STRATEGY FOR START-UPS

ROMASTUDIO/DREAMSTIME

BY JOSHUA GANS, ERIN L. SCOTT, AND SCOTT STERN

As a start-up, RapidSOS was an easy sell: It would bring 911 calls into the smartphone age. Emergency-response systems had evolved in a premobile era, which meant that few of them could accurately identify the location of callers who were using mobile phones, compromising response times and medical outcomes. The founders of RapidSOS—Michael Martin, an HBS graduate, and Nick Horelik, an MIT engineer—had developed a way to transmit mobile phone locations to existing 911 systems that would require only minimal adaptation on the part of other players in the emergency-services sector. After attracting early-stage financing at business plan competitions, Martin and Horelik reached a crossroads: How should they take their technology to market?

The answer wasn't straightforward—in fact, they identified four possible paths. (See the exhibit "The Entrepreneurial Strategy Compass.") They could be wildly ambitious and attempt to replace the emergency-response system altogether—creating an "Uber for ambulances." They could try a classic disruption strategy—initially targeting poorly served populations, such as people with epilepsy, with the intention of eventually expanding to a wider swath of customers. They could avoid direct competition altogether, either by helping incumbents modernize their operations—perhaps working with 911 equipment suppliers such as Motorola—or by partnering with insurance companies, which ultimately cover the cost of ambulance service.

Many entrepreneurs, operating in the fog of uncertainty, worry that exploration will delay commercialization. They go, therefore, with the first practical strategy that comes to mind, deriding the deliberation and planning that accompany careful strategizing. As Richard Branson has famously claimed, "In the end you [have] to say, 'Screw it, just do it' and get on and try it."

There are times when that approach works, of course. But usually such ad hoc experimentation should be avoided, even when it requires few resources. Entrepreneurs who commit to the first promising route they see leave their start-ups vulnerable to competitors that take a less obvious but ultimately more powerful route to commercialization and customers. Shai Agassi, for example, spent almost $1 billion building an ecosystem to support Better Place, his "swappable battery" approach to the electric car business. Elon Musk's more deliberative, stepwise approach to developing an integrated, highly reliable Tesla turned out to be a smarter strategy.

And that's not the only problem with an action-first philosophy. Founders are both more confident and more persuasive to investors, employees, and partners when they can demonstrate an idea's potential across multiple strategies, validating the underlying assumptions and strength of the idea itself.

Is there a way to think through your strategic options without slowing down the process too much? After working with and studying hundreds of start-ups over the past 20 years, we have developed a framework, which we call the entrepreneurial strategy compass, that allows company founders to approach the critical choices they face in a practical and clarifying way. It delineates four generic go-to-market strategies they should consider as they move from an idea to the launch stage, each of which offers a distinct way for the venture to create and capture value.

THE ENTREPRENEURIAL STRATEGY COMPASS

At the heart of our approach is the recognition that a go-to-market strategy for any innovation involves making choices about which customers to target, what technologies to apply, what organizational identity to assume, and how to position the company against which competitors. (See the sidebar "The Four Decisions.")

IN BRIEF

THE PROBLEM
In their haste to get to market, entrepreneurs often run with the first plausible strategy they identify. As a result, they end up losing out to second or even third movers with superior strategies.

WHY IT HAPPENS
In the innovation space it's easy to get overwhelmed by the apparent range of opportunities. Entrepreneurs fear that spending too much time weighing the alternatives will delay commercialization. The strategic commitments they make in moving forward limit their ability to pivot.

THE SOLUTION
Start-ups can improve their chances of picking the right path by investigating four generic go-to-market strategies, articulating multiple plausible versions of those strategies, and choosing the one that aligns most closely with their founders' values and motivations.

Many entrepreneurs worry that exploration will delay commercialization. So they go with the first practical strategy that comes to mind.

To complicate matters, the decisions are interdependent—the choice of customers influences the company's organizational identity and its technology options.

For corporations with resources, the four decisions involve analyzing data they probably already have. They can also quite often afford to engage in market research and experimentation along multiple fronts. And they can draw on prior experience. A start-up on a shoestring, in contrast, lacks a history and the knowledge it brings. However, that can actually be an advantage, because prior experience, historical data, and commitments that drive existing practices may create blind spots for established corporations, possibly even causing them to overlook innovations that pose an existential threat. Nevertheless, start-ups may ultimately face competition when incumbents wake up to new innovations, and they will definitely face pressure from other start-ups trying to beat them to market.

