



LEARNING AND ADAPTATION IN THE BUSINESS CREATION PROCESS

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Highlights

- Nascent and Young firms do learn and adapt through the business creation and development process providing opportunity for government policy, professional advisory services and educational programs.
- A substantial proportion of these firms have aspirations for national and international sales, see themselves as technologically sophisticated, offering something novel, and claim to have some strategic advantages.
- Most founders expect their ventures to operate as micro/small firms.
- Founders do learn to be more realistic and less optimistic as the venture develops over time.
- This learning usually leads to downward adjustment through lower growth aspirations, lesser claims of novelty and strategic advantages.
- Only a small minority of business start-ups undergo owner team changes, and these tend to occur more among teams formed with people other than a spouse.
- The rated importance of business planning goes down over time, but this varies depending on the purpose of planning. 'As a means to think things through' consistently remains the most important reason for business planning, while 'obtaining finance' is the least important.



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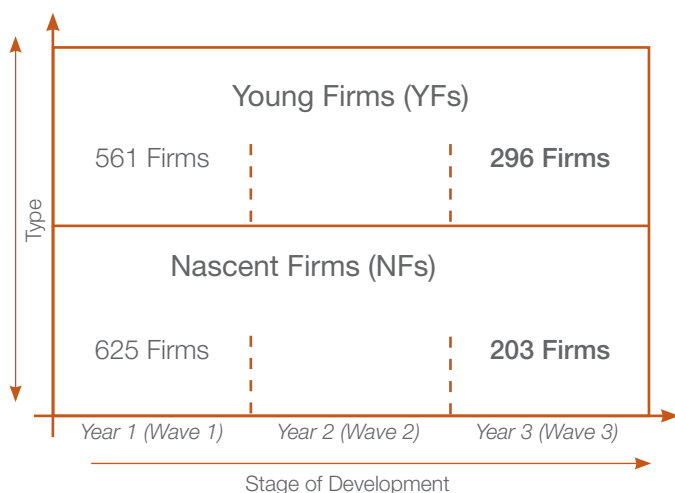
The CAUSEE Study

The Comprehensive Australian Study of Entrepreneurial Emergence research project, or CAUSEE, is Australia's largest entrepreneurship research project. It is the largest study of business start-ups ever undertaken in Australia and is the only large-scale study to track ventures over time. The project provides an exciting opportunity to improve our understanding of independent entrepreneurship in Australia.

CAUSEE has identified a sample of approximately 600 emerging, but not yet operating (Nascent – NFs) business start-ups. As well, the project has also identified a further sample of approximately 600 newly established young firms (YFs) that had already commenced trading. In addition, high potential, high growth firms have been identified and considered as a separate sample. All firms are being tracked over a four year period.

CAUSEE aims to uncover the factors that initiate, hinder and facilitate the process of emergence of new economic activities and organisations. Unlike much previous entrepreneurship research, the CAUSEE project does not put a singular focus on the 'entrepreneur(s)'. Assessing key characteristics of the venture including the venture idea, such as the degree and type of novelty the emerging venture has compared to what is already in the market, is also an important part of the research. Equally importantly is looking at the venture and the outcomes it may achieve along with the relationship between the characteristics of the venture idea and achieved outcomes.

Figure 1: From where was the data obtained?



This report focuses on NFs and YFs who have 'survived' the three years of the CAUSEE study. Given the time extended view taken by a longitudinal study, a number of firms who were included in year one have subsequently exited in year two and year three. In order for our comparisons to be valid, we have only included those firms who are 'survivors' at year three. Additionally, this report has not included the learning and adaptation behaviour of the high potential over sample group.

The focus of this report

This year marks the completion of data collection for year three (Wave 3) of the CAUSEE study. This report uses data from the first three years and focuses on the process of learning and adaptation in the business creation process.

Most start-ups need to change their business model, their product, their marketing plan, their market or something else about the business to be successful. PayPal changed their product at least five times, moving from handheld security, to enterprise apps, to consumer apps, to a digital wallet, to payments between handhelds before finally stumbling on the model that made them a multi-billion dollar company revolving around email-based payments. PayPal is not alone and anecdotes abound of start-ups changing direction: Symantec started as an artificial intelligence company, Apple started selling plans to build computers and Microsoft tried to peddle compilers before licensing an operating system out of New Mexico.

