

Outsourcing Innovation: A Guide for Start-ups

Tucker J. Marion¹ and Marc H. Meyer²

¹t.marion@neu.edu

²ma.meyer@neu.edu

All at the College of Business Administration, Northeastern University, 360 Huntington Avenue Boston, MA 02115 United States.

This paper explores the beneficial impact of outsourcing on new venture innovation development efficiency and effectiveness. The relationship of outside firms on innovation commercialization is highlighted, with an additional focus on the enabling role service providers such as rapid prototype fabricators and quick-turn manufacturers perform. We synthesize our research into five distinct lessons, which form a guide for new ventures in selecting and implementing these external resources. The first lesson is optimizing your firm to allow easy integration of outside resources. In our study, the most successful firms leveraged a network of outside providers by keeping internal head-count low, and migrating to a software-like agile development processes. The second lesson is strategically selecting partners that provide more strategic long-term assistance as opposed to only discrete development resources. These firms help connect channel partners, customers, and new investors. The third lesson is managing the innovation process through agile milestones, not onerous procedures. Maintaining a balance between flexibility and discipline is a pathway to success for the new venture. Next, the ability of the firm to quickly and inexpensively source and have solutions fabricated for internal and external customer testing is essential to an efficient process. These fast solutions place concepts quickly in the hands of the development team and potential customers – speeding the process to market through rapid vetting of successive iterations. Finally, the use of quick-turn manufacturers and assemblers can also help the new firm gather important sales data without having to invest large amounts of capital on costly inventory – helping the new venture preserve precious financial capital while capturing data needed for full commercialization. These guiding lessons not only contribute to applied management knowledge, but outline phenomenon that require further detailed empirical investigation in the space of new venture innovation development.

1. Introduction

850,000 new businesses are started each year in the United States (Price, 2006). These firms are usually started by 1-3 founders and need to raise hundreds of thousands, if not millions of dollars to reach market (Zimmerer and Scarborough, 2008). As such, resources, both in human and financial capital, are scarce. The demands placed on these founders can be great – and it necessitates them to take on numerous responsibilities - from engineering to fundraising. Research shows us that that the path the entrepreneur takes during development of their product or service is all-important for the ultimate success of the product and business (Gartner et al. 1998). It has been shown that in new firms, the success of the first product is key to firm survival (Schnoonhoven, 2007). Given the fact that these firms have limited resources and need to successfully get to market – are there solutions or services where these start-ups might turn for help? One option is outsourcing important

components of innovation development and commercialization. Outsourcing options include innovation design, engineering, prototyping, manufacturing and sales functions. An example of outsourced design and engineering is the use of the industrial design firm. Industrial design firms – made famous by firms like IDEO and Continuum – are those firms that specialize in developing innovation in products, services, and business models. Marion and Meyer (in press) noted that the most successful new ventures turned to outside design firms for assistance. These firms formed teams that ‘plugged into’ the new firm, adding engineering, design, and marketing resources instantly to the start-up.

The ability of new ventures to easily and effectively bolster limited internal resources is a recent development. Over the last ten years, a ‘perfect storm’ has developed that enables new ventures to design, develop, prototype and test new concepts more efficiently and effectively than ever before. What has fostered this perfect storm is the combination of Web-based services, low-cost rapid

prototyping, and the freelance economy. Capabilities that were once only available to the largest of companies are now accessible to the garage inventor – seeding the ground for an explosion of innovative products and services in the coming years.

In this article, we explore how entrepreneurs and new ventures can best take advantage of outsourced innovation. We explore via exploratory empirical research and multiple case studies how these firms are finding resources, developing relationships, maximizing results and return for the entrepreneur, and developing long-term partnerships. We synthesize our finding in a guide that outlines five distinct lessons for effective outsourcing. These include shaping your new firm to leverage outsourced innovation, choosing strategic partners rather than discrete service providers, agile management of key milestones, using rapid prototyping to iterate concepts and gain market feedback, and lastly, implementing quick-turn manufacturing to validate market acceptance before costly full-production. We conclude the paper with comments contribution to literature, directions for further research, and limitations of the current study.

2. Industry Trends and Research in Outsourcing Technology and Innovation

At its basic level, innovation is “a process that begins with an idea, proceeds with the development of an invention, and results in the introduction of a new product, process or service to the marketplace” (Edwards and Gordon, 1984). For new ventures, innovation is a risky business. Half of all firms are out of business after several years (Headd, 2003), close to half of new products and services fail (Adams, 2004), and products have a very short window (less than 6 months) to prove themselves in the marketplace (Schneider, 2002). Because of the competitive pressures and risks associated with new product development (NPD), companies – particularly the vulnerable new venture - are looking to improve their product development process to minimize cost and development time while maximizing the success rate, return-on-investment, and proliferation of new offerings.

