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Successful new companies must eventually face the chrysalis effect: a difficult metamorphosis into a mature company.

by Juliette Powell

In 2013, Jawbone, a leading maker of wearable activity-monitoring devices, acquired a startup called BodyMedia, reportedly for more than US$100 million. The leaders of the two companies shared a grand ambition: They dreamed of scaling up to become a multibillion-dollar wearables company, selling devices that collected not just health and fitness data but any data related to driving safety, travel, and the gamut of human experience, physical and emotional.

They knew that this was a long-term goal; devices of that scope would need hundreds of millions of dollars more in investment. But they were convinced that the newly combined company would outpace its competitors, including some of the largest companies in high tech.

"As one of the first consolidations of experience, technologies, and IP, the merger with Jawbone was a statement," recalls John ("Ivo") Stivoric, who had been a BodyMedia cofounder and chief technology officer and then became VP of Jawbone's research and development. "It was a show of force in the face of giants like Apple, Google, Microsoft, Samsung, even Amazon."

And indeed, the newly merged enterprise expanded quickly. Yet as the company grew, its momentum slowed. "In the early days," recalls Stivoric, "our team developed a track record for disruptive innovation — repeatedly. People would say we couldn't do something technologically, and we would go ahead and do it, as well as proving our solutions clinically. But over time, we got less and less nimble in taking risks."

This pattern is prevalent among startups. As they mature, they shelve their breakthrough innovations and move toward incremental releases such as feature updates. This problem is generally attributed to lags in market demand for new products. It takes time for the relatively small number of early adopters to expand into a broad base of customers.

But market demand is not always the main problem. Startups face internal challenges that hold them back even more. Once a company expands beyond a few hundred people, the informal, entrepreneurial management style of the early days no longer works. Fledgling companies need to grow large but keep the fluidity and productivity of a startup, and it's not obvious how to do so; first-time founders typically have little experience running bigger companies. Add to that the vagaries of competition and the challenges associated with recruiting and retaining good people, and it's no surprise that so few companies grow past the startup phase.

You could call this the "chrysalis effect." Several years after it's founded, an organization experiences something like the metamorphosis of a larva into a full-grown butterfly. Even in the insect world, this is a brutal transition; the caterpillar molts its skin four or five times and then, as a pupa, literally digests itself. Its old body becomes broth. Formerly dormant cells called imaginal discs, released by new hormones, replicate rapidly, forming eyes, wings, and color patterns. Only one in 400 caterpillar eggs survives to take flight.

Illustration by Lars Leetaru

The chrysalis metaphor is apt because the process of maturation for startups also involves severe winnowing. In 2015, startups died at a rate of one per week, according to venture capital database CB Insights. When it comes to "scale-ups" — companies moving from startup status to a global presence — the chances of survival are even lower. The survivors become famous: Google, Amazon, Facebook, Netflix, and Apple are among them. But to get through the transition successfully, leaders have to radically change their organizations and the way they manage, while still growing. During this necessary transition, many companies are sold or taken over. But if the upstart leaders have anticipated the transition — for example, by creating new roles for the founders, attracting people who have experience with similar transitions, developing collaborative networks, and borrowing established practices in their own deliberate way — they can restructure and soar.

Chronicles of the Chrysalis

When I first began asking technology leaders about the chrysalis effect, the phenomenon didn't yet have that name. But I knew startup leaders who talked about it informally, often with pain and in hushed tones. Scaling up was often more challenging than these leaders had expected, and most declined to be interviewed on record about it. However, some of their advisors and funders were willing to talk, and a few are beginning to codify the practices of transition.

One place where the transition is becoming codified is Stanford University. Silicon Valley investor Reid Hoffman (cofounder of LinkedIn and Greylock Partners) and his colleague Allen Blue — LinkedIn's cofounder and vice president of product management, and member of the U.S. Department of Commerce Data Advisory Council — taught a class on "blitzscaling" at Stanford in 2015 (which they then aired on YouTube). They billed the course as focused on rapid growth. But much of it covered the management disciplines needed for a company to expand beyond its early days. (Since the course was posted, LinkedIn made its US$26.2 billion deal with Microsoft, but the precepts still resonate.)

"First-mover advantage doesn't go to the first company that launches," said Hoffman, introducing the first session. "It goes to the first company that scales." He described a typical startup's transition from a "tribe" — with a handful of employees, and a market capitalization typically below $10 million — to a "village," with thousands of employees and a market cap in the billions. "You move past [the tribe stage]," he said, "not because you want to, but because you need to."