To what extent do Australian new ventures change and adapt as their ideas and business develop? As a longitudinal study, CAUSEE was designed specifically to observe development in the venture creation process.

In this research briefing paper, we compare development over time of randomly sampled Nascent Firms (NF) and Young Firms (YF), concentrating on the surviving cases (203 NFs and 296 YFs; see Fig. 1). We also compare NFs with YFs at each yearly interval. The 'high potential' over sample is not used in this report.



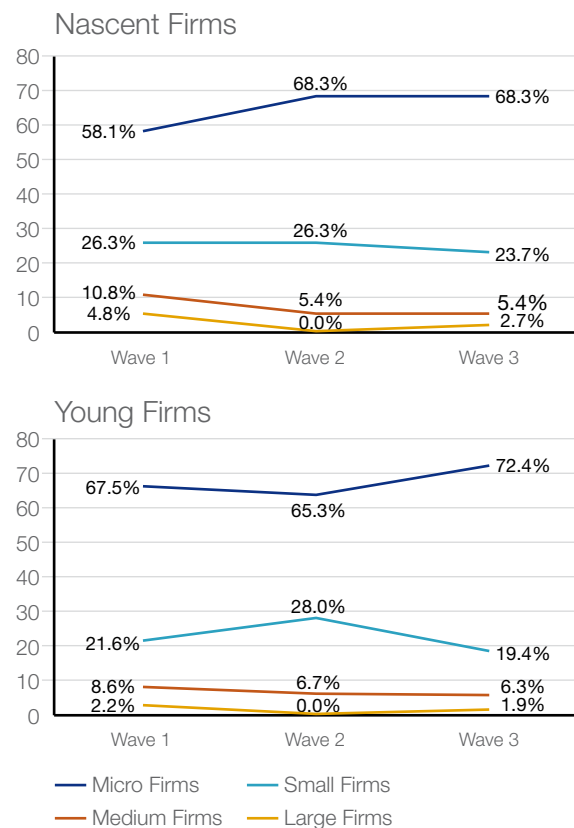
Aspirations: to grow or not to grow?

CAUSEE focused on the aspirations of founders as represented by their desire to grow their business. What are the growth expectations that founders have in regard to the size of the venture going forward five years?

We asked founders of YFs how many employees they expected to have working for the business in 'five years from now'. In a similar vein, NFs founders were asked how many employees they expected to be working for the business when it is 'five years old'. Then, using the ABS classification, we used the responses to deduce whether the venture, in five years time, sees itself as a) a micro firm (less than five employees); b) a small firm (five–19 employees); c) a medium firm (20–99 employees); or d) a large firm (>100 employees).

We found that the majority of founders (> 85 per cent) who were interviewed across all three waves (years) expected their venture to operate as a 'micro/small firm' in five years time. In YFs, these expectations tended to be fairly consistent across Wave 1, Wave 2 and Wave 3 (89 per cent : 93 per cent : 92 per cent). In NFs, the expectations tend to be consistent in the latter waves, Wave 2 and Wave 3 (94 per cent : 91 per cent), with a lower percentage reported in Wave 1 (84 per cent).

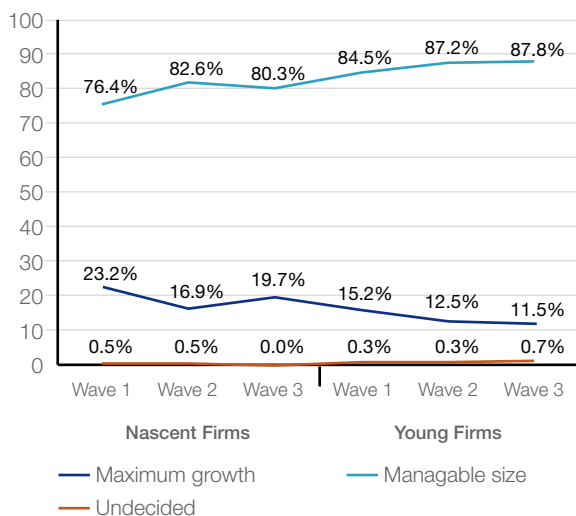
Figure 2: Expectations of firm growth (size)



While these results on average suggest that it is indeed very rare that emerging Australian ventures harbour ambitions of growing into medium/large firms, given that the medium firm lower range cut-off is 20 employees, we find it interesting that the majority of founders tend to have rather modest growth expectations.

