

## CORPORATE ENTREPRENEURING: CRITERIA USED BY CORPORATIONS TO DETERMINE START-UP FUNDING

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### ABSTRACT

Ideas involving employee initiative from within large corporations which are out of sequence with the normal funding cycle often encounter significant resistance. In order to identify the critical factors, a multi-company intervention was developed. Start-up funding from \$60K to over \$1,100K was obtained for 20 of the 34 projects at the end of the 12 week intervention. Choosing a project with high strategic fit, developing a comprehensive business plan and being capable of sustained effort all ranked high in importance, but did not discriminate between funded and unfunded projects. Selecting the right executive champion who has influence and power over the resources and developing a compatible relation proved to be the most critical factor. Unfortunately, the executive champion does not believe their role is critical. Choosing projects where the corporate entrepreneur had a good understanding of both the market and customer and requesting low initial funding were also found to increase the probability of success.

### INTRODUCTION

New ideas must acquire resources in order to proceed into a formal development project so that resource acquisition is a major theme for corporate entrepreneurs. What are the key factors which allow corporate entrepreneurs to acquire resources?

The front end of the innovation process may be subdivided into four distinct areas (Vesper, 1984): (1) new strategic direction, (2) autonomous business creation, (3) ordinary new product development and (4) initiative from below. New strategic direction would be the development of a new product and/or a new market based on the initiative and direction of senior management of the corporation or business unit. An example might be Hewlett-Packard's calculator, which was championed by the President, William Hewlett, or the Sony Walkman, which was championed by the honorary chairman Masaru Ibuka and chairman Akio Morita of Sony. Autonomous business creation would be the development of a separate corporate venture group to fund and pursue ideas which were not readily accepted by the traditional strategic business units. The third area, and the most traditional, would be ordinary new product development. Typically, products which are in strategic alignment with the business unit and represent logical incremental and platform extensions of the current products receive resources during the annual or biannual review process. The last area, which is the focus of this paper,

involves employee initiative from within the organization (i.e. corporate entrepreneuring) to undertake something new which is not already in the new product pipeline and is out of sequence with the funding cycle.

MacMillian, Sigel and Narasimha (1985) found that the five most important criteria for independent entrepreneurs obtaining funding from venture capitalists was the entrepreneur's capability for sustained effort, understanding of the marketplace, demonstrated leadership ability, ability to evaluate and react to risk and an opportunity for significant financial return. Are these the most important areas which the corporate entrepreneur should concentrate on?

Previous studies (Bacon, Beckman, Mowery & Wilson, 1994; Khurana & Rosenthal, 1998) investigating the front end of the innovation process have evaluated key success factors for managing the front end activities. However, none of these studies provide guidance to the corporate entrepreneur on how to acquire resources for a new project.

In order to evaluate the key factors and provide guidance to corporate entrepreneurs, an intervention was developed to encourage "initiative from below by encouraging interested employees from large corporations, such as Lucent, AT&T, Exxon, and Allied Signal, to attempt to obtain funding for a new product idea that was not already in the company's pipeline nor being considered for funding. The intervention was given over a 12 week period, meeting several hours a week, where the final project was the development of a business plan.

Start-up funding from \$60K to over \$1,100K was obtained for 20 of the 34 projects at the end of the 12 week intervention. Potential profitability for the funded projects over a 3 year period varied from \$500K to over \$20,000K. Key criteria and obstacles were evaluated between the funded and unfunded projects which should serve as guides to corporate entrepreneurs struggling to obtain support for their project.

## THE INTERVENTION

The intervention is divided into three parts. The foundation portion, or first part, deals with a review of the literature and a discussion of the key success factors which separates successful from unsuccessful new projects. The company portion, or second part, reviews the organizational and cultural factors affecting the success of new projects. In the final portion, the employees develop an business plan for their own project in teams of from 3-5 corporate entrepreneurs. For the most part each team consists of members from their own company - although 4 of the 34 teams consisted of members from more than one company.