Another expert chronicling the transition is Steve Blank, who founded the software company e.piphany (now part of Infor). In his book *The Startup Owner's Manual: The Step-by-Step Guide for Building a Great Company* (with Bob Dorf; K&S Ranch, 2014), he labels this transition as a move from post-customer development to customer creation (typically after a series C funding round): "A radically different stage during which the company suddenly shifts from 'searching for a business model' to 'executing one.' [It now has] revenue targets and timetables to hit, product and plans to deliver, and more granular and precise accountability to investors and board members."

For Micheál J. Kelly, dean of the Lazaridis Institute, a management research center at Wilfrid Laurier University in Toronto, the transition requires knowledge that few startup leaders have. "Entrepreneurs are very comfortable when they have 20 employees in their company," he says, "but as soon as they need to build structure around it, they have no idea what to do."

Thus, any company that truly wants to shape its future as a technological innovator must be ready to scale when the time comes. Or as Hoffman said in his class about the early days of entrepreneurship: "You [should be] thinking, what happens when it's 1,000 people; 2,000 people; 3,000 people? Because the mistake people frequently make in organizational stuff is they say, 'OK, let's wait until it's all broken and then try to fix it.' That's much harder." He added that the need to scale up was a factor in his 2008 decision to replace himself as LinkedIn CEO with Jeffrey Weiner. Weiner was recruited from Yahoo, where he had been executive vice president of the network division and had led a team of 3,000 people.

Leaders have to radically change their organization and the way they manage, while still growing.

Four Basic Principles

In the conversations I've had on this subject, and in forums such as the blitzscaling course, four factors keep coming up: setting up the founder in new roles that take advantage of his or her creativity; recruiting for scale by seeking talented people who have experience with the transition you're about to enter; developing meaningful networks within the company, so people can communicate even across large organizational structures; and selectively adopting a few key mainstream management practices, the kind that don't swamp you in bureaucracy.

These practices all have a key principle in common: to "remain the same but be different," as Hap Klopp puts it. Klopp, author of *Almost: 12 Electric Months Chasing a Silicon Valley Dream* (with Brian Tarcy; Motivational Press, 2015), has been a Silicon Valley entrepreneur since the mid-1980s, after cofounding outdoor retailer The North Face. "The same things that are embedded in the DNA of a company — its sense of urgency, singleness of purpose, passion, devotion, and energy — need to be retained while simultaneously expanding the team and expanding the horizon," he says.

• **Repositioning the founder.** In 1998, an engineer named S. Scott Crump and his wife, Lisa, were tinkering in their Minnesota garage to create a toy frog for their 2-year-old daughter. He discovered he could set up a hot glue gun to be programmed to shape 3D objects by affixing the device to a robotic gantry system (a movable hoist used to position tools on workbenches). This led him to invent fused deposition modeling (FDM), the 3D printing process on which many digital fabrication machines rely. The Crumps founded Stratasys, one of the first companies in this field. Crump was chairman and CEO of Stratasys until December 2012, when it merged with Objet Geometries. At that point, he was replaced as CEO and remained chairman. But he also took a role as the chief innovation officer — symbolically and operationally retaining a connection between the founder's role and the strategic direction of the enterprise.

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This pattern is common in mature technology startups. At Google, for example, Larry Page took a new role in forming Alphabet, Google's innovation-driven parent company. It allowed Page to focus his attention on fostering breakthrough innovation within the company.

• **Recruiting for scale.** With expansion comes rapid hiring, which can erode internal trust. To counter this tendency, companies that have successfully navigated the chrysalis effect put a great deal of time and effort into recruiting, even though they often face pressure to add staff quickly. They seek people who fit their original culture, who bring energy and a sense of accountability to their enterprises, and who know how to push back against positions they disagree with in a respectful, constructive way. These companies also look for people with a broad perspective.

"The people who survive the transitions from startup to scale-up," says Jawbone's Stivoric, "are sponges for learning, interested in all aspects of the business. It doesn't matter whether they are senior management material or deep into technical detail. You want them. They can flow with the phases and changes of the business because they see where and how the pieces connect."

Jawbone, for example, hired Jason Child as chief financial officer during its scale-up. Child had 20 years of experience in leadership roles at companies including Amazon. He had direct experience with the pitfalls of poor management and the triumphs of good leadership.

Silicon Valley's famous tolerance for failure stems from this factor. "Some VCs say it's essential to hire experienced people because they've learned hard-earned lessons from past mistakes," says Amish Shah, founder and CEO of the recruiting firm Millennium Search. "You want the double OPM: other people's mistakes on other people's money." However, the truly successful mature companies can also attract success stories, and prosper accordingly. On July 16, 2015, when the new CFO of Google and Alphabet, former Morgan Stanley CFO Ruth Porat, led her first earnings news conference at Google, its market capitalization jumped $60 billion — the biggest one-day gain in market value for any company in history, according to *New York Times* columnist James B. Stewart. Investors knew the value of having someone in place who had run a finance function effectively, especially for an investment bank.

