Engaging With Startups in Emerging Markets

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Startups in developing economies are addressing local problems through creative technologies and solutions. For large global companies, the prospect of working with such startups is appealing — and complicated.

For large global companies, forging effective partnerships with high-potential startups is easier said than done. The very traits that make such startups potentially complementary as partners also make it difficult for large companies to engage with them in the first place. Multinational corporations often struggle even to identify promising potential startup partners; startups, for their part, find it difficult to identify and reach the relevant decision makers within the often-confusing hierarchies of gigantic multinational companies.

The challenge, for both sides, is all the more vexing in emerging markets. Furthermore, most academic studies of the challenges that large companies and entrepreneurial ventures face in partnering — and the solutions the studies suggest — focus on mature markets, such as the United States and Europe.[1] Far less is known about how multinational corporations should engage with startups in emerging markets such as China and India — even though those markets already boast the presence of prominent multinational companies such as Amazon, Google, IBM, Microsoft, and SAP.[2]

To understand how multinational companies have partnered successfully with startups in emerging markets, we undertook a study in three major emerging market economies: India, China, and South Africa. Our research uncovered four key factors that multinational companies confront in such partnerships in emerging markets. We also unearthed four strategies — one corresponding to each of the factors — to help global companies engage with startups in emerging markets more effectively. While some factors may be more potent than others for a given multinational corporation, all four of these strategies are worth paying attention to. They are mutually reinforcing, interrelated strategies, and should be viewed holistically rather than in a piecemeal fashion.

Strategy 1: Compensate for the immaturity of the entrepreneurial ecosystem. The first key factor is the immaturity of the entrepreneurial ecosystem. Specifically, most emerging markets are afflicted by constraints and "voids" in their institutions.[3] One of the people we interviewed referred to this as the "last mile" problem: Getting things done is a challenge in nations with poor access to reliable information, weak property rights, and unsound governance. In these settings, competition is potentially dysfunctional — and can be lacking in fair play. Weak institutions make contract enforcement unreliable and necessitate the development of trusting relationships to ensure that partners deliver on their promises.[4] What's more, the lack of a robust entrepreneurial ecosystem makes it harder for multinational companies to identify high-quality startups; compared with their counterparts in mature markets, startups in emerging economies more often lack the legitimacy or resources to gain access to multinational corporations.[5]

In general, multinational companies that want to partner with startups in emerging markets must bear a greater burden to compensate for deficiencies in the entrepreneurial ecosystem. Notwithstanding some remarkable success stories in China and India, emerging market startups generally need some hand-holding from global multinational partners, given their lower levels of technical know-how. Several global companies we studied provide this support by supplementing their global startup programs with localized content that was tailored to the particular emerging market. A case in point is IBM's Global Entrepreneur Program in China. An important facet of the Global Entrepreneur Program around the world is free access to various IBM software technologies. In China, IBM localized this feature by also providing access to training — helping developers boost their skills to global standards.

Another worldwide feature of IBM's Global Entrepreneur program is its SmartCamp initiative, a contest that provides startup entrepreneurs with the opportunity to make a pitch to prospective investors. In China, this feature is localized in several ways: For example, startups also receive introductions to reputable incubators. In addition, IBM uses China-specific social media tools such as Sina Weibo and QQ in its community-building efforts. What's more, there's a separate Global Entrepreneur module for monthly activities in China. These include forums on particular vertical markets (say, health care or education), company visits, and face-to-face mentoring sessions with technical experts.

Indeed, mentoring startups is an important component of a number of multinational corporations' startup engagement programs. High-quality mentors are scarce in emerging markets, so some multinationals make a strong effort to cultivate mentor networks — and contribute to the mentoring process themselves. Microsoft's enhanced BizSpark program in South Africa is one example. Globally, BizSpark provides young startups with free access to Microsoft technology; in South Africa, which has a comparatively weak entrepreneurial ecosystem, Microsoft augments this offering by providing mentoring support, tailored to startups according to their stage of development.

Strategy 2: Commit resources to tapping the entrepreneurial energy in emerging markets. A second key factor is the appetite for entrepreneurship in emerging markets. Notwithstanding their constraints, emerging markets have opportunities aplenty. In some cases, innovative, successful growth companies[6] have spawned startup ecosystems in emerging markets; consider the agglomeration of software and gaming startups in Hangzhou, China, in the vicinity of the well-known e-commerce company Alibaba Group Ltd. The increasingly mainstream appetite for entrepreneurship in emerging markets was apparent when NDTV, one of India's leading television news channels, announced that six startups with $1 billion valuations (so-called "unicorns") were its collective "Indian of the Year" for 2015.[7] Another factor contributing to increasing interest in entrepreneurship in emerging markets is the role of returnees from mature markets. One study found that a sizable proportion of returnees coming from the United States back to China and India intended to start new businesses.[8]

Perhaps also relevant is the inevitable slowing of growth in emerging markets, including China, which makes the potential for self-employment through entrepreneurship important.[9] Notable in this regard is China's entrepreneurship policy initiative, announced in 2014 by Premier Li Keqiang. The title of the policy roughly translates to "entrepreneurship by the populace, innovation by the masses."