Further support for this was found by asking NYs and YFs whether they preferred 'maximum growth' rather than going for 'manageable size'. Our analysis of the change over time in the aspirations of emerging firms suggests that growth aspirations in general tend to diminish when examined over a three year period. In 2007, when the CAUSEE data was first collected, over 15 per cent of the surviving Young Firms (N=296) indicated that they would want the future size of their business to be as large as possible. These figures progressively dropped to approximately 12 per cent in 2008 and 11 per cent in 2009. Similar patterns were found in surviving NFs (N=203) with nearly a quarter aspiring to achieve a large business size in 2007, and then decreasing to approximately 17 per cent in 2008 and 20 per cent in 2009. The lower figure in 2008 perhaps reflected the challenging business conditions caused by the global financial crisis. On the other hand, a majority of the surviving firms (> 80 per cent) had more modest aspirations from the outset indicating that they would prefer to establish a business which they could manage by themselves or with the help of a few employees.

Figure 3: Change in growth aspirations



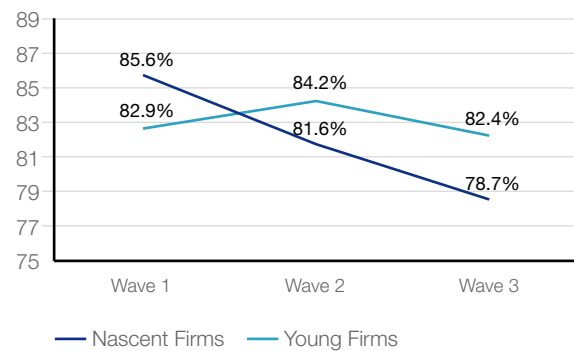
Interestingly, when comparisons are made across the spectrum of NFs and YFs, we find that the proportion of firms aspiring for large business size growth tend to halve in the third year (11 per cent) when compared with the first year (23 per cent). This is a big drop in the levels of aspiration.

Overall, these results indicate that emerging firms lower their growth aspirations over time, perhaps in line with the realities of the business and marketplace. It is likely that the consistent gradual lowering of expectations as firms move from Nascent to Young reflects a systematic recognition that the desirable capabilities, needs and opportunities that are necessary to grow and develop the venture are not as robust as they first thought.

Change in survival confidence

The ability of a firm to be viable in the long run is based at some degree on its confidence in being able to survive. Our assessment of the survival confidence of emerging firms was based on the question we asked founders in emerging ventures as to the likelihood of the business being in operation five years from now. Our findings suggested that NFs are likely to be more confident in their first year of operation (mean = 86 per cent) in comparison with the third year (mean = 79 per cent). A weakening of this confidence over time possibly suggests that NFs are likely to lower their confidence as they progressively complete different business activities for their venture. Interestingly, we do not find a similar significant effect in YFs. The NF–YF difference possibly suggests that YFs, by the virtue of them being more established have more consistent confidence levels across time.

Figure 4: Survival confidence over time

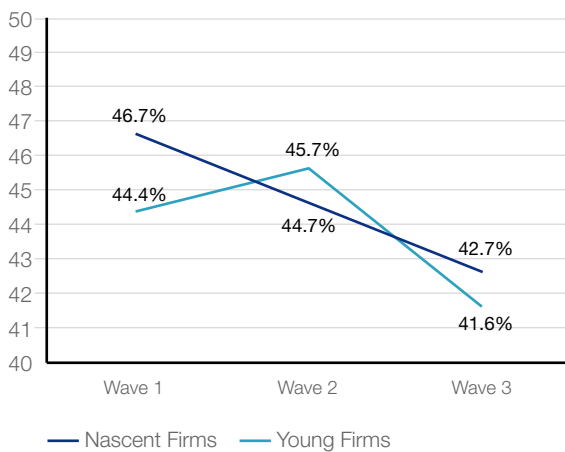


Change in over-optimism

We were interested in assessing ‘over-optimism’ in emerging ventures as reflected by how much higher they rated their own survival probability to that of an average similar start-up in five years. To assess ‘over-optimism’, we first asked founders to rate their survival likelihood in five years time and then subtracted their rating about the survival probability of the average firm in the industry to compute an ‘over-optimism’ score.