### Part I - Foundation

The principal purpose of this portion is to allow the employees to learn the key success factors which separate successful from unsuccessful projects (Bacon, Beckman, Mowery & Wilson, 1994; Cooper & Kleinschmidt, 1987; Karakya and Kobu, 1994; Montoya-Weiss & Calantone, 1994). The major emphasis was concentrated on the factors which the corporate entrepreneur could influence during the conceptualization of the idea. Other important factors related to project definition and predevelopment proficiencies are discussed in Part III - Business

Plan Development. Activities related to market test and market launch were excluded since they dealt with factors important to later stages of the development process.

Based upon this foundation, it was felt that the employees would understand the key issues associated with successful projects and be able to better self select the higher potential ones. These concepts were further reinforced when the employees evaluated successful and unsuccessful projects in their own companies.

## Part II - Organizational and Cultural Factors

In order to be successful in acquiring resources, the corporate entrepreneur needs to understand the often prevalent difficulty that corporations have with new projects that our out of sequence with the funding cycle. Organizational and cultural factors (Burgelman, 1984), along with management behaviors (MacMillan & George, 1985; Venkatraman, Shane, McGrath & MacMillan, 1993) are reviewed since they play a significant role in determining new product success. Employees then study the organizational structure which exist in their own company so that they can better understand the obstacles and hurdles which they are likely to encounter.

All projects required an executive champion<sup>1</sup> since corporate entrepreneuring typically involves activities which violate the normal rules and procedures in the organization and executive champions help absorb the risk. Executive champions early involvement has been shown to be important to obtaining resources (Knight, 1987; MacMillan & George, 1985; Maidique, 1980; Tighe, 1998).

## Part III - Business Plan Development

Developing a business plan for the new idea represents the final project of the intervention. The proficiency of developing the idea into business terms has been shown to be an important element of the fuzzy front end (Bacon, Beckman, Mowery & Wilson, 1994). The business plan involves a clear product definition (Bacon, Beckman, Mowery & Wilson, 1994) and emphasizes the risk and assumptions (MacMillan, Block & Narashimha, 1985; McGrath and MacMillian, 1995) associated with start-up rather than focusing on elaborate financials. The participants were required to complete the business plan and attempt to obtain funding.

## PROJECT MIX

The relative innovativeness of the projects may have influenced the results. Alternatively, the participants may have only chosen projects that had relatively low levels of innovativeness. The projects were grouped in Table 2 into six distinct categories using the format suggested by Griffin and Page (1996). No clear pattern between unfunded and funded projects is identified. Cost reduction projects, which presumably are of lower risk, had an equal mix between funded and unfunded projects. Even a “new to the world” project, which typically has high risks associated with it received start-up funding, although four other “new to the world projects” did not receive

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<sup>1</sup> The term of executive champion was used by Maidique (1980) to denote the executive who has direct or indirect influence over resource allocation and uses this power to channel resources to new projects.

funding. Overall, there is an equal mix of funded and unfunded projects with no distinct pattern related to the degree of newness to the market and to the company.

## RESEARCH METHODOLOGY

The questionnaire designed by MacMillian, Zemann and Narasimha (1987) and Siegel, Siegel and MacMillan (1988) to determine the key decision criteria used by venture capitalists was modified to fit with a corporate project (see Table 5). Additional criteria related to working with the champion and strategic fit with the corporation were added, while issues specifically related to venture capital funding were eliminated. Each employee at the end of the intervention was asked to evaluate on a 5 point scale the key factors which they felt were essential to the funding decision - ranging down to those factors which were irrelevant to the funding decision.

In a similar manner, the key obstacles associated with corporate venturing were evaluated by MacMillian, Block and Narashimha (1986) in a previous study were similarly modified (see Table 6). The questions were evaluated on a 5 point scale ranging from irrelevant or not applicable ones to significant obstacles.