Entrepreneurs may feel overwhelmed by the vast number of choices they face, even though some paths can be dismissed as impractical, and some won't coherently mesh. Our research suggests, however, that the four categories of the compass make the process manageable, getting young companies to workable go-to-market strategies quickly and laying bare the assumptions that inform choices.

To sort through potential strategies, every new venture must consider two specific competitive trade-offs:

Collaborate or compete? Working with established players provides access to resources and supply chains that may enable the start-up to enter a larger and better-established market more quickly. Then again, the venture may encounter significant delays owing to the bureaucratic nature of large organizations and may also capture a smaller fraction of that potentially larger pie. (The incumbent is likely to hold greater bargaining power in the relationship—particularly if it can appropriate key elements of the start-up's idea.)

The alternative, too, has pluses and minuses. Competing against established players in an industry means the start-up has more freedom to build the value chain it envisions, to work with customers that the incumbents may have overlooked, and to bring innovations to market that enhance value for customers while displacing otherwise successful products. However, it means taking on competitors that have greater financial resources and an established business infrastructure.

Build a moat or storm a hill? Some companies believe that they have more to gain from maintaining tight control over a product or a technology and that imitation will leave them vulnerable. Thus they invest in protecting intellectual property. Formal IP protection, though expensive, can allow a technology-driven start-up to exclude others from direct competition or to wield significant bargaining power in negotiations with a supply chain partner. But prioritizing control raises the transaction costs and challenges of bringing an innovation to market and working with customers and partners.

In contrast, concentrating on quickly getting to market speeds up commercialization and development, which typically occurs in close collaboration with partners and customers. Start-ups that choose to pursue this route prioritize the ability to experiment and iterate on their ideas directly in the marketplace. Whereas a strategy built on control can delay entry, start-ups focused on getting to market expect competition and use their agility to respond when competitive threats arise. They move fast and break things.

Zeroing in on these two questions greatly simplifies the process of strategic reflection. Rather than seek to identify an á la carte combination of choices that are "right" for a given idea, a founding team can consider the potential for value creation and value capture from the various options that might be crafted within each of the four strategies.

Let's now consider the four.

THE INTELLECTUAL PROPERTY STRATEGY

In this quadrant of the compass, the company collaborates with incumbents and retains control of its product or technology. The start-up focuses on idea generation and development and avoids the costs of downstream, customer-facing activities. The core idea must be of value