The over-optimism score for both NFs and YFs in all waves was positive, indicating that founders tend to see themselves as more successful in comparison with other similar firms. However such over-optimism slightly drops over time for both NFs and YFs, indicating that both groups seem to (learn to) become somewhat less over-optimistic over time.

Figure 5: Over-optimism over time

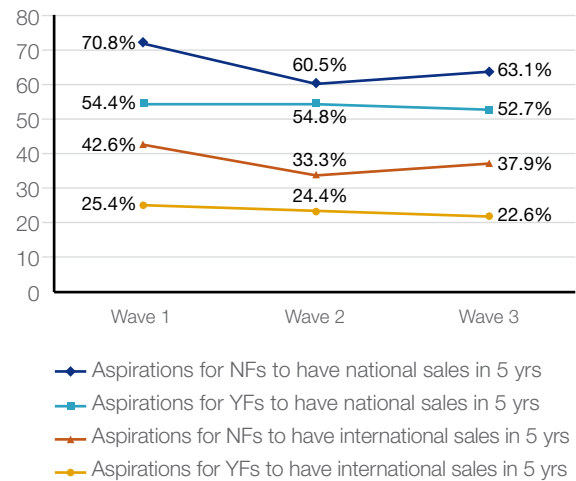


National and international markets?

We assessed the change in aspirations for NFs and YFs in relation to sales in five years time from customers in Australian and international markets. The proportion of firms aspiring for national (as opposed to regional or local) and international sales over time can be important indicators of the broader market objectives that these ventures may have.

We find significant differences when NFs are compared with YFs with respect to national sales aspirations. Average data across the three waves indicates that a higher proportion of NFs (65 per cent) show aspirations towards national market sales with a corresponding figure of only 54 per cent for YFs. Similarly, an average across all three years reveals a higher proportion of NFs (38 per cent) in comparison with only 24 per cent YFs who show aspirations towards international sales. This suggests that NFs tend to be more confident than YFs in both their national and international sales aspirations.

Figure 6: Expectations of firm growth (sales)



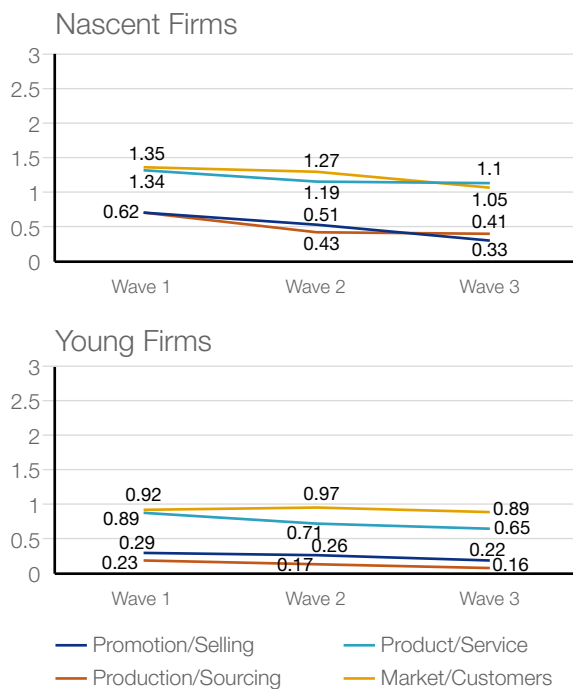
When comparisons are made within groups over time, we find significant differences when NFs in Wave 1 are compared with those in Wave 2 and Wave 3, with lower national as well as international sales aspirations in the latter waves. Despite these significant drops, it is interesting that NFs still register higher national and international sales aspiration levels than seen in YFs. While this may suggest that NF sales aspirations tend to be more robust in comparison with YFs, it is important to note that a substantial proportion of these YFs have actually brought some of their aspirations to fruition – that is, of surviving YFs over 52 per cent and nearly 20 per cent have achieved national and international sales, respectively.

Novelty over time

We asked founders of NFs and YFs for their views on how their ventures rate on the novelty of their business idea. Changes in four different aspects of novelty were assessed over time: 1) product/service; 2) promotion/selling; 3) production/sourcing; and 4) markets/customers.