At the end of the intervention, the executive champions and entrepreneurs were asked to anonymously complete the questionnaires and indicate if their projects received start-up funding. Completed questionnaires were obtained from 27 of the 34 executive champions and 96 of the 118 corporate entrepreneurs.

## RANKING OF FUNDING CRITERIA AND OBSTACLES

Ranking of the most important criteria is shown in Table 3 as a percentage of champions and entrepreneurs who rated the funding criteria as a "5" or essential. The most important funding criteria identified by both the champions and entrepreneurs was strategic fit. Understanding the business aspects and developing a comprehensive business plan are key hurdles which the entrepreneur must successfully vault.

Ranking of the obstacles is shown in Table 4 as a percentage of executive champions and entrepreneurs who rated the obstacle as a "5" or significant. Tables 4A and 4B show the top five obstacles indicated by executive champions and entrepreneurs, respectively. The principal obstacles cited by 24% of the executive champions (Table 4A) were lack of a comprehensive business plan and competition for resources in the company. This appears paradoxical since the executive champions also ranked the business plan in Table 3A as being critical in importance. This may be explained by noting that the executive champions from the unfunded group gave this obstacle a top box ranking of 43%, while the executive champions from the funded group ranked it as 15%. Thus, the lack of a comprehensive business plan represented a significant obstacle to the unfunded projects.

The principal obstacle cited by 33% of the entrepreneurs (Table 4B) was the lack of real corporate commitment to the project. This obstacle (Table 6, G-1) was found to be a significantly greater ( $p=0.013$ ) to the unfunded entrepreneur. Lack of corporate commitment to the project (G-

1) may be a reflection of the lack of authority of the executive champion (J-2) as indicated by the strong correlation between these obstacles ( $r=0.633$ ,  $p<0.001$ ).

## DIFFERENCES BETWEEN THE FUNDED AND UNFUNDED PROJECTS

The significant differences ( $p<0.05$ ) between the funded and unfunded projects may be grouped into the four areas as indicated below.

### Executive Champion

The importance of carefully choosing and developing a good working relationship with the executive champion was found to be a key discriminator between funded and unfunded entrepreneurs. Executive champion compatibility (Table 5, A-6) and familiarity (Table 5, B-6) with the entrepreneur team were both found to be significantly different, ( $p=0.025$ ) and ( $p=0.002$ ) respectively, between the unfunded and funded groups. Working with an executive champion who controls the initial funding (Table 5, E-2) was also found to be significantly different ( $p<0.001$ ) between funded and unfunded projects.

Developing a good working relationship was ranked fairly high by the entrepreneurs receiving a top box ranking for developing a good working relationship and being compatible with the executive champion of 50% and 45%, respectively. However, the executive champions do not give these criteria the same level of importance. Top box ranking for the same two areas by the executive champions were 11% and 7%, respectively! Executive champions for the funded group indicate that their teams are better ( $p=0.032$ ) able to except criticism (Table 5, A-5) than the unfunded groups, which again stresses the importance of the team developing a good working relationship with the executive champion.

Choosing an executive champion who has the authority to approve the project (Table 6, J-2) was a significant discriminator identified by both the executive champions ( $p=0.032$ ) and entrepreneurs ( $p<0.001$ ). Previous studies (MacMillan & George, 1985; Maidque, 1980) stressed the importance of having executive champion involvement in radical projects. The results of this study indicate that an executive champion is important even in smaller, less complex projects, although the executive champion does not understand how critical his or her role is to obtaining resources.

Executive champions for the unfunded projects expected a project with significantly ( $p<0.001$ ) higher market attractiveness (Table 5, D-5) and significantly ( $p=0.035$ ) lower long term potential (Table 3, E-4) than the funded group. Executive champions in the unfunded group were interested in projects with low risk (i.e. high attractiveness) while being less concerned with the long term potential. In contrast, executive champions who were instrumental in obtaining funding were not as concerned with market attractiveness, but more concerned about the long term potential. Executive champions may be segmented into low risk unfunded and high risk funded groups.

