



PURPOSE AND PERFORMANCE IN A STARTUP ENVIRONMENT



Derived from our first BlackWood Lab session with HEC Paris Professor Rodolphe Durand, this white paper describes the impact of Purpose-based management on the intrinsic performance of startups.



In recent years, there has been an increased focus on the importance of Purpose in the development and performance of early-stage startups. This is due to several factors, including the changing landscape of the startup ecosystem, the increased pressure on startups to scale quickly, and the need to stand out in a crowded marketplace.

This has derived from a general shift in the business world towards a more Purpose-driven approach. Companies are beginning to see the importance of having a higher Purpose, beyond financial goals.

The essence of Purpose has become especially dense and raw in startups, which are often driven by passionate individuals who want to make a difference in the world. But how exactly does Purpose affects the performance of startups? Why is it becoming an important factor in the development and funding of early-stage startups?

We discussed the above during the last session of the BlackWood Lab, with HEC Paris professor Rodolphe Durand. We looked at the research to distinguish between the fashionable trends and tangible Purpose impact in the context of early-stage startups.

HOW TO DEFINE PURPOSE?

The essence of Purpose is especially dense and raw in startups, which are often driven by passionate individuals who want to make a difference in the world.

Purpose is a statement that expresses the "raison d'être" of the firm and its ability to thrive in the long run. It is not to be confused with the Mission, that many firms already have integrated into their company statements.

Purpose touches upon why we do what we do. It is cultural, and aspirational, and instils ownership while the Mission is more quantitative, financial, and strategic in nature, and relates more to the governance and incentive structure. Purpose can set the limits of action of what a firm can and cannot do. Both in terms of business-related decisions affecting operations and sales.

To give a few examples, Patagonia's renowned change in ownership clearly aligns with their stated Purpose of "we are in business to save our planet" relegating quantitative metrics to a second priority. Disney's statement "we create happiness" is positive and does not necessarily restrict the firm's activities.

Long-term investors tilt their investments towards CSR-active firms, asset managers develop new market and investment categories, and activist shareholders are well-equipped to detect Purpose-washing.

While The Body Shop's statement "Enrich, not exploit" has a negation, which prevents and to some extent forbids the firm from engaging in certain activities. Though it should be noted that Purpose is not limited to being prosocial, it must be incarnated into practices and discourses to make a firm's Purpose credible, legitimate, and effective.

WHY NOW?

The notion of firms having a Purpose has been increasing since the 1950s and is more important today due to rising awareness of the negative impact of exploiting natural resources and the growing need for implementing risk-mitigating strategies associated with this.

Another driver of CSR and firms having a Purpose is the shift from shareholder maximization to "stakeholderism" – with boards and corporate leaders starting to feel the pressure to satisfy all stakeholders on social and environmental measures.

Only 7 percent of Fortune 500 CEOs believe their companies should "mainly focus on making profits and not be distracted by social goals¹. Larry Fink, CEO of BlackRock, notably wrote in his letter to CEOs that "without a sense of purpose companies will ultimately lose the license to operate from key stakeholders"².

However, Purpose may be stated by firm members but not coincide with leadership practices per se. Hence, Purpose based Leadership consists in practices and discourses that make a firm's Purpose credible and legitimate. Purpose needs an incarnation to be effective.

HOW DOES PURPOSE AFFECT STARTUPS?

While some may argue that Purpose is not a necessary component of success, the evidence suggests otherwise. A study by Harvard Business School³ found that startups with a clear sense of Purpose are more likely to raise capital, grow faster, and be more profitable than those without one. Similarly, a study by Bain & Company⁴ found that Purpose-driven companies are more likely to outperform their peers financially.

In fact, there are several reasons why Purpose is becoming more and more important in companies' development. These reasons span different stakeholder categories and particularly apply to startups.

First, investors are increasingly looking for companies that are driven by more than just profit. They want to invest in companies that are making a positive impact on the world.

As discussed, shareholders are recognizing the value of Purpose-driven management. Long-term investors tilt their investments towards CSR-active firms⁵, asset managers develop new market and investment categories⁶, and activist shareholders are well-equipped to detect Purpose-washing⁷. This is especially true for venture capitalists and impact investors. As such, it is becoming more and more difficult for startups to raise money without having a clear Purpose.