We found statistically significant differences in two instances: a) when NFs progress from one wave to the next; and b) when NF and YF groups are compared with each other within the same wave. Firstly, when NFs in Wave 1 are compared with NFs in Wave 2, we find that the perceived novelty scores tend to decrease across all the four novelty aspects. We find a similar pattern when Wave 2 NFs are compared with Wave 3 NFs. A similar behaviour is typical of YFs although the scores do not decrease so rapidly. Secondly, when the NF–YF groups are compared, we find that NFs consistently judge their novelty higher than YFs, perhaps reflecting higher optimism in relation to the outcomes of changes to be undertaken.

Figure 7: Self-assessing novelty



Note: values reflect a 1–3 novelty score where '3=new to the world' and '0=no novelty at all'

Interestingly, both groups rate their degree of novelty lower for methods of production/sourcing and promotion/selling relative to their offerings (i.e. product/service) and targeted customers/markets. This may be because the former tend to be ongoing incremental process improvements, often without being recognised as such.

We also asked founders of both groups about their reasons for estimating a lower or higher degree of novelty than in the previous wave. Typically, among those who

adjusted their scores downwards, 70–80 per cent said it was because they had realised that their idea was not as different from other offerings in the market as they previously had thought, with most of the others indicating that it was the actual changes in the business idea that caused it to become less novel. Conversely, among those who adjusted their assessment upwards, approximately 60 per cent said it was because they realised that their idea was more different from other offerings in the market than they previously thought with the rest saying that there was an actual change in the business idea to become more novel.

Technological sophistication

Emerging firms in the sample were asked about their perceptions in relation to aspects of technological sophistication. In particular, we asked two questions – whether R&D spending was a major priority for the business; and whether they would consider their business to be high-tech. These aspects are important in that firms that see themselves as technologically sophisticated often tend to be at the forefront in undertaking learning and adaptation initiatives.

Our findings indicate that a substantial number of emerging firms tend to view themselves as technologically sophisticated. The proportion of NFs who show R&D spending being a priority tends to average nearly twice relative to YFs, with the difference in emphasis increasing in the latter waves.





Figure 8: R&D spending

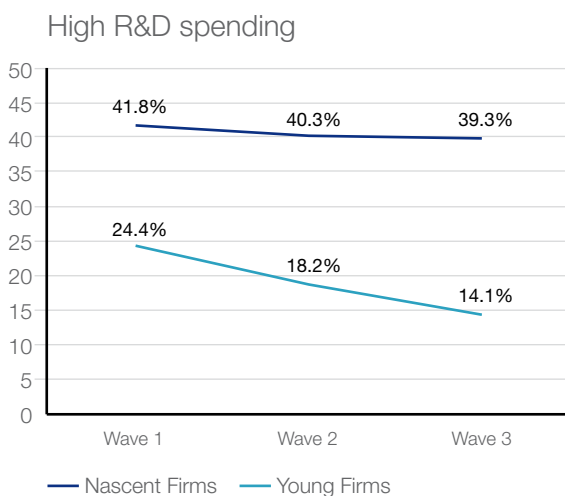
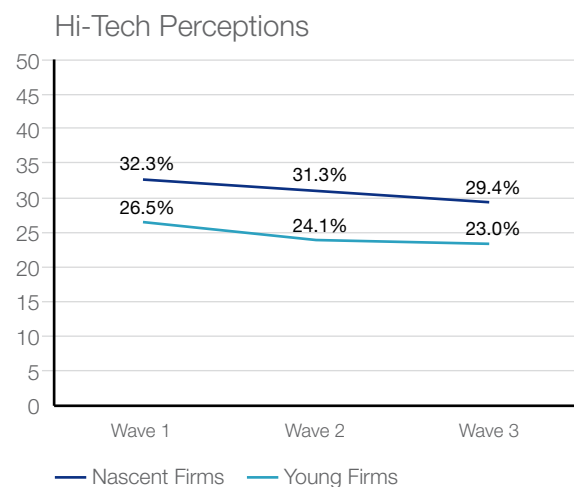


Figure 9: Hi-tech perceptions



Although the differences in the hi-tech perceptions between NFs and YFs are not dramatic, they are consistently higher for NFs than YFs. Not only are the very high technological perception figures for NFs surprising, but the fact that they do not come down much over time signals that a substantial number of NFs show a consistently strong inclination towards R&D spending and hi-tech orientation. Correspondingly, for YFs the R&D spending emphasis goes down significantly over the three years, perhaps an indication of the depletion of scarce resources that YFs have at hand.