"The most successful entrepreneurs have been in [big] business before," says startup veteran Annette Kramer, who advises entrepreneurs and venture capitalists on strategy. "They've seen how poor management severely curtailed growth in enterprises when they were employees. Their first priority now is to develop the company with an eye on growth, right from the beginning."

Below the executive levels, staffing an organization with the right people requires the same intensive attention. The strategy employed by Regeneron, a biopharmaceutical company whose staff size tripled in four years, shows the importance of organizational culture. Faced with the need to swiftly add many experienced scientists to staff large research projects, Regeneron invested first in articulating what was special about its high-engagement, high-integrity culture. "Once these cultural values were clearly articulated, they were able to attract new employees who fit," says Benoit Hardy-Vallée, an executive advisor with IBM who wrote a case study about the initiative.

• **Developing collaborative networks.** Having recruited the right people, bring them together regularly in ways that enable them to learn together, particularly across internal boundaries. This can be done in large-scale gatherings focused on the company's goals. In 2015 at Makerbot, a manufacturer of 3D printing technology, Jonathan Jaglom, then the general manager of the Asia-Pacific and Japan business, was promoted to CEO and charged with overcoming a slowdown and revitalizing the company's growth. "One of the first things I did," he recalls, "was to set up a 50-person voluntary creative staff council." His team identified the top influencers in different departments, and he asked them to meet regularly with him as a group, to collaboratively redefine Makerbot's culture.

Meaningful networks can also be built through one-on-one conversations. When Jeff Weiner became CEO of LinkedIn, he arranged in-depth meetings with each senior team leader to talk about the company's strategy, priorities, and measurable objectives. He asked them what they would focus on, and instructed them to think about the company's culture and values in that context. He then synthesized this into a common set of priorities, articulated on a single page so everyone could understand what they were working toward.

"This is still the same mission that we work with today.… It's important to have this, because it is actually the touchstone which becomes part of daily decision making among the people who are within the company," explained Hoffman in the blitzscaling course.

• **Selectively adopting mainstream management practices.** "Any product that becomes popular and spreads through the Internet can see revenue jump from $1 million to more than $100 million," says J.F. Gauthier, head of business development at Compass (formerly Startup Genome), which provides a management dashboard and benchmarks for tech startups and e-commerce. "But that's just the tip of the iceberg." Now comes the time to bring in the established management practices that will allow you to move forward. These may include better ways of training and evaluating people, designing business processes, working across internal boundaries, keeping track of performance, marketing and selling at scale, building relationships with customers, incorporating data analytics into your products, and managing technology teams.

In conventional companies, these jobs are typically handled by staff in functional departments: IT, human resources, and organizational design. That tends to slow an organization down. In startups, as Reid Hoffman said in a *Harvard Business Review* interview, the company moves more quickly, scaling faster than its competitors, taking on more risk, and seeking, as he put it, "freedom from normal rules" of management.

You can't avoid controls entirely; for example, you need them to ensure quality throughout your company. You therefore have to selectively borrow those practices, metrics, and organizational designs that fit well with your company — and that allow you to keep tapping the insight and experience of the people you hire. For example, Alphabet defined itself within Google through its organizational design. It has a division called X (or Google X) where entrepreneurs such as Stivoric — who left Jawbone to join Alphabet two weeks after our interview — can develop new businesses separately from the rest of Google, but with the support they need to grow. X has set up recruiting and management processes, long-term funding, and collaborative practices that will presumably help these new businesses overcome the chrysalis effect.

The Unicorn and the Butterfly

Devouring your old practices and consciously creating new ones may be painful. But the alternative, for many startups, is worse. In the blitzscaling video, Hoffman recalled how entrepreneurs facing this transition think: "Now I'm going to really crank up my burn rate. I'm going to hire a whole bunch of people. I'm going to really make a go at this." But if you're wrong, he said, "it's pretty painful. It may be death. If it's not death, it's a massive retrenchment and loss of opportunity."

To Silicon Valley's unicorns — the tech startups that have gained a market capitalization of $1 billion or more — the challenges of growth may not seem relevant. They have, in effect, won for themselves the capital with which to scale. But capital is not enough for reliable growth.

The world may celebrate the unicorns of technology, but the economy needs butterflies: companies that can introduce and manage innovative technology with the maturity to stay afloat. Navigating through the chrysalis effect, growing wings, and developing the ability to fly afterward may differentiate your enterprise. The process represents a rite of passage for today's generation of startups, and it may be a necessary factor for our future economic health. +

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