BABSON COLLEGE
2021 BCERC DOCTORAL CONSORTIUM
Research Translation Showcase

Why Luck, Talent And Money Shape Startup Growth In Counter-Intuitive Ways

Julien Salanave, Hong Kong Baptist University

Why do most new firms fail to grow while a handful of outliers such as Google, Facebook or Tesla account for almost all financial returns and job creations? Entrepreneurs, investors and policy makers alike ponder on some version of this question, yet no consensus has emerged around a clear answer.

One proposed explanation is that early differences in access to critical resources such as money and talent amplify through rich get richer dynamics into highly skewed outcomes over time. A small fraction of new firms become successful because they skilfully mobilize more such resources early on which compound over time to give them a decisive advantage over competitors Meanwhile, most other new firms struggle to grow and eventually fail because they never secure access to sufficient financial and talent resources.

An alternative explanation suggests that such skewed growth outcomes arise from the fact the growth of new firms essentially follows a random walk. Most new firms either live a lacklustre early existence struggling to find product market fit or suffer from unfortunate events outside their control which crush their early traction. Meanwhile, a few blessed ones benefit from lucky breaks or even streaks that change their destiny forever by putting them on a hyper-growth path.

A sensible common path forward follows Louis Pasteur's prescription that luck favours the prepared: the most successful new firms are skilful at securing more money and human talent early on and benefit from lucky breaks which demultiply such resources. But our research reveals that randomness and resources affect the growth performance of new firms in surprising ways: having too little or too much of either is equally damaging while magic occurs when entrepreneurs have just enough of both.

First, money and talent are double-edged swords for growth performance. While being under-resourced financially is detrimental to startup survival, financial resources quickly reach diminishing returns and being over-funded early on creates hyper-growth expectations from external investors incompatible with the incompressible maturation phase required to find and polish product market fit. Similarly, while larger founding teams with more diverse experiences may have a decisive performance edge over solo founders, extended founding teams are prone to slower and less efficient resource allocation, particularly in conditions of high uncertainty and ambiguity which characterize new firms.

Likewise, randomness, defined here as unpredictable events outside of new firms' control, affect their growth performance in a nonlinear way. One area where this clearly manifests is the take-off phase of an emerging market. Google wasn't the first search engine nor Facebook the first social network, but they entered their respective industries in the early innings before these markets transitioned to steep growth thanks to an adoption take-off of fixed and mobile broadband respectively. The timing for this adoption take-off is outside these companies (or any other market participants) control. They essentially take a bet to enter these markets early enough to learn the playing field and shape it to their advantage but late enough to still be alive if and when that market finally takes off.

Finally, talent and money have complex interactions with randomness in the case of firm growth. First, new firms are prone to dynamics similar to a phenomenon well documented in professional sports known as the paradox of skill: as the average skill of participants to a competition (or a market) increases, the skill gap between them narrows down and the role of luck in outcomes increases. Furthermore, the respective influences of talent, money and randomness fluctuate depending on the level of complexity prevailing in the pursued market. Talent and money shape growth outcomes more than randomness in simple predictable markets where errors are rare and inconsequential. Meanwhile randomness dominates as market complexity escalates towards the edge of chaos.

The central implication of these findings for entrepreneurs is that while their startup growth performance is not entirely outside (or within) their control, their room for decisive action is not necessarily where commonly believed. It is neither in trying to secure ever-more money or talent early on, nor in taking inconsiderate "all-in" bets. Instead it may, perhaps, be in mobilizing just enough resources to join the right table and build the capacity to be decisive when the pot materializes.

CONTACT: Julien Salanave, julien@life.hkbu.edu.hk. Hong Kong Baptist University, Hong Kong China.