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The Industrialization of Global Internet Start-ups: The Klaus Hommels Model

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"We industrialized the building of global Internet start-ups."
Klaus Hommels

In spring 2010, Klaus Hommels, a leading European business angel based in Switzerland, was at his Zurich office reading another news article on the tremendous growth potential of U.S. online group-buying company Groupon. Although the company had been founded just one and a half years ago, it had already generated more than $75 million in revenues and attracted around one million paying customers. Klaus was inspired by the Groupon business model and wanted to invest in other companies in the developing group-buying market. However, he recognized that there was a major problem with starting and growing technology businesses in Europe, compared to the United States or big emerging markets:

> "Europe was a market which was too fragmented and too slow. Unless a European business had a global focus from the beginning, it could never grow fast enough and big enough."

Over the past two years, Klaus and his team, based in Zurich, have therefore been developing a new non-traditional concept to enable the rapid rollout of Internet start-ups from Europe across various geographical markets. The idea was to select a business model which had already been validated by an early mover, usually in the United States, and replicate it as quickly as possible in the growing emerging markets and only partly, if at all, in Europe.

Klaus' team had already successfully applied this new concept. Since 2008, he had invested in seven Internet companies, in eight different countries, with a revenue run-rate of more than $300 million. All of these companies were launched by replicating the same business model as the French Internet shopping club Vente-Privee. Now, Klaus' team wanted to apply his new concept of global rollouts to the group-buying business model originally invented by Groupon.

This case was prepared by Lenka Menden, MBA 2011, under the supervision of Professor Heinrich Liechtenstein as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. January 2012.

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The goal was to create a network of Internet group-buying companies around the world, and there were several complex decisions that needed to be taken in order to quickly roll out the companies to win markets ahead of Groupon or any other copycat competitors.

First, Klaus' team had to decide what markets to target. Which countries promised the highest returns? Secondly, with whom should they develop businesses in those countries? With a strong local entrepreneur as a partner or with hired staff? Finally, the structure for the entire network of companies had to be designed. Should there be one parent company on top with local subsidiaries in each country or would it be better to find local entrepreneurs and build independent companies in each country? Klaus' team already had a concept in place applied for the rollout of shopping club companies. The question was whether to change it for the group-buying companies or any other business model to be rolled out subsequently.

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Background

Klaus Hommels was a leading European seed and early-stage business angel who made several highly successful early-stage technology investments in the European and U.S. markets. These investments included companies such as Skype, Spotify and Facebook (see **Exhibit 1**). Klaus had achieved outsized average returns in his top investments: more than 30 times growth in valuations and more than 15 times cash-on-cash return.

Klaus' investment strategy was focused on investments in start-ups and early-stage companies with software or platform business models that aimed at mass-market retail consumers (B2C) and that could be scaled quickly at extremely low fixed cost. He invested in promising companies that had the potential to become major players in the Internet space. The focus areas included e-commerce, online payment services, marketing and advertising services, online gaming, social media, digital media content, localized services, Internet enablement & infrastructure.

In late 2008, new e-commerce business models, such as private shopping clubs (Vente-Privee, Gilt Group, Privalia, etc.) and later group-buying sites (Groupon, LivingSocial, etc.) inspired the worldwide emergence of new copycat Internet companies which would build on the success of first mover companies who came up with the business models (see **Exhibit 2**). Klaus began to think about possible strategies that would enable him to best realize returns from the wave of new copycat Internet start-ups.

Both business models fitted Klaus' investment strategy. Moreover, they were already proven and validated by other entrepreneurs and investors. The early movers in both sectors exhibited exceptionally rapid customer base and revenue growth and reached an unparalleled scale within only a few months after their launch. Despite the views that anyone could replicate these types of Internet companies, Klaus was aware that the market inherently favored companies with scale, as well as the early movers who build the infrastructure in the market. Given the high customer acquisition costs, the lifetime value of customers mattered. Capturing selected geographical markets early and fast was crucial. However, unlike other Internet companies such as Skype-which by definition had a global product-shopping clubs and group-buying companies required the deployment of local people on the ground to develop networks in each country.

Klaus believed that in the case of these business models, rapid global expansion out of Europe across many different markets required a non-traditional concept. With his new concept of a global rollout, Klaus believed that he could avoid the typical barriers to growth faced by many European businesses, which usually launched from only one market and subsequently expanded internationally, usually at a very slow pace.

The European Disadvantage

As a leading European business angel, Klaus Hommels was often asked why Europe wasn't creating more big technology companies. Business angel investing and venture capital were two types of financing available to high-growth oriented early-stage companies. In most cases, this financing was essential to enabling new companies to get up and running (see **Exhibit 3**). As a matter of fact, in Europe the volume of investments in early-stage companies and their valuations were substantially lower than in the United States or China (see **Exhibit 4**). Europe was lagging behind in volume of invested venture capital as well as venture-backed IPOs and M&As (see **Exhibit 5**). Furthermore, the overall market capitalization of European public technology companies reached only 1% of that in the United States and 8% of that in China (see **Exhibit 6**). The subdued level of entrepreneurial activity in Europe was frequently attributed to a lack of start-up-friendly legislation or a culture averse to taking business risk.

In Klaus' opinion (see **Exhibit 7**), this situation was caused by the fact that the European technology start-up ecosystem was missing a clear geographic and identity center with a concentration of big technology companies, which could develop talent and also acquire smaller companies. Moreover, Europe was clearly lacking a strong financing environment. Although the situation was improving, the financing metrics were still lagging behind.

Another issue, according to Klaus, was that so far many European entrepreneurs still wanted to serve single, small European markets, instead of having global aspirations and focusing on acceleration of scale. Also, given the differences between the infrastructures in each European country, the barriers to reach the hundreds of millions of consumers in Europe were much higher than the barriers to reach the same number of consumers in the United States or the big emerging markets. This was the case especially if a company had high staff requirements in local countries in order to scale its product.

Global Rollout Model

For the above reasons, Klaus and his team developed a new global rollout model. Instead of focusing only on the European markets, in 2008 they rolled out a network of private shopping club sites in big emerging markets. The major criterion for new market selection was real GDP growth 4% higher than in Western Europe, population and Internet penetration. After a careful analysis of data from all countries, the team established shopping club companies in Australia, Brazil, India, Mexico, Russia, UAE (as a hub for the MENA region) and Turkey (see **Exhibit 8**). They also set up a company in Switzerland, as they were based there and could use this as a small showcase nearby.

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