### Low Initial Investment

Low initial start-up funding (Table 5, E5) was found to be an important discriminator ( $p < 0.001$ ) by the entrepreneurs between funded and unfunded projects. This is not surprising due to the nature of the short time between the beginning and end of the intervention. The entrepreneurs had only 12 weeks to find an executive champion, develop a business plan and obtain support. High levels of funding in large companies often takes many months to achieve. Thus, the intervention may be biased to lower funding levels.

Low initial funding could still remain a statistically significant criteria even if the employees were given more time. Starr and MacMillan (1990) indicate that developing social assets and working relationships throughout the corporation may reduce the need for significant start-up funds. Requesting large initial funding may handicap the start-up by forcing it to compete with already committed projects. Low initial, milestone based funding represents a typical funding methodology for venture capital seed stage funding.

### Marketing Synergy

Being familiar with the project/service and understanding the market was ranked by executive champions as 4<sup>th</sup> and 8<sup>th</sup> in importance as indicated in Table 3. Entrepreneurs who obtained funding rated project familiarity (Table 5, B-1) and market understanding (Table 5, B-2) significantly higher, ( $p < 0.001$ ) and ( $p = 0.002$ ) respectively, than their counterparts who did not receive funding. A lack of understanding of the market was a significant obstacle ( $p < 0.05$ ) identified by the executive champions in three obstacle categories (Table 6, F-1, F-2 and F-4). In addition, entrepreneurs chose projects in markets (Table 5, D-5) which were more attractive ( $p = 0.044$ ) to their company. This data suggest that funded entrepreneurs had a better understanding of the marketplace which their company participated in.

### Expected Market Acceptance

Projects expected to enjoy easy market acceptance (Table 5, C-2) were judged by the entrepreneurs as an important discriminator ( $p = 0.018$ ) between funded and unfunded projects. This result indicates that the product or service which has a good fit with existing market requirements has a much better chance of receiving funding. Products launched in markets where the customer needs are well known is a hallmark of success. Projects which were unable to attract start-up funding presumably represented more of a stretch from the demonstrated and known customer needs.

## DISCUSSION

Corporate entrepreneuring or initiative from below is inherently frustrating and difficult. The results from this study of 34 projects, of which 20 received funding from \$500K to \$1,100, may help to explain why and offer insights so that the corporate entrepreneur may be successful.

### Importance of the Executive Champion

Top management support has been shown (Copper and Kleinschmidt, 1987) to be essential to achieving success to eventual new product development success. However, the role

of management in championing “initiative from below” projects has not been as extensively explored. Madique (1980) indicated that an executive champion was important to radical innovation. MacMillan and George (1985) validated the importance of senior management involvement in “new to the company” and “new the world” projects but did not discuss their value in product strategies of lower risk. Knight (1987), in 1987 [28], in his study of corporate innovation in Canada indicated that (Knight, 1987; pp.288] “...top management sponsorship was also especially necessary for ideas which arose well down in the level of the organization.” Tighe (1998) suggests that finding a sponsor is critical for securing resources for new products, but offers no empirical data to support his conclusions. *Our data indicates that the executive champion for “initiative from below projects” is critical to success even in incremental projects.*

Developing a good working relationship, achieving compatibility and choosing an executive champion who controls the initial funding were all identified as important funding criteria by the corporate entrepreneur. Groups who rated these criteria high in importance to the funding decision had a significantly higher probability for success in obtaining resources. *Thus, finding and developing a good relationship with an executive champion is critical to the corporate entrepreneur.* Tighe (1988) makes the same point in his recent article (Tighe, 1988; pp.76) and states that “...without an energetic and enthusiastic sponsor most projects will never be implemented...” *What is paradoxical and probably accounts for some of the frustration associated with corporate entrepreneuring is that the executive champions do not believe that their role is critical, as indicated by the low criteria ranking they gave to these same areas.*