Some multinational companies are responding to this opportunity by prioritizing emerging markets. For example, in 2012 when Microsoft launched its Microsoft Accelerator initiative, a program providing support and training for high-potential startups, the program included a focus on emerging markets: Two of Microsoft's first four accelerators were located in Bangalore and Beijing. Microsoft's focus served as signals of commitment and interest to local startups in emerging markets. Importantly, the actions led to meaningful measures in these locations to bolster entrepreneurship.

In Bangalore, for example, Microsoft Ventures has leveraged the "10,000 Startups" initiative of the National Association of Software & Services Companies (NASSCOM), a trade association for the software industry in India. Specifically, Microsoft Ventures has become a sponsor of the "10,000 Startups" program, along with prominent peers such as IBM, Google, and Amazon Web Services. Furthermore, in addition to its own accelerator in Bangalore, Microsoft Ventures has an extended portfolio of activities in India through its #CoInnovate program.

The #CoInnovate program has three elements. First, a "partner in acceleration" initiative helps other actors, including key Microsoft customers, with their own startup engagement. For instance, there is now a GenNext Innovation Hub in Mumbai that is a joint initiative between Reliance Industries Ltd., a Mumbai-based conglomerate, and Microsoft Ventures. Second, a "market access" program facilitates go-to-market strategies within key verticals, where promising startups participate in events targeting the CIOs and CTOs of key Microsoft clients. Third, a "high-potential" program enables venture capitalists or corporate partners to nominate high-potential startups to participate in the #CoInnovate program. CanvasFlip, a startup based in Hyderabad, India, that creates fast, clickable prototypes for mobile apps, is a case in point. A venture capitalist brought this startup to Microsoft's attention, resulting in its entry into the Bangalore accelerator.

Strategy 3: Work with local groups to overcome the limitations of outsider status. The third factor is the outsider status of Western multinational companies. While multinationals normally face unfamiliar conditions in foreign markets, the deficits in their knowledge base vis-à-vis local conditions are magnified in emerging markets.[10] This challenge can be compounded by ignorance at corporate headquarters if headquarters executives fail to heed warnings from local subsidiary managers about the importance of understanding local conditions.[11] Another challenge is the multiplicity of stakeholders that Western multinationals face in emerging markets, where they are often held to higher standards than domestic companies are — and expected to produce socially relevant outcomes, not merely economic ones.[12] The upshot is this: Western multinationals usually find that it takes longer for them to shed their outsider status[13] in emerging markets than it does elsewhere. Consequently, it is a greater challenge to screen and identify allies in general — and startup partners in particular.

What's the solution? Amazon Web Services Inc., which entered China later than such other well-known Western multinationals as IBM and Microsoft, decided to partner with T-Dream incubator, a newly established organization working closely with local governments in Shanghai, Beijing, and Chongqing. T-Dream is run and managed by an independent entrepreneurial team, with some government support and incentives. It is branded as being "powered by Amazon Web Services." For Amazon, this is a China-specific initiative that helps signal a commitment to the Chinese market — but does not require Amazon to build the support infrastructure from scratch, all by itself. Moreover, the effort is aligned with the Chinese government's priority to support entrepreneurship. In addition to common incubator services — mentoring, marketing support, and introductions to venture capitalists — startups in the T-Dream incubator gain access to Amazon cloud technologies and business services, as well as training to make the most of these technologies.

Multinational companies that are relative newcomers to an emerging market could take a page from Amazon's playbook, using existing actors to build a bridge between themselves and local startups. In other words, multinationals can combat the challenge of outsider status by building upon and complementing the work of reliable local actors.

Strategy 4: Co-innovate with startups to access novel technologies. The fourth key factor in emerging markets is proximity to novel technologies. While Western multinational companies may have originally been attracted to emerging markets by their lower cost base and large market size, there's an additional enticement: tapping innovative technologies.[14] For example, "frugal innovation," which entails the creation or modification of low-cost products and services, has emerged across myriad sectors in China and India since — despite those countries' growing affluence — they remain home to large low-income populations.[15] Western multinationals may be able to leverage such technologies in advanced markets. What's more, in countries such as China and India, there's a growing shift from imitation to innovation,[16] and some of the innovation is quite different from what global companies have access to in advanced markets.[17]

In spite of — or perhaps because of — the constraints of emerging markets, some startups solve local problems by developing creative technologies that are unavailable in advanced markets. For example, Qualcomm Inc., a developer of wireless technologies based in San Diego, California, worked closely with Mango Technologies Pvt. Ltd., a startup in Bangalore, India, that developed software for low-end mobile phone handsets. Eventually, Qualcomm acquired the technology, using it in emerging economies with large rural markets.

In addition, global companies can tap innovative technologies through co-innovation initiatives in emerging markets. For instance, the enterprise application software company SAP SE, based in Walldorf, Germany, has co-innovation labs in China and India (as well as a number of other locations around the world) through which it works with local partners. Although this program is not specific to startups, some of the partners are smaller, entrepreneurial companies.

