ScaleUp DNA

What drives scaling success?

A preview of the ScaleUpNation research findings.

MEDE MOGELIJK GEMAAKT DOOR DE GOLDSCHMEDING FOUNDATION

Foreword by Menno

It gives me great satisfaction to share with you this short overview of our most recent ScaleUpNation research into drivers of scaling. Having studied Physics and Mathematics, I had a theoretical understanding of what scaling is, but I only developed a real appetite and gut sense for scaling through my work with entrepreneurs.

Back when I was at McKinsey & Company, I experienced first-hand the limitations of a non-scaling business. We would jokingly call it a pizza eating contest with the first prize being more pizza. To break out of this I created McKinsey's first software business (in social sentiment analysis, head quartered in NY) and realized two things. First, that it is very, very difficult to build a new business model within a large, successful firm. And second, that there is a lot more to scaling than "just" having a distinctive product with great market fit.

In 2010, Bas Verhart and I co-founded THNK, the School of Creative Leadership. We had the honor to build and nurture an inspiring community of individuals passionate about finding entrepreneurial solutions and opportunities to address the world's most persistent societal challenges. Time and again we heard the same frustration: we have a solution, we have proven the concept, but why can't we scale?

We were approached by Deloitte Fast Ventures in 2015 and offered the chance to analyse a database of 400,000 new enterprises[1] *from all over the world. We found that the chance of a new enterprise scaling is tiny: 50% of new enterprises fail before their fifth birthday, and only 1 out of 200 reaching this milestone have revenues of $10 million or more. This was a moment of realization: we were not alone, scaling is a universal struggle.*

The probability of start-up success really came to life for me when I was a board member of New Venture. In

[1] Defined as new enterprises excluding independent professionals, craftsmen, non-profit, farming and small hospitality companies.

the 15th year of our business plan competition, we summed up the annual revenues generated by all start-ups who had participated in the program by that time. This came to an impressive $1.5 billion. However, this was the cumulative annual revenue for 1,000 start-ups with half of it, $750 million, coming from just two ventures.

At THNK, we have spent the past five years delving in to scaling with hundreds of business entrepreneurs. We looked at scaling in nature and economics, we used systems thinking, strategy, leadership, along with analysing practices such as the Rockefeller habits. We quickly realized that every story is unique, context dependent, with good and bad luck playing a big role. This is why scale-up entrepreneurship is so personal and exhilarating. That said, as we look across this experience we start to see common patterns. In the full awareness that we do not want to dumb it down or make it mechanistic, we find that the imprint of scale-up DNA is crystallizing.

This really got me going – if we can determine scale-up drivers, could we use this to support scale-ups to reach their full potential? Can we help scale-ups survive what many call the second valley of death – the shift from a team to a company – and thrive on the other side? We created ScaleUpNation to take on this challenge, working with scale-ups to support them to create significant customer value and positive social impact.

Last year, we were approached by the Goldschmeding Foundation. They resonated with our cause as they know that only what scales moves the needle on employment and social impact. The Goldschmeding Foundation told us that we were working on something tremendously important, and so we had better be sure it is correct. This set us on a path to properly test and deepen our insights into the drivers of scaling.

For this first project, we worked hard to develop a thorough survey that was devoid of academic or consulting jargon. We sent it out to about 200 scale-ups… and got a 0% response rate. We doubled our efforts, trying all kinds of incentives – prizes, personalized feedback, chocolate and wine. Still nothing. It was only when we contacted a few directly to ask them why they would not fill it out that things *shifted. Scale-up entrepreneurs don't have time to answer surveys. But when they heard our story, one golden rule of entrepreneurship kicked in: entrepreneurs help other entrepreneurs. The lock was picked, and a community of Dutch scale-ups – 114 of them – shared with us insight into the inner workings of their business.*

I am delighted to share our findings with you in this short report. It coincides with the launch of our Runway Program where we bring groups of potential scale-ups together to support their growth. The golden rule is in full force here once more: there is no need for teachers; peer-to-peer learning and collaboration are explosive.

This is the beginning of a journey for us to build a vibrant community of scale-ups that generate powerful insights to trigger scaling. We're curious to hear your reactions – reach out to us at hello@scaleupnation.com.