### Low Initial Funding

Low initial funding was also found to increase the probability for obtaining start-up funding. This may be a biased result since high levels of funding in most large companies take months to achieve. Obtaining low initial funding may seem easy to obtain in large billion dollar companies. None of the companies business units included in this study has special funds set aside for projects out of the yearly budgeting cycle. The projects discussed in this study had to compete with the resources currently available. In addition, human resources often need to be reassigned from other areas, if the project is approved. The majority of the projects must overcome the naturally high resistance from already approved and ongoing projects. The important issue for corporate entrepreneurs may be to legitimize their project so that it may enter the product development juggernaut and be able to compete for more resources. The key issue may not be the amount, but the development of linkage between the product and the innovation initiatives of the corporation.

### Marketing Synergy

Marketing synergy (i.e. being familiar with the product and understanding the market) and expected easy market acceptance also increased the probability of obtaining funding. Understanding of the market and customer needs presumably allowed the corporate entrepreneurs to develop a compelling story for their product. Not only did the corporate entrepreneur understand the market, but presumably conceived an opportunity so compelling to the customer that easy market expectation was anticipated. Market familiarity has been shown to be a key criteria for venture capitalists (MacMillan, Siegel & Narashimha, 1985) in determining funding.

### Strategic Fit and Business Planning Skills

Surprisingly, a number of issues were not discriminators between funded and unfunded projects. The importance of choosing a project with high strategic fit is a key finding and was ranked as the most important criteria by both executive champions and entrepreneurs (Table 3). Likewise developing a comprehensive business plan was also ranked high by both the executive champion and the entrepreneur. However, there was no discrimination between the groups since both thought that strategic fit and developing a comprehensive business plan was essential. While trite, it is the contents of the business plan which matter.

### Team Characteristics

Team characteristics, such as capability for sustained effort (Table 5, A-1), has been cited (Siegel, Siegel & MacMillan; 1988) as the most important criteria to venture capitalist's new projects. The venture capitalists gave this criteria a top box ranking of 64%. In contrast, executive champions ranked it as 6<sup>th</sup> (Table 3) with a top box rating of 41%. Venture capitalists consistently rank the team as the most important characteristic in the funding decision. In contrast executive champions rank issues of strategic fit, product and market strategies ahead of team characteristics. This result does not mean that corporations do not value team performance, but that they have considerably more employee depth than a start-up. A venture capitalist cannot easily change the employees in his start-up since they typically embody the core knowledge competence. In contrast, corporations can and do transfer people in and out of projects in order to best optimize reward and risk.

### Corporate Culture

Having a corporate culture which does not support innovation (Table 6, K-2) should have been a key discriminator, with funding more difficult to obtain in the less entrepreneurial environment. The characteristic is almost significant for the entrepreneurs ( $p=0.068$ ). In contrast, the executive champions in the unfunded group did not identify this an important hurdle. Not one of the executive champions in the unfunded group ranked this is a significant obstacle! The lack of agreement between the executive champion and the entrepreneurs about their corporation's culture may be another indication of the lack of compatibility between these two groups.

Alternatively, having an innovative culture may not matter if the entrepreneur develops a good working relationship with an executive champion who controls the initial funding and requests low start-up funds for a project where he or she has a good understanding of the market.

## CONCLUSIONS

The results of this study provide important guidance to the corporate entrepreneur seeking start-up resources. The choice of the executive champion is probably the most critical factor that will affect the entrepreneurs' ability to obtain funds. The entrepreneur should choose projects where they have intimate understanding of both the market and customer. Low initial funding increases the probability of success, legitimizes the project and develops project awareness which

is probably more important than the amount of the award. Choosing a project with good strategic fit, developing a convincing comprehensive business plan and being capable of sustained effort doesn't guarantee success, but should be viewed as prerequisite requirements to participate in the fuzzy front end.