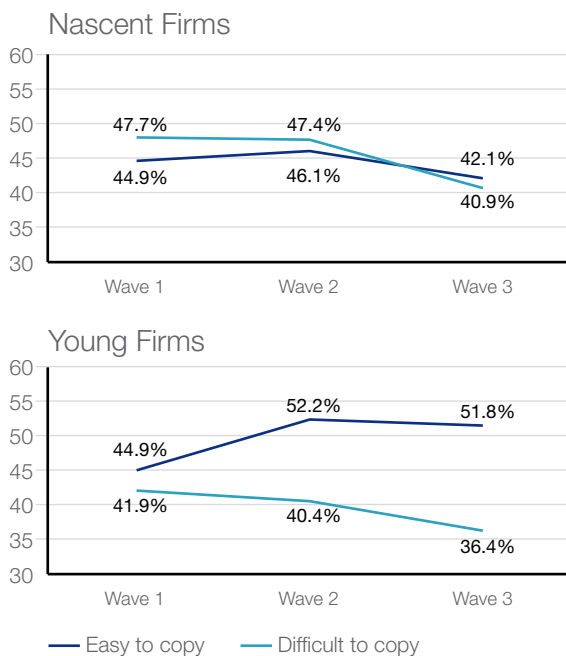
Gaining and sustaining strategic advantages

A vast majority of the surveyed firms (namely 92 to 98 per cent) across the three years indicated that they possess some form of strategic advantage that is key to their business success. While the proportion of NFs who said they had some form of strategic advantage was at the lower end of the spectrum in Wave 2 (i.e. 92 per cent) perhaps on account of the challenging business conditions of the global financial crisis – only a small proportion of emerging firms said

that their business had no particular advantage. This is encouraging as the majority of emerging firms appear to identify, assign due importance, and be confident about the strategic advantages they possess in a competitive marketplace.

Across the three years, of those who indicated they had some form of competitive advantage, the proportion of NFs who felt that it will be difficult for other businesses to copy their advantage was consistent across the first two waves (48 per cent–Wave 1; 47 per cent–Wave 2) with a slightly lower number reported for the third year (41 per cent). YFs showed a similar pattern. On the contrary, when asked whether competitors could easily match/copy their business advantage, it appears that YFs more than NFs realise over time their advantage is not as strong as they previously thought.

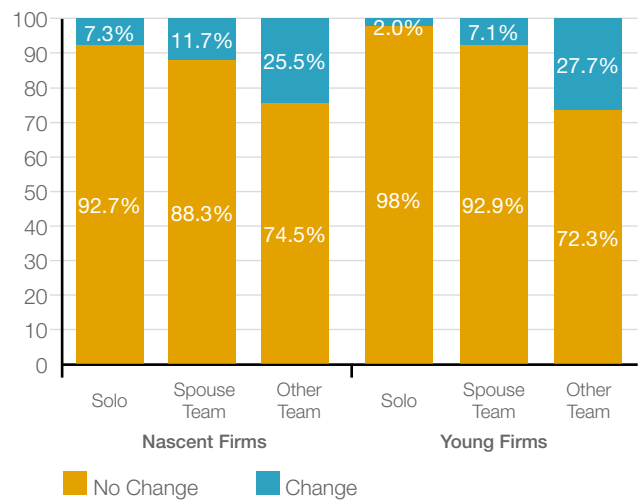
Figure 10: Sustainability of competitive advantages



Changes to the founder/owner team

To examine how team compositions change over time, we looked at whether new members joined or others exited over the three year period. Essentially, we compared across three groups: 1) solo founder; 2) with spouse team; and 3) with others team.

Figure 11: Most firms do not change their structure



Comparisons made between consecutive waves show that only a small minority of firms undergo changes in ownership. These changes are generally a bit higher for the NFs relative to YFs and are more likely in the cases of teams formed with others. On the other hand, solo firms for both NFs and YFs tend to have the least ownership changes. While it is less surprising that solo firms change the least over time, it is interesting that teams formed in partnership with spouses appear to be less prone to ownership changes than teams formed with others.