Menno Van Dijk
Founder of ScaleUpNation

Scaling drivers

Every scale-up has their own unique story originating from the inherent qualities, vision and entrepreneurship of the founders; defined by the characteristics of the product and the market; and shaped by the opportunities and challenges harnessed along the way. Scaling is an art form as much as a science. No model of entrepreneurship can detract from the inimitable journey that an individual scale-up has taken.

That said, we do see common patterns among scale-ups which seem to correlate with success, growth and impact. Over the summer of 2017, we delved into the DNA of scale-ups to clarify these commonalities and identify what makes them different from other young companies. We surveyed 114 Dutch companies that have scale-up ambitions.

All of these companies have successfully raised seed funding, were at least three but less than ten years old, have recurring revenues, and have an established organization.

1. Selection of Dutch scale-ups in the survey

We allocated the ventures into two groups based on their size and speed of growth: scale-ups and potential scale-ups. We define “scale-ups” as companies that had more than 15 FTEs by the end of 2016 and had grown by more than 20% in employment per year over the last 3 years[2]. The “potential scale-ups” either did not meet the 15 FTE threshold or grew less than 20% in employment per year over the last 3 years. The scale-ups were on average 6 years old, had a median of 35 employees, and a median of 67% annual growth in employees. The “potential scale-ups” were about as old (on average 7 years), had a median of 10 employees, and a median of 14% annual growth in employees.

Our research was quantitative as well as qualitative, testing multiple scale-up drivers. We found that scale-ups more than potential scale-ups have a team of serial entrepreneurs on board; they more often delight their customers and they more often continuously innovate products and services; they are more likely maintain control and establish a supervisory board; they more frequently marry their vision with diligent planning, adapting these plans to harness opportunities as these arise; they are more likely to go direct to customers and sell online; and they more often maintain focus and momentum with clear accountability, goals and KPIs.

[2] OECD definition of high growth firms

Here, we illustrate nine of the most important drivers for scale-up success. We hope it provides insight as well as inspiration for ambitious entrepreneurs and their companies as they scale.

1. Scaling is about serial entrepreneurship

Scaling-up is not for first timers but for serial entrepreneurs. The first time –whether successful of not – is an invaluable investment in learning. What counts is that you have done your tour of duty. The vast majority of scale-up founders have created an enterprise before. As experience is what counts, it is critically important to accumulate as much as possible – by working in a team of experienced co-founders, by having a board with experienced entrepreneurs and by collaborating in a community of seasoned entrepreneurs.

For the other group – the “potential scale-ups” – the percentage of scale-up founders who are serial entrepreneurs is significantly lower. We hope they are able to surround themselves with seasoned entrepreneurs as co-founders and board members.

Interestingly, only experience in entrepreneurship makes a real difference. Industry experience,

> ***Serial Entrepreneurship.*** *TheSocialMedwork is a social enterprise working to help seriously ill patients access the latest medicines that are not yet available in their own country but have been approved somewhere else in the world. It was founded in 2016 by a team of three co-founders, each of whom are serial entrepreneurs: Sjaak Vink has founded eight ventures and has deep expertise is in the patient’s experience of pharmaceutical and medical treatments; James Heywood has previously founded four ventures in the biotech and therapy domain; and Bernard Muller is a successful multinational entrepreneur in the drug development arena and winner of the FD Gazelle Gold Business Award.*

leadership experience, management experience, experience in a large corporation – these, we found, do not significantly differentiate the scale-up from the potential scale-up.

2. No-one is perfect, but a team can be

Scale-ups are more likely to be founded by a team (2 or more founders). And these are genuine teams who jointly set the direction and make decisions. In the words of serial entrepreneur and THNK co-founder Bas Verhart: no-one is perfect but a team can be.

The good news is that this can be addressed. Geert-Jan Bruinsma, founder of Booking.com, was comfortable setting up and managing the business with a small team in 1997. However, by 2003 he came to the conclusion that he didn’t want to lead the business on his own. He knew he needed to form a management team of serial entrepreneurs to take the company forward into new international markets. He built his dream team and international expansion took off. Founders can learn from this successful strategy by asking themselves: should I augment my team; should I strengthen my board; should I establish peer-based relationships with other scale-up entrepreneurs?

