What the best startups have in common

Not all entrepreneurship is created equal

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CAN you tell when a company is founded whether it has a real chance of hitting it big?

Actually, yes, you sort of can. These are among the results of a study of new business registrants in 12 states from 1988 through 2014:

What successful startups look like

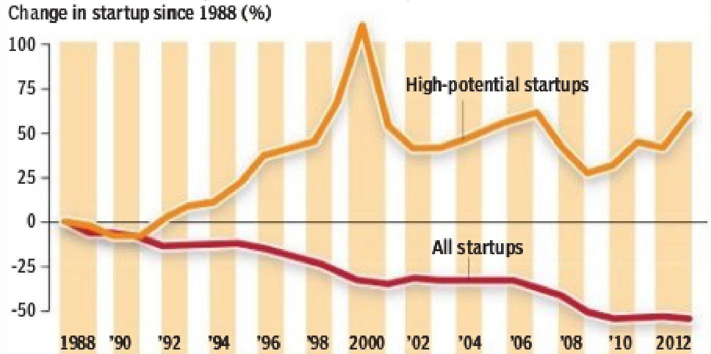
Characteristics associated with subsequent growth*

	% change in probability of growth
Firm named after founder	-70
Has short name	248
Corporation (not partnership or LLC)	405
Trademark in first year	501
Patent and no Delaware registration	3,534
No patent and Delaware registration	4,470
Both patent and Delaware registration	19,640

*Meaning that the firm achieves an initial public offering or is acquired at a meaningful positive valuation within six years of registration
Source: Catherine Fazio, Jorge Guzman, Fiona Murray, Scott Stern and Bloomberg

Ambitious startups aren't declining

Change in startup since 1988 (%)



Sources: Census Bureau, Stern and Guzman

After I saw that I was all ready to drop everything and start work on what would surely be a huge bestseller, "Don't Name Your Company After Yourself and Register It in Delaware: The New Rules of Startup Success." Until I read this:

We strongly caution against a causal interpretation of the regressors we employ for our predictive analytics—while factors such as eponymy and business registration form are a "digital signature" that allows us to differentiate among firms in the aggregate, these are not meant to be interpreted as causal factors that lead to growth per se (i.e., simply registering your firm in Delaware is not going to directly enhance an individual firm's underlying growth potential).

That's Jorge Guzman and Scott Stern of the Massachusetts Institute of Technology's Sloan School of Management, ruining my party. They are out not to derive sure-fire money-making tips but to assemble a better metric of startup activity. Existing startup measures such as the Kauffman Foundation's index of startup activity and the Census Bureau's business dynamics statistics have been showing a long-running decline in entrepreneurship that is at odds with both popular perception and evidence from venture-capital surveys. Guzman and Stern's measure of "entrepreneurial quality" is intended to differentiate startups with big growth potential from run-of-the-mill small businesses, and allow them to be counted separately.

It turns out that the high-potential startups Guzman and Stern identified, as FiveThirtyEight's Ben Casselman has already reported, do not appear to be in decline. True, the startup boom/bubble of 1999 and 2000 hasn't been matched since, but the overall trend line slopes upward. Casselman made such a nice chart that I'll just use that:

So that's heartening. Less so is Guzman and Stern's finding that, since 2000, startups that pass the entrepreneurial-quality screen have been less likely to make it to an initial public offering or positive-value acquisition than they were in the 1990s. Something is making it harder for startups to strike it rich, although it's not entirely clear what. I do wonder whether it's that the dot-com enthusiasm of the late 1990s and 2000 made it too easy for startups to strike it rich, thus making otherwise perfectly respectable subsequent success rates look poor in comparison.

Guzman and Stern's research also allows us to compare entrepreneurship across regions in a new way. According to the Kauffman index of startup activity, the Miami area topped even the San Francisco and San Jose areas in startup activity in 2015. But according to Guzman and Stern's entrepreneurial-quality measure, there's really no comparison.

In and around Silicon Valley, people are apparently starting businesses with short names, patents and Delaware corporate charters. In and around Miami, people are starting business with long names—often their own names—that are structured as partnerships or limited liability companies. Some of those eponymous companies might still hit it big (think Ben & Jerry's), but they are less likely to than their Silicon Valley peers. Not all entrepreneurship is created equal.

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