SAP employees who work at the co-innovation labs grow their innovative skill sets. SAP, in turn, gains the ability to transfer that know-how across geographical borders when the employees move on to other positions and opportunities. For example, an SAP manager who had moved from Shanghai to Johannesburg, South Africa, which at the time did not have an SAP co-innovation lab, championed the creation of one there.

Understanding Differences Among Markets

It is also important that Western multinationals recognize differences *among* emerging markets. While numerous differences exist, we found three to matter particularly in relation to multinationals' engagement with local startups: priorities, restrictions, and scale.

Priorities Different emerging markets have distinct national priorities that affect multinationals' strategies. For example, in China, an explicitly stated high-priority policy agenda item is to promote mass entrepreneurship. This has meant that startup engagement is an obvious area of focus for Western multinationals — above and beyond their own individual rationales for the partnership.

In South Africa, an important priority is black empowerment, to redress social injustices historically faced by nonwhite communities. This can lead to innovative startup engagement programs. For instance, Microsoft South Africa launched a program for a small number of software startups that qualify in terms of black-ownership criteria and high innovation potential. These companies receive a deep mentoring experience, with the goal of enabling them to become "global technology companies by 2018."[18]

Restrictions Emerging markets vary in the restrictions they impose on corporations in general and foreign multinationals in particular. For instance, China is highly regulated in ways that force foreign multinationals to face certain technological restrictions. One consequence is that certain global companies, such as Google, elect to disengage, while others end up partnering with local companies. Another consequence is the rise of domestic corporations that dominate the local market and pose stiff competition to would-be foreign entrants; that is the case with the so-called BAT triumvirate (Baidu, Alibaba, and Tencent) of Chinese e-commerce. Despite China's restrictions, the vast majority of technology-based Western multinationals seem keen to align with Chinese governmental priorities and to engage with startups. The reason for this relates to the third point of difference among emerging market economies: scale.

Scale An important area of difference across emerging markets relates to scale — of economic activity in general and entrepreneurship in particular. China and India have a critical mass of startups and associated actors such as venture capitalists. Countries like South Africa do not. Reflecting this, the Western multinational subsidiaries we came across in China and India appeared to have greater autonomy than their South African counterparts and could more readily attract the attention of headquarters. China, in comparison with India, operates on an even larger scale in terms of economic activity and the technological sophistication of its startups. One multinational executive we interviewed commented, "There are only two markets in the world that have a large enough scale to warrant building market-specific infrastructure: the U.S. and China."

For many global companies, it has become trendy to include some form of startup engagement as one of the organization's innovation strategies. However, in emerging markets, our research indicates that engaging with startups effectively requires dedication and effort, and should not be undertaken lightly. By devising strategies to tackle the key factors we have identified, multinational companies will greatly increase their odds of creating mutual value for themselves and their startup partners.

Exhibit 1: About the Research

We conducted more than 30 interviews between September 2015 and March 2016 with entrepreneurs and managers from six multinational corporations in the information technology sector across three emerging markets: China, India, and South Africa. At three of the multinational companies (IBM Corp., Microsoft Corp., and SAP SE), we conducted interviews in all three markets, at two (Amazon.com Inc. and Google Inc.) we conducted them in China and India, and at one (VMware Inc.) we conducted interviews in China only. These multinational companies varied in terms of their age. Three were established pre-internet (IBM, Microsoft, and SAP) and three during the internet revolution of the 1990s (Amazon, Google, and VMware). Additionally, two corporate venture capital managers — one from Intel Corp. and another from Qualcomm Inc. — were interviewed, to obtain a complementary point of view from an equity-based engagement perspective. Our focus in the study, however, was on non-equity partnering through startup engagement programs such as Microsoft's BizSpark, IBM's Global Entrepreneur Program, and SAP's Startup Focus program. We deliberately chose to study multinational companies with a strong record of startup engagement. The purpose of the interviews was thus not to compare more versus less successful multinationals but rather to understand how successful ones adapted their startup engagement strategies in emerging markets.

Exhibit 2: Key Factors in Partnerships With Startups in Emerging Markets

Our research suggests four key factors — and four strategies to address them — that global companies should keep in mind when seeking to partner with startups in emerging markets.

THE ISSUE	**KEY FACTORS IN EMERGING MARKETS**	**STRATEGIES TO ADDRESS THEM**	**EXAMPLES**
Many multinationals are engaging with startups. But how should they do so in emerging markets, given the special constraints and opportunities of these settings?	1. Immaturity of the entrepreneurial ecosystem	1. Compensate for deficiencies	IBM's enhanced startup program in China
	2. Appetite for entrepreneurship	2. Commit resources to tapping the entrepreneurial energy	Microsoft Ventures' accelerator programs for startups in emerging markets
	3. Outsider status of Western multinationals	2. Work with local groups	Amazon Web Services' support of an incubator initiative in China
	4. Access to novel innovations	4. Co-innovate with startups	SAP's co-innovation labs in emerging markets

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