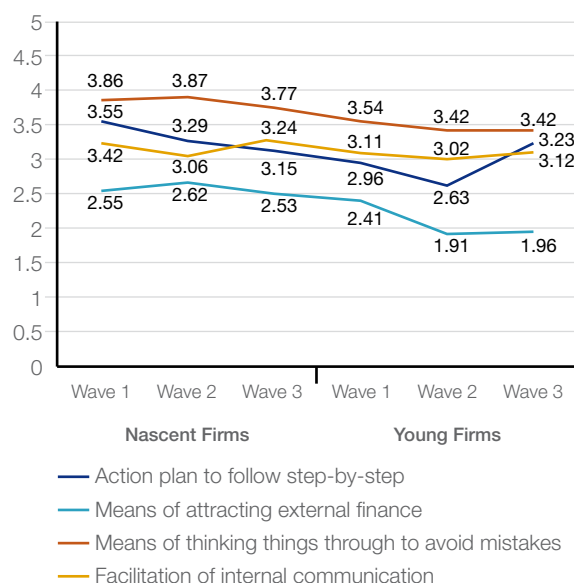


Change in the use of the business plan

Over 60 per cent of the emerging firms who had a business plan in the first year (56 per cent of NFs and 47 per cent of YFs) reported making revisions since it was first written. The gap between NFs and YFs widened in the second and third years, with just over 50 per cent of the surveyed NFs and 62 per cent of the YFs indicating they had revised their business plan in the last 12 months.

We next examined how emerging firms put their business plans to use over the three year period. Our analysis identified four key uses: 1) as a step-wise action plan; 2) as a means to obtain external finance; 3) as a means to think through things to avoid mistakes and; 4) as a means to facilitate internal communication. The use of the business plan as a means to think things through stands out as the most important and is followed by its use as a means to facilitate internal communication. Both these uses tend to remain relatively stable across the three waves. The use of the business plan as an action plan is also quite important, but goes down over time for both groups with a rebound in the last wave for YFs. This downward-then-upward trend may mean that founders are initially disappointed with the limited usefulness of the plan for this purpose in the highly uncertain and malleable conditions that prevail during early development. Possible as things stabilise, using the business plan as a step-by-step action plan becomes feasible. Somewhat surprisingly, the importance accorded to the use of a business plan to secure external finance decreases for YFs after the first wave. We also found that NFs consistently score higher than YFs across the three waves.

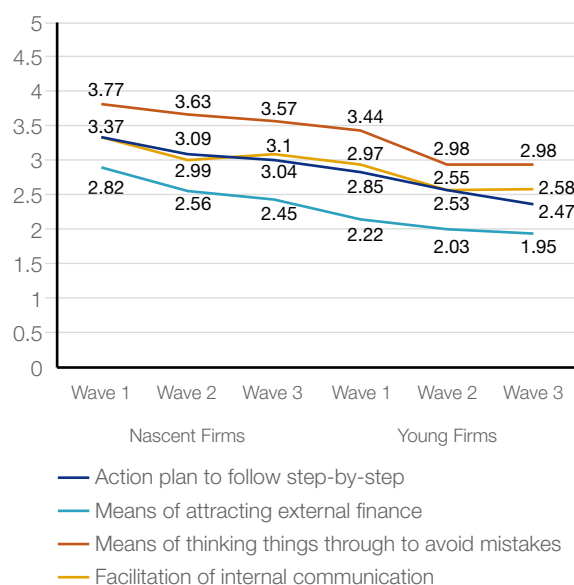
Figure 12: Use of business plan by firms which survived all three waves



Note: values reflect a 1–5 importance scale.

Overall, our findings indicate that a substantial majority of emerging firms which prepared a business plan actively use it and regularly upgrade it. The variation in usage of a business plan over time provides support for its usefulness in the business planning process. However when we asked NFs and YFs to indicate the planned use of their business plans in 12 month's time, all uses of the business plan appeared to be rated less importantly.

Figure 13: Anticipated use of a business plan



Note: values reflect a 1–5 importance scale.

So what does all this mean?

The findings in this report highlight a number of areas that those involved in the venture creation and development process should be mindful of, and also identifies potential opportunities for improved support to the development of new ventures.

From a policy and business incentive perspective it seems that policy makers should not assume or expect that most firms will respond to financial incentives to grow – the reality is that many ventures appear to not want to grow into big organisations. The analysis of the CAUSEE data certainly identifies quite modest growth expectations. Perhaps industry and government focus needs to be on encouraging more new ventures to start, and assisting these ventures in developing the skills and activities earlier in their developmental lifecycle, so that they have a greater likelihood of surviving and making a positive contribution to overall economic growth.