Second, customers are also becoming more Purpose-driven in their purchasing decisions. They want to buy from companies that share their values. In a crowded marketplace, it is essential for startups to have a strong brand identity that differentiates them from their competitors. This factor is exacerbated for millennials and Gen Zers who grew up during a time of increasing social awareness. As such, startups need to be clear about their values from the very beginning so that they can attract the right customers.

Third, Purpose can help a startup attract and retain top talent. Employees are also increasingly looking for meaningful work, in companies that have a higher Purpose. They want to work with those who are making a difference. Employees are one of the most important stakeholders in terms of the operational efficiency of a company, and According to a McKinsey report, 82% state that it is important to have a Purpose, and 72%⁸ say Purpose should be given more weight than profits.

Finally, empirical studies suggest that Purpose, as stakeholder orientation, is conducive to better performance. It increases unit and operational efficiency and cooperation by 10%. This effect doubles down on the increasing talent attraction of the company, as it has been observed independently of the team composition.

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Other studies also observed that Purpose or CSR policies favours unit and operational efficiency of the teams¹⁰ and increases innovativeness by encouraging experimentation and enhancing employees' innovative productivity¹¹.

In fact, Purpose provides clarity and direction for the founders and employees of a start-up. Without a clear sense of Purpose, it can be difficult to make decisions or prioritize initiatives.

This is driven by the idea that when people in a firm or in a team are working towards a common Purpose that motivates them, the time spent on decision-making is less than in a context without a tangible Purpose.

With the Purpose incarnated into management practices, individuals tend to better understand what to do. If it is associated with the goal of the team, employees' own objectives are becoming more defined by the Purpose and aligned with the firm's direction. Hence aligning intrinsic value with a clear company Purpose facilitates the micro decision-making processes and increases collaboration.

However, on average, Purpose delivers an above-average performance only when granted legitimacy by the employees. Purpose is therefore not something that can be created overnight; it takes time and effort to develop a clear sense of Purpose for a startup. When granted, it increases intra-team trust by 25% and the autonomy of employees by 28%. More trust, autonomy, cooperation, and helpfulness between team members foster an innovative environment where people censor themselves less, are more likely to pitch their ideas, and dare to take risks associated with innovation. Therefore, the innovativeness of a team led with Purpose-based leadership is 17% higher on average compared to a team that is not led with Purpose.

CONCLUSION

The evidence is clear: Purpose matters for early-stage startups. It is becoming increasingly important in development and performance for several reasons including attracting investors, customers, and employees as well as building long-term success. Startups need to be clear about their Purpose from the very beginning so that they can set themselves up for success down the road.

FOR FOUNDERS

If you're looking for ways to improve the development and performance of your startup, you might have to start by focusing on Purpose. The effect Purpose-based leadership has on company performance, enabled by the factors of intra-team trust, innovativeness, autonomy, and cooperation – is amplified in startups, and even effective for smaller teams of as little as three people.

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A founder's journey can be hectic and filled with financial and technical constraints, but it's never too early to reflect on what is meaningful in the development of a project, the "why".

Like technical debt, we believe startups can build themselves a "Purpose-debt" by hiring and growing an organization that does not coincide with the deeper meaning that will fuel the company over time.

Clarify why your startup exists and what it stands for, build a strong brand identity, and attract and retain top talent. These efforts will position your startup for long-term success.

FOR INVESTORS

Early-stage investment boils down to buying a vision and trusting a team to reach it. As discussed above, investors and VCs are giving more attention to Purpose in the screening process, for a variety of reasons spanning from performance, marketing, and of course, alignment with their own Purpose.

However, we believe there is room for VC firms to go one step beyond and strengthen the definition and incarnation of Purpose. The post-investment support and added value that VCs brings to portfolio companies is too often ignoring Purpose.

More efforts can be made to integrate founders' values, help them align their organization, and position themselves as a carrier of the Purpose of portfolio companies beyond financial considerations, which will only be positively affected.

We believe that values alignment between VC and founders is quintessential to value creation. At the crossroads between a startup and a VC fund, BlackWood has a mission to become the most value-creating European early-stage investor, with the Purpose of supporting the companies that will incarnate the values of tomorrow.

Startups are at risk of building a “Purpose-debt” by hiring and growing an organization that does not coincide with the deeper meaning that will fuel the company over time.

FOR THE FUTURE

This white paper gives a glimpse into the intersection between empirical research on purpose by Pr. Durand notably and first-hand insights from the startup ecosystem explored during the BlackWood Lab sessions. To build on the notion of providing qualitative insights, future BlackWood Lab sessions will elucidate more on the topic - Purpose.

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