

FORETHOUGHT

David and Goliath, Reconsidered

by Amar Bhidé



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opinion

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There's a myth that small start-ups and big companies are locked in a battle for supremacy. In reality, they live in harmony, not strife.

by Amar Bhidé

Large companies have fallen out of favor. It is now widely assumed that the very characteristics that underpinned their success—scale, stability, consistency—are hindrances to competing in today's fast-paced markets. To avoid being displaced by small, entrepreneurial upstarts, the thinking goes, big companies will have to learn how to mimic those upstarts. They must, in the words of Gary Hamel, "bring Silicon Valley inside" or they will die.

Precisely the opposite view prevailed just a few decades ago. As large, professionally managed companies rose to prominence in the last century, business practitioners and scholars came to believe that corporate giants would inevitably render entrepreneurs obsolete. Even Joseph Schumpeter, the prophet of "creative destruction" and patron saint of the new economy, came to assume that big, centrally managed corporations would usurp the entrepreneur's role. The "perfectly bureaucratized giant industrial unit," Schumpeter wrote in his 1942 book *Capitalism, Socialism and Democracy*, would be able to automatically discover and fulfill all "objective possibilities" for innovation. It had "come to be the most powerful engine of progress."

The common wisdom was wrong then, and it is wrong today. Large corporations and small start-ups are not mutually exclusive organizational forms. Rather, they exist symbiotically, each requiring and drawing on the unique capacities of the other. Yes,

it is easy to point to examples of upstarts attacking incumbents, such as Compaq taking on IBM and Amazon.com targeting Barnes & Noble, but such battles are exceptions to the rule. Most start-ups pursue small, low-cost, and highly uncertain opportunities, while giants take calculated risks on large-scale initiatives. David and Goliath do not wage battle; they rely on each other.

Corporations enjoy several advantages in undertaking large initiatives. Their track records and stability enable them to gather large amounts of capital from investors and gain commitments from suppliers, customers, and employees. And their well-defined organizational structures and processes allow them to coordinate complex projects. Intel has invested an estimated \$8 billion and hundreds of man-years developing its next-generation Merced chip. Few entrepreneurs could contemplate such a task.

But the governance structures and long-term orientation of large companies preclude them from undertaking small initiatives with poorly defined risks and rewards. That's the space in which entrepreneurs operate. As Clayton Christensen has shown, many new "disruptive" technologies are not suitable for mainstream markets; their initial development often takes place in out-of-the-way niches. The personal computer started in 1975 as a quirky toy for tinkerers and hobbyists. Only individual entrepreneurs had the incentive to serve this unformed market and

create practical uses for the PC through their small-scale innovations. Swarms of start-ups serve a Darwinian purpose: their experiments enable the “fittest” new products and technologies to emerge.

Even after a new technology has entered the mainstream, entrepreneurs continue to provide a valuable role by offering complementary goods and services whose revenue potential is too small to interest established companies. As IBM PCs proliferated in corporate offices in the early 1980s, an army of start-ups provided services such as installation and maintenance, and products such as hardware add-ons, software programs, and educational books and videos. The start-ups took advantage of IBM’s efforts to create a large, stable market; at the same time, they helped IBM by accelerating the sales of PCs.

Opportunistic entrepreneurs play other important economic roles as well. At the margins of a market, they provide highly customized offerings that the standardized processes and procedures of big companies can’t accommodate. When PCs were in short supply in the early 1980s, for instance, IBM’s policy of treating all authorized dealers equitably meant ignoring differences in regional demand. IBM would not reallocate computers to a particular region even if customers there were prepared to pay a premium for them. As a result, new businesses, including both value-added resellers and gray-market distributors, rushed in to the market. In exploiting IBM’s unwillingness to distribute products in an economically rational way, these businesses also helped IBM mitigate the inflexibility of its distribution policies.

IBM was able to maintain its reputation for treating its dealers equally, while entrepreneurs provided computers to customers that most valued them.

In a similar way, entrepreneurs help mitigate the rigidity of big companies’ employment policies. To promote the cooperation and teamwork needed to carry out large initiatives, corporations recruit individuals who will fit their cultures. But such people aren’t always suited to all tasks. Entrepreneurial contractors can take up the slack, providing people with specialized talents whose personalities may not fit into corporate molds. Corporations can also draw on start-ups to fulfill short-term labor requirements. That way, they avoid damaging their reputations by bringing in new workers only to let them go a short time later.

The great economic progress of the twentieth century was fueled by innovation – innovation that resulted from the combined, complementary efforts of new, growing, and mature companies. If the coming century is to be as fruitful and prosperous, it will be because entrepreneurs, large corporations, and, possibly, new organizational forms work side-by-side. Free-market economies thrive on diversity. The hegemony of any one organizational model is dangerous to our wealth.

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