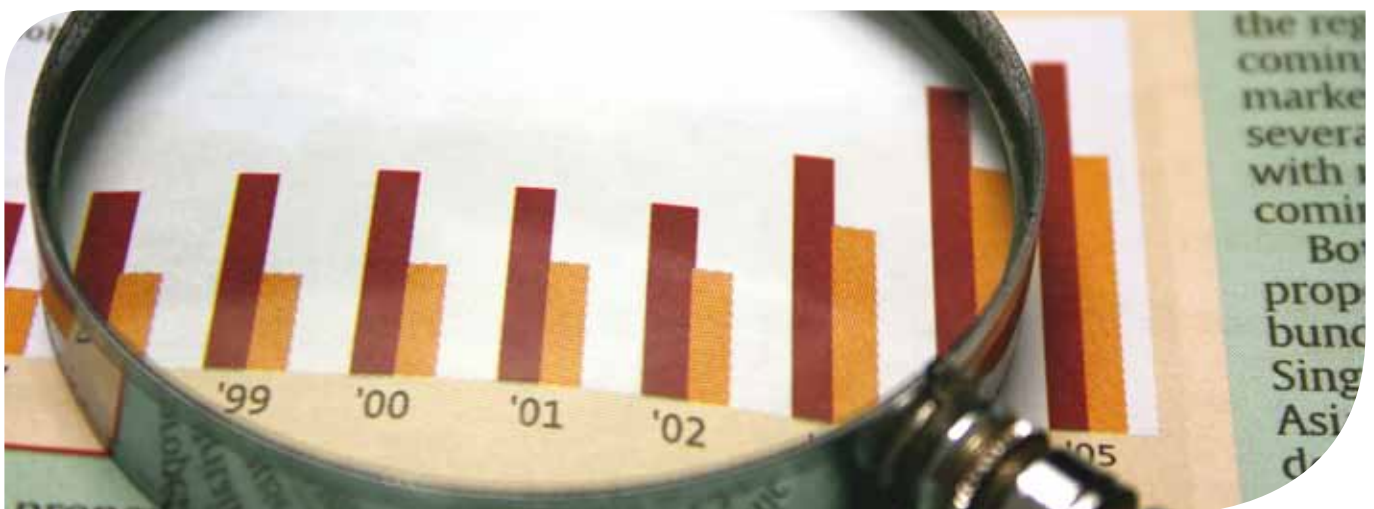
There is certainly cause to recognise that it is tougher out in the marketplace than perhaps founders initially thought as reflected in that relatively more founders find reason for 'downward' adjustments in things such as growth aspiration and idea novelty than those finding opportunities and strengths being greater than they first thought. There was a noticeable impact of the global financial crisis in a redefining of founders expectations, and these have appeared to continue to trend either downwardly or at best flatlined. This impact may also be reflected in the relatively low aspirational levels that business founders have in the potential growth of their ventures over time.

The 'realities' from getting 'dirty and sweaty' building a business are reflected in the lower levels of optimism expressed by Young firms as compared with Nascent firms. It is also expressed in the differences in aspirations as regards overall growth and market focus. This

presents an opportunity for advisors to help firms in early stages with being more realistic about their degree of novelty, their technological sophistication and the value that may or may not bring, as well as a more careful consideration of their strategic strengths. Understanding these more realistically may help to more appropriately focus the developing venture on the things that will contribute to their sustained success and growth.

Business planning appears to be a valued exercise with a number of expressed uses, however in line with previous findings, consideration needs to be given to more action orientated planning that is not done once and shelved, but more importantly interlinked with the ongoing growth and development of the business. The findings suggest a reduced use over time of the business plan as an 'action plan'. This again presents an opportunity for advisors to assist new ventures with tools that 'add value' to the business as much as they provide information for other stakeholders. Developing new ventures is as much about action as it is about planning and we need to be careful from an educational and advisory perspective that the use of the business plan does not come at the cost of actions that drive the venture forward.

Whilst the analysis tends to suggest downward movement in overall levels of founder aspirations, this need not be considered as a negative effect. Rather, it can be argued that it as a clear indicator that founders and participants in Nascent and Young firms, do learn and can adapt, as evidenced in this report. This continued ability to learn and adapt provides continued opportunities for policy, advisory activities and educational programs to contribute even more to the support and development of these ventures.



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