# Stanford eCorner

## Data on Category and Company Value

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**Video URL:** http://ecorner.stanford.edu/videos/4228/Data-on-Category-and-Company-Value

Al Ramadan, co-founding partner at Play Bigger Advisors, shares statistics compiled by his firm that show when category and company?value is formed. The category-design firm conducted qualitative and quantitative research to gain insights into valuation and market-capitalization growth, building a database of every venture-backed?technology company founded since 2000.

#### Transcript

- We did a bunch of research here around this whole notion of category. It's new, and it's something that's really topical at the moment. And we invested quite a lot of time and energy and Clarence was one of the examples on the qualitative side of the research. We interviewed more than 100 of the great leaders of technology companies in the United States. We did a whole bunch of reviews around that which led to what Dave's gonna talk about in a little bit which is what we call the category design playbook which is how do you do category design? If it's a new discipline, what are the things that you need to do to ultimately become what we call the category king. And then on the other side, we did a bunch of quantitative research, and this quantitative research looked at every single company founded since 2000, U.S. based, with VC backing, and if you do that, you'll find that there's about 8,000 companies that fall into that bucket of which about 850 plus or minus are involved in an M and A transaction. That's their exit, if you'd like. That's the way they create the value. 75 of them actually make it to being public companies.

And so these are the two aspects we want to talk to you today, is sort of some of our findings related to this research. And we want to start by giving you sort of what we would call is the cliff notes of category design. And there's five things we want to talk to you about. The first one is this is very much, the technology industry is very much a winner take all industry, and in fact, in our research, which we did, it was called A Time to Market Researchers available on playbeyou.com/research If you want to have a look at it, it was about 18 months ago that we first sort of discovered this that if you take a look at the market cap of the category kings, relative to everybody else in that field of 8000 companies there are 35 category kings and they represent 76% of the market cap of the tech space and if you're the category king, That is the one that leads in the space, you take 76% of the market cap of the category. Think frozen foods, lifetime value 100 years. It's not market share, market cap. So 76% goes to the winner and there's in this particular research, might be a little difficult to see but there are three cohorts, three euras as we called them, and it's pretty much between 71, 72, and 79 in the middle cohort Facebook so it distorts it a little bit, but 76% so remember that. The winner takes all at 76%. The second thing is, is that we discovered that categories themselves actually have a natural life cycle. And the natural life cycle looks like this.

We call it the category lifecycle model. And on the x axis the horizontal axis here, you've got time and what you're looking at in that graphic there is about 15 years plus or minus, and I'll show you some little bit more detail on the timing here. But it's plus or minus 15 years. And on the y axis the vertical axis, it's the market cap of that entire category, so think every single company in the CRM category for example, add up the market caps of all of those companies. That is the category value, and what happens is categories in the first phase, kind of, this is probably duh, but it starts out really slow and it takes awhile for a category to really pick up then in the middle phase it accelerates really quickly, and then it'll drop off towards the, once the category becomes really mature. Nothing super exciting in that graphic. You've probably seen something like that before in the form of a bell curve, but if you relate it over time it looks like this. The exciting thing was a guy called Paul Gorowski, wrote a book and he talks about the number of what he calls providers, explodes in the early phase of a category and then ultimately drops off over time. And if you think about what's happening here, it makes sense that the, in the early stage lots of competition, not a lot of value in the category itself, in the middle phase, competitors are dropping off, the category's really taking off and in the end phase, one company takes 76% of the market share. That's what we call the category lifecycle model.

The third thing we wanted to do was we looked at those 75 companies that did go public and we wanted to know was there something related to age in those public companies and it turns out that companies that go public when they're somewhere between six and ten years of age are the ones that create all of the value. This is the cohort from 2000 onwards, and we've looked back, already started to look back back through to the 80's and it seems to hold. And Harvard Business Review just ran a big study on this actually based off of our research. It's in the latest version of the Harvard Business Review. And here's what we found, this is what we call the six, ten law. And it is on the x axis again. You've got the years and then we've binned all of the companies into years. So all of the companies that for example, age seven, created that amount of value in billions, and the way that they measured that was the day after they went public we looked at what their price was, looked at it what it is today, so the value created since public offering is what you're looking at. And so you can see that companies that go public too early, pretty much crater. Companies that go public too late are kind of yawners, right there's nothing really happening out there but this middle spot, this sweet spot, as we called it in the IP, in the Harvard Business Review, is where all of the action is.

And it started getting us to think well okay so if age is the determinant we also did something else you'll see in the Harvard Business Review, which is we tried to look at it based on the amount of money that a company had raised and there is no correlation. So it's fascinating there's no correlation as it relates to the amount of money you raised as a company, yet there is a relation as it relates to age. And it started us thinking about well what could possibly be driving that phenomenon. And it turns out that the phenomenon is when you lay these two charts over the top of each other what you see is, that the middle section this develop phase of the category lifecycle curve is where all of the value gets created. And it makes sense. These are all of the actual companies underneath that graphic that you can see. And it makes sense, and George Lee who is from Goldman Sachs sat down with us one time, took a look at this, for those of you who don't know George, he's the head investment banker there, so he does this for a living, and he said that makes complete sense. That makes complete sense and the reason is because public investors are looking for two things. They're looking for growth and they're looking for margin expansion or profitabilty. And if you think about it during that middle phase what's happening, companies are growing really fast, the category's kind of exploding, and what else is happening, number of competitors is disappearing, is dropping so pricing pressure goes off, you can then increase your prices, ultimately increase your margins, so that's why this is happening.