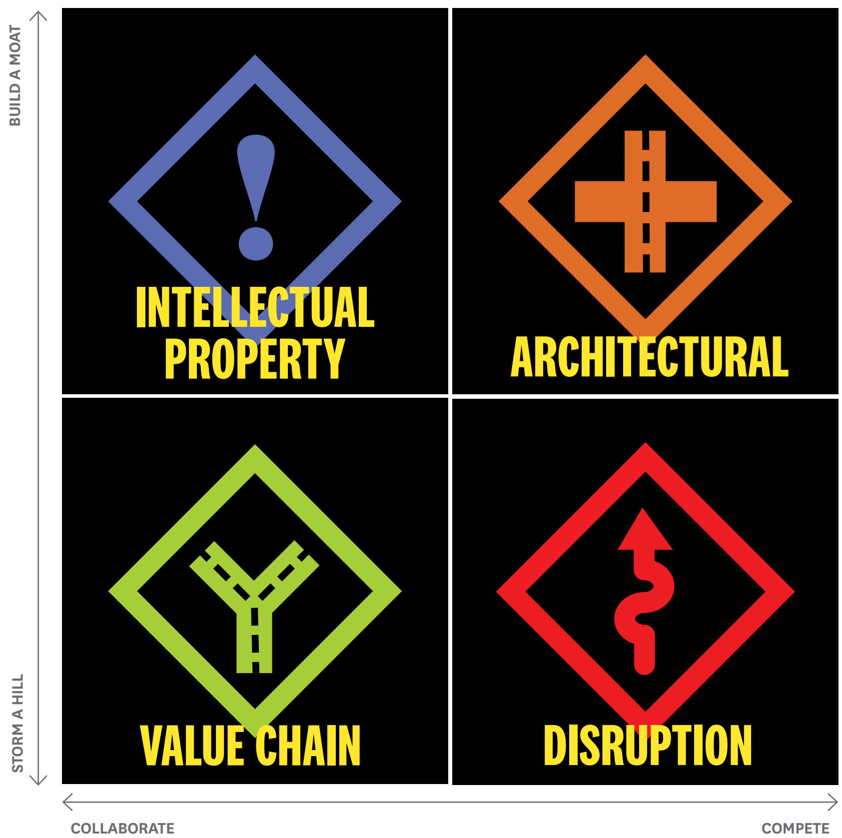
THE ENTREPRENEURIAL STRATEGY COMPASS

Strategic opportunities for new ventures can be categorized along two dimensions: attitude toward incumbents (collaborate or compete?) and attitude toward the innovation (build a moat or storm a hill?). This produces four distinct strategies that will guide a venture's decisions regarding customers, technologies, identity, and competitive space. The emergency-services provider RapidSOS used the compass to explore its strategic options.

Maintain control of the innovation and find a way to create value within the existing marketplace. Focus on being an idea factory.

For example, Dolby is the global standard setter for sound technology; it licenses proprietary technology to Sony, Bose, Apple, and others.

RapidSOS could keep the technology proprietary and work with existing 911 equipment suppliers such as Motorola to modernize operations.



Create and control a new value chain, often using a platform business. Protect intellectual property.

For example, OpenTable developed a proprietary platform that allowed diners to make reservations efficiently and in so doing established influence over customer flow to restaurants.

RapidSOS could replace the existing emergency response system altogether.

Focus on creating value for partners in the existing value chain. Execute quickly.

For example, Peapod became the leading U.S. internet grocer by fitting into—and improving—the grocery industry.

RapidSOS could partner with insurance companies (which ultimately pay for ambulance services); the product might take the form of a smartphone app.

Compete directly with incumbents. Take them by surprise with fast execution.

For example, Rent the Runway challenged high-end retailers by offering aspiring fashion-oriented women the ability to rent rather than buy designer clothes.

RapidSOS could first target poorly served populations (such as epilepsy patients) and later serve a larger swath of customers.

to the customers of incumbents; therefore, development choices concerning it will dictate which incumbents are the most suitable partners for the venture.

In addition, because cooperation requires alignment with the incumbents' activities, the start-up will probably choose generalizable technology investments compatible with existing systems. Finally, the start-up's identity—as a kind of idea factory—will be reflected in its development of innovations that can be brought to market through chosen incumbents. But it will see itself as developing a small number of modular technologies that can make a decisive difference for the industry and it won't engage in unstructured experimentation with every potential new technology.

The sound company Dolby provides a quintessential example. Anyone in the market for a stereo system or watching a movie in a theater is guaranteed to come across the Dolby name. Dolby Laboratories' patented noise-reduction technologies, invented by Ray Dolby in 1965, became a global standard, retaining market leadership for 50 years. Dolby technologies have been credited with elevating the emotional intensity of iconic films such as Stanley Kubrick's *A Clockwork Orange* and George Lucas's *Star Wars*. Yet Dolby's multibillion-dollar valuation was achieved with only limited interaction with film directors, music producers, and audiophiles. The company has licensed its proprietary technology to many product developers and manufacturers, including Sony, Bose, Apple, and Yamaha.

Entrepreneurs that pursue a strategy like Dolby's take maintaining and protecting their intellectual property very seriously. Carefully conceived patents and trademarks, managed in combination with solid R&D, can create powerful defenses that allow a start-up to preserve bargaining power over long periods of time. This strategy dictates culture and capability choices: The start-up needs to invest not only in relevant R&D skills but also in smart and committed legal minds. The IP strategy has proved powerful not only in narrow cases like Dolby's but across whole industries, such as biotechnology; with leading technology platform players, including Qualcomm; and for market intermediaries, such as Getty Images.

THE DISRUPTION STRATEGY

This strategy is the polar opposite of an IP strategy. It involves a decision to compete directly with incumbents, emphasizing commercialization of the idea and the rapid growth of market share rather than control of the idea's development. Disruption entrepreneurs aim to redefine established value chains and the companies that dominate those chains. But the very nature of disruption permits others to follow. Thus the heart of this strategy is the ability to get ahead and stay ahead.

Although the word "disruption" connotes chaos, the entrepreneur's initial goal is in fact to avoid poking the beast and provoking a strong (and potentially fatal) response. The start-up strives to quickly build capabilities, resources, and customer loyalty so that when the incumbents finally wake up, the start-up is too far ahead for imitators to catch up.