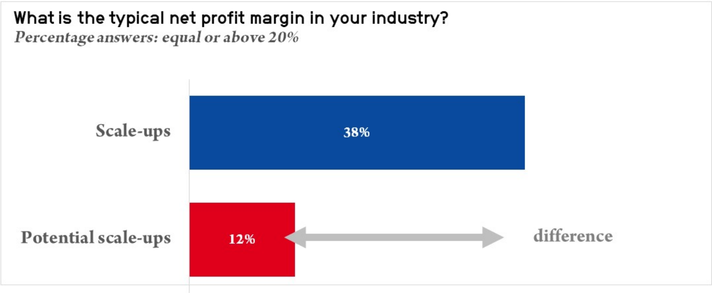
3. Walk the talk, again and again

There is a lot written about the leaders that build the innovative businesses that change the world. These iconic characters are incredibly inquisitive, independent, contrarian, visionary, inspirational, bold, risk taking, confident and decisive. We found these characteristics to be common also among the founders of both Dutch scale-ups and potential scale-ups.

What differentiates the two groups is that the successful scale-up entrepreneurs are much more planning oriented. They are not gamblers hoping for the best. They translate their big ideas into concrete plans and execute these using formalized methods. They identify their risks and mitigate these. And they work really, really hard in a highly disciplined fashion to make their dreams a reality. When asked for the number one driver that defined their success, they say: "perseverance".

4. Pick your game

Scale-ups build scalable businesses that more often focus on attractive markets, and are more often in B2B. Selecting attractive product/market segments in which to play is key to prospering. It is just much easier to grow when also the market is also growing, when most other players are making a profit and the competition is less severe.



"Good" business is good business: i.e., business that makes the world a better place – by protecting the planet or improving people's lives – can also be a profitable business. Business is shifting focus from reducing negative impact (misconduct and environmental burden) to having a positive impact (mission oriented innovation and entrepreneurship). Millennials want to work in good companies. This is the ultimate reframe: the world's largest societal challenges are also the largest business opportunities and only those businesses that scale make a real difference. The majority of scale-ups in our research are driven by social impact as well as financial performance and about a third track their social impact in order to optimize it.

Distinctive products. *From just a prototype three years ago, Land Life Company has planted over 150.000 trees using their COCOON technology in over 20 countries. Jurriaan Ruys, co-founder, designed the COCOON to support a seedling through its first critical year. It is a doughnut-shaped wax paper sheath that contains a sapling, enough water to sustain the tree, and a small dose of beneficial fungi. This might sound simple, but it is a game-changing innovation that results in tree survival rates of up to 95%. The COCOON is a proprietary, low-cost, sustainable, scalable and profitable solution that is tangibly making progress towards Ruys' vision to "achieve global land revitalization within our lifetime".*

Scale-ups typically have an international scope. The Netherlands is a small country in a big world. Many scale-up business models are nowadays digital and software based which facilitates international roll-out. As one founder of a Dutch-based internationally successful scale-up shared: "Every year I waited to enter the US market has, in hindsight, cost me a factor in my ultimate scale".

5. Create irresistible products

We live in times where customers want to be free and your competitor's product is "only one click away", so customer loyalty is far from obvious. Still the products of scale-ups do generate significant customer loyalty, much more than those in potential scale-ups. Scale-ups delight their customers by providing a product that is irresistible, must-have and delivered with passion and care. Customers convince their family, friends and colleagues to buy the product too, so sales go viral – an important scaling driver.

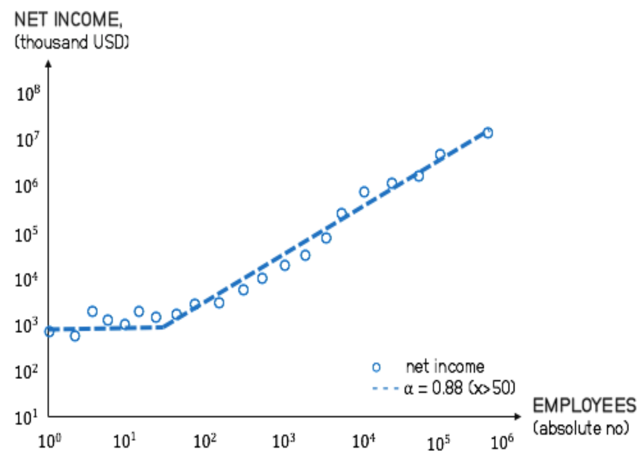
6. Feed the innovation engine

What distinguishes a scale-up from a potential scale-up is their higher likelihood to have a distinctive edge through proprietary technology and their ability to keep the "innovation engine" revving. They continue to commit significant resources to R&D even once their initial product range has significant traction and they obsessively measure their speed of progress in product development. When asked to make a choice between optimizing performance and pursuing further opportunity, the majority of scale-up founders choose the latter. As a result, the successful scale-ups receive a significantly larger share of sales revenues from new products than the potential scale-ups. Their R&D results in new-to-world innovations – most scale-ups do not have a direct competitor.