Since new firms are challenged for capital – both human and financial – new firms are at a disadvantage to arrange, manage, and commercialize their technology. Barring the rare exception of the well-funded new venture - these firms do not have marketing departments, tooling shops, pilot production plants, or expensive R&D facilities. These new firms have to maximize their internal resources by ‘wearing many hats’ and develop a network of partners to assist in innovation development and commercialization (Marion and Friar, in-press). These human capital variables are likely to influence the development of an idea and the organization of resources, which forms the environment surrounding the start-up. Van Gelderen, et al. (2006) noted the environment surrounding the start-up can include how it is funded, managed, and the network to which the firm belongs.

The network of external relationships is an important factor in the development and success of the new venture. In a study of 60 firms, Lechner, et al. (2006) showed that entrepreneurial networking is as much about adding new and different relationships as about transforming existing relationships. These relationships can include technology

development to free legal advice. In an in-depth study of 27 firms over a several year period, Gartner, et al. (1998) noted that entrepreneurs who devoted more effort to 1) working with established suppliers or subcontractors, 2) analyzing potential new entrants, and who devoted less effort to, 3) determining the identity of their business, were more likely to start a new venture that survived. For the new venture, the most readily available practice for increasing network relationships and associated team skill sets is through outsourcing.

Outsourcing, or the use of outside suppliers to provide services or products, frequently offers a cost competitive alternative to performing the required activities in-house (Rainey, 2005). According to Wu, et al. (Wu et al., 2005), outsourcing can be viewed as a strategically important activity that enables an enterprise to achieve both short- and long-term benefits. These strategic benefits include focusing on core company strengths such as innovation and design in order to maintain competitive advantages. Assigning tasks to an outside firm or to another group within the company may prove effective in accelerating the overall project (Ulrich and Eppinger, 2004). This allows companies like Apple to continue to focus on developing the next iPod while not being burdened with direct manufacturing management (Levy, 2006; Marion et al., 2007).

Over the last ten years, the ability to seek, develop, and enhance entrepreneurial networks via outsourcing has increased greatly. This change has been largely enabled by information technology, which includes Internet services, computer-aided-design (CAD), and global development sourcing. This ‘perfect storm’ of the integration of the Internet and e-collaboration, CAD, and a global network of suppliers and manufacturers allows companies to develop products at much faster rates using fewer resources and outsourced development teams (Marion et al. 2007). For the new venture – this flexibility of arranging development resources can be essential during initial phases.

Eppinger and Chitkara (2006) state “a new paradigm has emerged whereby companies are utilizing skilled engineering teams dispersed around the world to develop products in a collaborative manner. Best practices in NPD are now rapidly migrating from local cross-functional collaboration to a mode of global collaboration.” MacCormack (1998) notes that a flexible development process requires that as development proceeds, changes to the evolving design can be made quickly and at low cost. This global flexibility during development allows the start-up - working within their NPD network using e-collaboration and constantly *pulling-in* resources and information when needed - to quickly change the product design based on feedback from suppliers, potential customers, and the testing of rapid prototypes.

Our research validated these industry trends and highlighted ground-level execution of outsourced innovation. Our sample firms were gathered from the U.S. Small Business Development Centers¹ and *Inc.*

¹ The SBDC are state-funded organizations whose primary mission is to grow the U.S. economy by providing entrepreneurs with the education, information and tools necessary to build successful businesses.

'test dive' potential full-time hires for a period of time. These freelance experts can be contacted and 'plugged into' a team when and where needed, without the burden of hiring a full-time employee. Need an industrial designer to design the exterior look and feel of your product? Go to Coroflot (www.coroflot.com). Need a temporary accountant to handle Quickbooks? Got to iFreelance (www.iFreelance.com). Do you need to find an engineer or designer to help realize your technological vision? Try Guru for any type of engineer, from software to mechanical engineering (www.GuRu.com). Eventually these functions can be staffed full-time as company growth permits – but for the start-up the freelance economy is a key enabler in limiting overhead expenses before breakeven.

In order to accomplish this plug-and-play arrangement of human capital, firms need to stay small, and take advantage of communication technology. In our study, many of the freelance personnel were not local to the firm. The companies in our study actively used the latest collaboration tools to foster the integration of high-potential part-time individuals into the team. These included project Wiki's and PC-based video conference tools such as Skype®. Keeping the firm small, adopting leading collaboration tools, and adding top-notch part-time freelance employees is a good first step in outsourcing innovation in the new venture.

4.2 Strategic Selection: Sourcing Partners That Are Much More Than Service Providers

Entrepreneurship literature notes the importance of networks in the success of the start-up. The firms in our study are no exception. In addition to adding quality part-time employees to fill important roles, these firms partnered with outsourced firms that provided key functionality to the new venture.

Pervasive was the use of outside industrial design firms to design and engineer the technology architecture into distinct products. However, these design firms went beyond pure physical design, but helped in validating business models, costing, and manufacturing. In many instances, these firms provided key networking contacts in sales, supply chain development, and production sourcing. Additionally, several of these firms directly invested in the projects, providing direct and indirect capital to the start-up. In selecting outsourced partners, new ventures need to internalize how these new partners might help with more than the discrete development – but provide complimentary skills, contacts, and resources that will accelerate growth.