For this reason, the initial choice of customers is usually a niche segment—typically one poorly served by incumbents and off their radar screen. This allows the start-up to establish credibility and explore (before anyone notices) new technologies that may have initial flaws but solid prospects for dramatic improvement. If they prove viable, these technologies are usually difficult for incumbents—whose capabilities and commitments are built around established technologies—to adopt.

The disruptive entrepreneur's identity projects hustle and verve. The start-up is staffed by the young and the hungry (and not just for ramen noodles). It doesn't fear the competitive war to come; rather, it's eager to engage. It must be lean and quick to respond. And it is intensely focused on growth.

Netflix is a poster child for this quadrant. Frustrated by movie-rental overdue fines, its founders, Marc Randolph and Reed Hastings, envisioned a solution that would leverage the then-emergent technology of DVDs. After testing their concept by sending a disc through the U.S. mail, they created a service in the late 1990s that allowed cinephiles—rather than mainstream consumers who simply wanted to watch the latest blockbuster—to receive and return DVDs that way. Netflix's strategy was to take advantage of the "long tail" of (low-cost) content and build a recommendation engine that would reinforce customer relationships, enabling the development of a new method of movie rental that would render the brick-and-mortar Blockbuster model obsolete. (Blockbuster initially dismissed Netflix as not serving mainstream customers in a timely manner but then saw the profitability of its stores drop and ultimately disappear.)

Rent the Runway is using the disruption playbook in its drive to reshape the women's high-end clothing market. Two Harvard MBAs, Jennifer Hyman and Jennifer Fleiss, founded the company in 2009 after identifying the challenge that fashion-oriented women faced in having to buy dresses that they might wear only once. Rent the Runway developed an online site offering aspirational women the option of renting rather than buying designer clothing and focused on solving the operational and logistical challenges of shipping dresses back and forth. Although the company has yet to displace Neiman Marcus and other more traditional players, whose focus is on wealthy haute couture customers seeking a personalized in-store experience, it has created a dedicated customer base that evangelizes the brand across social networks. Its extraordinary growth is testament to the power of execution in the face of less nimble incumbents.

THE VALUE CHAIN STRATEGY

Disruption is exciting; by comparison, a value chain strategy seems somewhat pedestrian. The start-up invests in commercialization and day-to-day competitive strength, rather than in controlling the new product and erecting entry barriers, but its focus is on fitting into the existing value chain rather than upending it.

A pedestrian approach can nevertheless create very lucrative businesses. Consider Foxconn, the Chinese electronics manufacturer, which is one of the few global companies that can bring new products from Apple and others to market at scale and on time. The identity of such corporations arises from competence rather than aggressive competition. And although value chain entrepreneurs are driven by the customers and technology of other companies, they focus on developing scarce talent and unique capabilities to become preferred partners.

The value chain strategy is available to most start-ups. While the online grocery business Webvan, founded in 1996, was trying to disrupt the supermarket industry, Peapod became the leading U.S. internet grocer by serving as a value-added complement to traditional retailers. (Webvan went bankrupt in 2001.)

An early partnership with a Chicago-area food supplier, Jewel-Osco, allowed Peapod to clarify who its ideal customers were (professional women) and what they valued (the ability to repeat an order on a regular basis and to schedule deliveries for certain times, among other things). Whereas Webvan's disruption strategy required reconceptualizing the entire grocery-shopping experience, Peapod's more-focused approach allowed it to develop a meaningful value proposition for customers who were willing to pay a premium for automated ordering and delivery, resulting in a profitable partnership with the supermarket chain Stop & Shop. Peapod gained the knowledge and developed the specialized capabilities with which it has led the online grocery business for nearly 20 years.

Entrepreneurs who adopt Peapod's approach create and capture value by focusing on a single "horizontal" layer of the value chain in which their expertise and capabilities are unrivaled. In probably no other entrepreneurial strategy does the founder's team play a more important role. In addition to hiring salespeople who are focused on final customers, or engineers who can improve the technical functioning of the product, it must be able to integrate innovators, business development leaders, and supply chain partners.

THE FOUR DECISIONS

At least four domains of decision making are crucial for every venture. Although any company will face additional choices that are particular to its context, a start-up that has not wrestled with at least these four decisions is unlikely to create and capture value on a sustainable basis. Amazon's story is illustrative.

