. A good example is how Sam Walton operationally benchmarked his stores against rivals’ stores and was willing to improve upon them if it suited his purpose.

Walton spent a significant amount of his time investigating competitors. He counted the number of cars in Kmart and Target parking lots – both of which were founded the same year as Wal-Mart. He tape measured competitors’ shelf space and noted sales prices at Ames, a department store chain.

Walton also copied his competitors’ best ideas. For example, Walton knew Sol Price, who...

Entrepreneurs like Walton are driven by an overriding vision. In Wal-Mart’s case it was to lower consumers’ cost of living. The Sam Waltons of the world also recognize that they don’t have to invent all their ideas. Instead, they’re happy to realize their vision by expropriating ideas that competitors have proven will work.

Changing the rules of the game
Ask any manager in a large company. He or she will list a set of rules by which the competitors play in the industry. Naturally, they are leery of changing them. Successful start-up CEOs, on the other hand, thrive on crafting strategies that makes customers and partners better off by changing the rules of the game.

In 1986 an upstart Irish airline, Ryanair, decided to offer a cut-rate service for the hour flight between Dublin and London. Ryanair hoped to turn into customers a chunk of the 750,000 people who took the nine hour, 55 IR£ train or ferry rides between the two cities. At 99 IR£, Ryanair’s plane tickets were half their competitors’ price. Despite British Air’s planned initial public offering at that time, British Air decided to undercut Ryanair’s price before the service launched. Fortunately for Ryanair, the low industry price created so much demand – much of which came from rail and ferry customers seeking to save time – that Ryanair was able to operate their service at 100 per cent capacity. Ryanair’s game changing strategy worked not because it put competitors on edge but because it yielded a quantum increase in customer value that created an entirely new market for Ryanair and its rivals.

Using paranoia
Success contains the seeds of its own demise. When a company achieves market leadership, it often develops habits that prevent it from sustaining that leadership. In some companies this success leads to complacency that can cause a formerly successful company to lose market share to upstarts who take market share by out-competing complacent incumbents.

Successful start-up CEOs guard against such complacency by maintaining a healthy sense of paranoia. Cisco Systems’ CEO, John Chambers, worked earlier in his career for Wang, a creator of the word processing market in the 1970s that went out of business after it failed to respond to the popular adoption of PCs and word processing software. Chambers participated in the layoffs that resulted from the collapse of Wang’s revenues. Cisco’s Chairman, John Morgridge, had worked at Honeywell where he saw that the best computer salespeople tended to be more loyal to their commissions than to a particular employer. When one of their customers started buying equipment from a company other than Honeywell, the salesperson decamped to that company.

In order to prevent the same phenomenon from taking place at Cisco, Morgridge encouraged Chambers to keep an eye on shifts in the way its business customers were spending IT money. As a result, Chambers has managed Cisco Systems with a healthy paranoia – putting pressure on its executives to monitor closely how customer needs are changing and adapt accordingly. If customers started shifting to products from small companies other than those sold by Cisco, it would acquire those companies. The result was that Cisco retained its sales people, paying them higher commissions as their sales rose, and Cisco added a new line of products that boosted its revenues and profits. This healthy paranoia is the key to fighting the creeping enemy within, complacency. Large companies ranging from IBM to General Motors have paid a heavy price by letting complacency take over their firms when success seemed to come easily in the market place.

Avoiding head-to-head competition
Nothing is more detrimental to a start-up than having to confront an incumbent endowed with large resources at an early stage in its life. By avoiding head-on competition, upstarts fly under the radar, get stronger over time, and then attack the incumbents when the incumbents are not expecting it.

Over the last 30 years, Mittal Steel has grown
from a single steel mill in Indonesia to become the world’s largest steel producer. At the core of this extraordinary success story is a series of steel mill acquisitions in out-of-the-way locations that failed to attract the attention of more established competitors. The result is that Lakshmi Mittal, the architect of this growth, is the world’s fifth-richest man today, according to Forbes.

In 1976, Mittal – then 26 – convinced his father, Mohan Lal Mittal, a successful Calcutta steel trader, to help him buy (for $100,000) a small 30,000-ton steel mill in Indonesia with a strategy of setting prices below those of Japanese imports. By 1988 Mittal had grown the plant tenfold and wanted to expand abroad so he could realize his unique vision that the steel industry needed to change from a largely government-owned, production-driven, failing enterprise to a business led by global demand and run according to modern management practices.

To do this, he engaged in an eight-year global acquisition spree that culminated in the 2006 formation of Arcelor Mittal, an amalgamated powerhouse steel company with $71 billion in 2005 revenues. The Mittal story illustrates the entrepreneurial intelligence of avoiding head-to-head competition. If an upstart can operate in markets that established rivals ignore, the upstart can achieve significant scale while attracting minimal competitive retaliation. Once the upstart attracts incumbents’ attention, the upstart may be able to withstand that retaliation, as Mittal did during its Arcelor takeover battle.

The strategic principles enumerated above are not just for entrepreneurs. They are also applicable in existing businesses, even large corporations. But, unless the traditional corporate world starts to manoeuvre like the entrepreneurs cited here, it will be hard, if not impossible, for today’s large organisations to join the emerging entrepreneurial economy.

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