Only a few scale-ups have already acquired other companies. Add-on acquisitions and consolidating moves will become more relevant in a later growth stage.

7. Keep it together

In his latest book "Scale", Geoffrey West shows the relationship between net income and scale for companies in the US. The relationship is remarkably linear for companies from around 30 to 100,000+ employees. However, there is a tipping point around the 30-employee mark below which the curve is flat.



What is going on here? It seems that around 30 employees, the scale-up experiences a phase transition: the organization grows from a team to company and priorities shift to building scalable production processes, all while fuelling that "innovation engine". This might feel like less fun: more formal, more corporate, less personal. The distance between the founders and the organization becomes larger. The founder becomes a CEO. But it is in this phase transition that net income starts to scale.

We found that scale-up founders typically guide their company through this phase instead of passing on the baton. Indeed, in 75 percent of scale-ups one of the original founders is still the CEO. Most scale-ups maintain centralized decision making and manage to keep voting control even though they now have external investors on board. At the same time, the majority of scale-ups have a supervisory board in place, which provides them with a diverse insight, access to new networks, and supportive checks and balances.

8. Find the business beat

You can only rapidly ramp-up if you have the house in order: flawless sales, production and delivery processes. Dutch scale-ups are on top of this. Most sell directly to their customers and mostly online - this is significantly more than for potential scale-ups - which allows for real-time feedback and growth hacking: rapidly improving lead generation, conversion and reducing cost of sales.

Business beat. *Fairphone makes phones a little differently. They are designed to be long-lasting, use only fair materials, ensure good working conditions throughout their supply chain, and build for reuse and recycling. In the highly competitive mobile handset business, reaching scale rapidly is a prerequisite. Co-founder Bas van Abel is clear about how difficult the phase transition was from a small, creator team to a professionalised organisation with structured planning and project management, rapid talent on-boarding, and production ramp-up. Many founders can feel this leads to a personal sense of helplessness or overload. Surviving this phase is about finding a strong business beat that pulses through the organisation and drives things forward.*

Scale-ups, far more than potential scale-ups, find and maintain a strong "business beat", using clear goals and operational KPIs to create the structure within which their organization thrives. We equate this to the introduction of the drumming in jazz music, which provided the rhythmic beat to focus the energy and create a platform on which the soloist can shine.

9. On-board the best talent

Even though scale-ups mention “having the best people” as one of their top scaling drivers, there is no clear focus on hiring best people in the market. Scale-ups state that they do not find it difficult to attract talent and few provide targeted training or on-boarding procedures. Could this be an untapped opportunity for Dutch scale-ups to step-up the talent game?

Next for ScaleUpNation

This research initiative has given us confidence that scale-up DNA can be distilled in such a way to boost success. What does this mean for us? First, we are inspired to dig deeper, looking in more depth at the dynamic nature of scale-up drivers and understand how to impact this. To house these activities, ScaleUpNation is creating a Lab that will be the go-to source for knowledge on scale-up drivers and will translate this knowledge into tools for scale-ups, practitioners and investors.

More importantly, we are about putting what we learn into the ScaleUpNation Practice. We are building and supporting a community of Dutch scale-up serial entrepreneurs to support each other and to find co-founders, peer coaches, venture partners and board members. We are also directly supporting scale-ups in our learning programs. For these we select innovative enterprises that have developed beyond the start-up phase and have significant societal impact, growth potential and an attractive business model. Our programs focus on peer-to-peer coaching and learning-through-practice.
Finally, we noted the importance of a supervisory board to scale-up success: we will launch a training for board members of scale-ups in 2018.

Contributors

This research was conducted in the Spring and Summer of 2017 by a joint research team from ScaleUpNation (Kathryn Maunders, Sander van Lochem, Jessica Beketa, Elizabeth Gray, Annie Chen, Menno van Dijk); Utrecht University (Erik Stam, Chen Fleisher, Rainer Harms, Pedrag Ignjacevic); University of Twente (Petra de Weerd-Nederhof, Isabella Hatak); and University of Groningen (Aard Groen), with financial support from the Goldschmeding Foundation.

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