CUSTOMERS

Identifying customers and understanding their needs is usually the first step in any go-to-market strategy. But the target customer is not necessarily the first customer—and it is important that you understand the relationship between the two. You validate your product by getting the right early adopters. Amazon's decision to initially target book readers was a strategic choice. Its leadership recognized that books were a beachhead from which the company could expand into other retail categories.

TECHNOLOGY

Technology and customer choices are interrelated. Amazon could have built a simple online ordering system to service existing stores. Instead its goal was to let consumers buy the long tail of books that could not be stocked physically at the local mall. Thus the company had to invest beyond transaction services to build a database and a search engine capable of guiding readers through millions rather than thousands of books.

IDENTITY, CULTURE, AND CAPABILITIES

Choices in this category should both create a narrative about what the company will stand for and communicate to all stakeholders what behavior to expect and what capabilities it will develop. Readers loved Amazon's offer, and Wall Street quickly saw how much money the company could make. But Amazon's founder, Jeff Bezos, wasn't building a bookstore. He wanted to create the "everything store." That would require that ordinary consumers trust they were getting a good deal, which meant that Amazon would focus relentlessly on lowering prices, despite pressure from investors for early returns.

COMPETITORS

Amazon defined its competition as other retailers and chose to compete aggressively by offering consumers more choice, greater reliability, and lower prices. In its early days it could easily have chosen to work with existing retailers—perhaps even defining them as customers. Competitors would have been other search and logistics service providers, and the company could have established itself as a premium service provider by adding more value for booksellers.

The start-up's capabilities must translate into enhanced differentiation or cost advantage for the established companies. And even if the innovation does enhance the competitive position of the overall value chain, the new venture can prevail only if other players in the chain are unable to replicate the value it has created.

THE ARCHITECTURAL STRATEGY

Whereas the value chain strategy is the domain of quiet achievers, entrepreneurs who choose and succeed with an architectural strategy tend to have very high public profiles. This strategy allows start-ups to both compete and achieve control, but it is out of reach for many if not most ideas and incredibly risky when it is feasible. This is the domain of Facebook and Google.

Entrepreneurs who follow an architectural strategy design an entirely new value chain and then control the key bottlenecks in it. They may not be the originators of an underlying innovation—search engines existed prior to Google, and social networks prior to Facebook—but they bring it to a mass market through careful alignment of customer, technology, and identity choices. Facebook committed early to not charging users, even though the dynamics of social media would lock them into the platform. Google adopted the motto "Don't Be Evil" so that it could achieve dominance without the pushback that had plagued other digital firms such as IBM and Microsoft. But in each case pivots were taken off the table. In other words, the risks for architectural entrepreneurs come from the fact that they may have only one shot at glory. (Remember the much-lamented Segway.)

It is perhaps not surprising that architectural entrepreneurs often end up trying to build platforms rather than products. Although platforms can be commercialized through the other strategies, if the core of a platform is closed, the entrepreneur may be able to control a new value chain.

Consider OpenTable, an online restaurant-reservation service founded in 1998 by Chuck Templeton. Motivated by the challenge of making a simple dinner reservation over the phone, Templeton hypothesized that in addition to offering a reservation platform, a successful online intermediary would have to solve the problem of restaurant-seating management. He decided to build systems that combined restaurant reservations with seating and management software, putting him in direct competition with established point-of-sale vendors such as IBM and NCR.

As Templeton recalls, OpenTable in its earliest days was "the one running wire through the rafters to get power and connectivity." To tip the market toward his start-up, he targeted the most influential restaurants first. "We were able to get the top 20 restaurants [in San Francisco]," he says, "and the next 50 would all want to be where those top 20 were. There began to be a critical mass on the website." Templeton reorganized the value chain of the dining industry so that the internal operations of restaurants were integrated into customers' first engagement with them: the reservation phase. OpenTable achieved control over valuable proprietary data on customer preferences and demand and established a hard-to-dislodge platform that is "table stakes" for a new restaurateur. This dominance underlay its $2.6 billion acquisition by Priceline in 2014.

Let's look now at how entrepreneurs can use the strategy compass to decide among the four basic approaches.

MAKING THE CHOICE

The first step is to fill as many of the quadrants of the compass as possible with strategic options. This is no simple task. It involves gathering additional information and experimenting to some degree (but commitments should be modest until a choice is made).