4.3 Agile Innovation: Managing Milestones Rather Than Process

The new ventures in our study were pervasive adopters of an agile development process. Software developers first used the concept of agile development, but it is now more universally applied to products and services beyond software. Agile is a straightforward concept: quickly build, test, improve, and test again. User insights are translated into new design prototypes in a matter of days. Prototypes are constructed and reviewed by the development team (and potential customers) as quickly as possible. The firms in our study were all adopters of this

quick prototyping throughout the. Star-ups are well-served by adopting this quick design, validation, and test methodology.

In terms of the development process itself, these firms managed to milestones, not to a defined process. The most successful firms in our study had a clear focus of what was needed to get the project completed. Even if details on technological issues were fuzzy along the way, teams were not deterred. We found that these firms put less focus on managing the process and more emphasis on managing their goals. By removing bureaucratic layers and eliminating overarching procedures during development, firms quickened team reactions and reduced development cycles. To compete in an ever more difficult global environment, new ventures need to be quick, agile, and effective. Adopting fast design and prototyping methods along with a strong focus on milestones is a sure path to success.

3.4 Rapid Solutions: Near Instant Feedback on Design and Functionality

In the 1980's, technology was developed that allowed virtual computer-aided-designs (CAD) of products to be built quickly using new technologies such as stereo lithography (SLA). These prototyping machines were expensive – and available only to the largest of firms such as automobile manufacturers. However, over the last ten years new technologies combined with refinements in existing machines have lowered the cost exponentially. There are now desktop machines that can create parts for several thousand dollars, approaching the point of being affordable for the average citizen. Additionally, these fast prototyping machines – combined with Web services such as Quickparts (www.quickparts.com) – can turn around look and feel prototypes in a matter of days, sometimes faster.

These parts, a cornerstone of agile development, can be used for rapid feedback on design efficacy and from target users - allowing firms to move quickly to market. Rapid prototyping has also entered other more complex spaces such as electronic circuit board turnaround, and production tooling (www.protomold.com). For new ventures, the ability to quickly design, prototype, and iterate has multiple ramifications – from pitching your technology to potential investors to beta testing production-like units without committing to costly production ramp-up.

4.5 Quick-Turn Production: Production-level Sourcing While Reducing Capital Needs

From your desktop, netbook, or smartphone is a collection of services that allow the new venture to design, source, manufacture, and test concepts. These services allow a limited number of founders to establish a network of providers that act as the purchasing department, manufacturing, and engineering – turning micro businesses into fact acting, and capable virtual corporations. These services are inexpensive and fast. They also help the new venture maintain low overhead – maximizing funds for technology development and commercialization. Do you need to find a microcontroller for your new device - tomorrow? Go to Digikey – a leading supplier of electronic components (www.digikey.com). Do you need to find a manufacturer

to build your product, and provide detailed quotes for cost engineering? Uploading product designs on MFG.com can net dozens of potential manufacturers in near real-time (www.mfg.com).

These services and potential manufacturing partners allow the new venture to pilot produce and commercialize their products without draining large amounts of capital during launch. The most successful firms in our study did not purchase hundreds of thousands of units for inventory – instead they found production partners and component vendors to produce production-ready goods in lower volume, allowing the new venture to test market and validate their products and services. This data can then be used to tweak the product, market positioning and full-launch plan. Many firms tested retail in a just few select stores, or in specific geographic areas. This data then helped the firm refine their business plan and ensure a smooth and less risky move to full-rate production and sales. By following this approach, new ventures can realize their potential without putting their entire business at risk of failure.

5. Conclusions and Future Research

New ventures are at the center of innovation in the economy. Unfortunately, most new firms fail. Failure modes include capital constraints, poor management decisions, and mis-steps during new product development and launch. The start-ups are resource constrained, both in human and financial capital. Through our research, we have found that a successful approach – fostered by changes in technology and globalization – is outsourcing key components of innovation. These include partnering with part-time individuals and firms to increase corporate skills sets. Using design and engineering firms to realize the potential of the firms' core technology architecture, and partner with key vendors to cost effectively execute product tests and full launch. Overlaying these key issues in outsourcing is the ability for the firm to rapidly design and test their technology through rapid prototyping. The final analysis of outsourcing innovation is the ability to greatly increase the network of the entrepreneur, provide world-class capability for low cost, and deliver results much faster than tradition methods. New ventures would be well-served to adopt the key points and lessons outlined in this article. However, this is just a first step in research the impact of outsourcing innovation in new firms. Additional studies are needed to further validate our findings. We hope future research will include non-U.S. firms and additional industries. What is clear from this initial research, however, is that the new venture is in a unique position to integrate services and solutions throughout the development process to increase innovation efficiency and effectiveness.

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