Particularly effective approaches for start-ups can be found in Eric Ries's *The Lean Startup,* Alexander Osterwalder and Yves Pigneur's *Business Model Generation,* and Bill Aulet's *Disciplined Entrepreneurship.* Whatever framework is chosen, however, it should involve an explicit process of hypothesis building and testing—an observation that was nicely made in "Bringing Science to the Art of Strategy," by A.G. Lafley, Roger L. Martin, Jan W. Rivkin, and Nicolaj Siggelkow (HBR, September 2012).

This process at a minimum yields crucial insight into stumbling blocks associated with particular paths within the compass. Some alternatives can be dismissed owing to lack of feasibility or lack of alignment with the capabilities of the founding team. In other cases, the requirements—in terms of capital, commitment, and momentum—will be clear, allowing the start-up to focus on them to make the chosen strategy work.

Once the alternatives have been identified, how should the entrepreneur actually make a choice? Let's go back to RapidSOS. As the founders debated the next steps for their idea—mobile-centric emergency-response systems—they used the compass to identify four strategies. As noted earlier, they could use an architectural strategy to replace the existing 911 system with an "Uber for ambulances." They could use an IP strategy to collaborate with existing players in the emergency-response sector. They could use a value chain strategy to work with insurance companies and other consumer-facing partners, becoming a feature for a corporate smartphone app. Or they could use a disruption strategy to focus on a narrow customer segment for whom emergency response is a priority—such as epileptics—and partner with patient advocacy groups to meet its needs.

For each compass quadrant the company identified which customers to target, which technologies to focus on, what identity to assume, and whom to compete with and how. All four paths looked plausible, which was a striking validation of the founders' idea. If only one viable vision of the future exists, the entrepreneur probably doesn't have much of a business to begin with.

Having several good options need not be paralyzing. Quite simply, entrepreneurs should choose the strategy that aligns best with the purpose they originally brought to the venture. The RapidSOS mission to improve services for specific patient groups led the team to focus with a high level of conviction on a disruption strategy. This commitment—which Martin and Horelik could communicate with passion and purpose—allowed them to win over patient groups and stakeholders throughout the emergency-response sector, enabling RapidSOS to roll out its technology to the broader market over two years.

The founding team does not just make the choice; it has to live the choice. Alignment between strategy and purpose is crucial for motivating founders and persuading early stakeholders to travel the chosen path. To be clear, making a choice requires commitment but does not foreclose all other paths forward. RapidSOS's decision to engage with both patient advocates and the emergency-response community meant that the start-up was unlikely to bypass traditional 911 systems—at least in the medium term. But the focus on patient advocacy groups encouraged end-user engagement, which over time generated meaningful collaboration opportunities and attracted investment from more-established players, including Motorola.

Still, every strategy affects possible future pivots, removing some and opening up others. A venture must be mindful of this so that it doesn't raise future costs but does enable opportunities to move from the start-up to the scale-up phase.

THE ENTREPRENEURIAL STRATEGY compass does not eliminate or minimize the uncertainty inherent in launching a start-up. What it does is provide a coherent framework for escaping the perceived realities of the existing environment and defining possible new environments to choose from. The word "choose" is critical here: When a start-up is competing with new products in the absence of a significant innovation, its success is largely determined by how its strategic choices are informed by the environment. Among established businesses, the winner is usually the company that understands the environment better. But entrepreneurs offering something significantly new have an opportunity to reshape the environment—perhaps, as with Dolby, to create a part of it that they will own or, as with Amazon, to create an altogether different reality. Which they choose is largely up to them. Our framework is designed to help them make that choice successfully and channel imagination and commitment toward the realization of their ideas.

HBR Reprint R1803B

JOSHUA GANS is the Jeffrey S. Skoll Chair of Technical Innovation and Entrepreneurship at the University of Toronto's Rotman School of Management and serves as chief economist in the Creative Destruction Lab. **ERIN L. SCOTT** is a senior lecturer in the Technological Innovation, Entrepreneurship, and Strategic Management Group at the MIT Sloan School of Management. **SCOTT STERN** is the David Sarnoff Professor of Management at the Sloan School and serves as faculty director of the Martin Trust Center for MIT Entrepreneurship. Scott and Stern gratefully acknowledge financial support from the Jean Hammond (1986) & Michael Krasner (1974) Entrepreneurship Fund, the Edward B. Roberts (1957) Entrepreneurship Fund, and the MIT Sloan School of Management.