

The Advantages And Disadvantages Of Using The Lean Start Up Method For Setting Up A Company In Romania

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Abstract: *In the multitude of methods and procedures for initiating and implementing new businesses over the past decade, the Lean Start Up methodology also follows the research conducted by IT entrepreneur Eric Ries from 2008. The Romanian economic context after the effects of the international financial crisis revealed an increasing trend, albeit variable, in terms of economic growth and the development of new business and entrepreneurial initiatives. This article aims to highlight the possible impact of the Lean Start Up methodology on entrepreneurial thinking and practice in Romania, both at the beginning of the road and in its continuous evolution. The paper first performs a research on specialized scientific literature, then focus on the presentation of the Lean Start Up methodology, on the advantages and limitations of the method in question, and on the implications of its use in Romania. The results of the research result in highlighting a number of possible guidelines and guidelines to follow regarding the application of the method to the newly established enterprises in Romania.*

Keywords: Lean Start Up methodology, entrepreneurship, business model, startup, innovation-accounting

JEL Classification: M13, M16, M53, O31

Introduction

In the multitude of methods and procedures for initiating and implementing new businesses over the past decade, the Lean Start Up methodology also follows the research conducted by IT entrepreneur Eric Ries from 2008. The Romanian economic context after the effects of the international financial crisis revealed an increasing trend, albeit variable, in terms of economic growth and the development of new business and entrepreneurial initiatives. This article aims to highlight the possible impact of the Lean Start Up methodology on entrepreneurial thinking and practice in Romania, both at the beginning of the road and in its continuous evolution.

In the context of the research of the specialized literature, the article tries to highlight the importance of the methodology on the theoretical and practical aspects regarding the establishment of new business, the use of this method in Romania, as well as the advantages and drawbacks outlined by the methodology in question.

The research methodology considered a qualitative research that aimed at collecting, analyzing, evaluating and interpreting the theoretical and practical information and views on the Lean Start Up methodology.

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Literature review

Born in the aftermath of international financial crisis as a new method to set up a new business, but with the roots of the concept

since 1999, this approach was based on the state of economy at that time characterized by tightened debt markets, closed windows for Initial Public Offerings (IPOs) and mergers and acquisition (M&A) and Venture Capital distrust after a period when cash was easily available as much as follow on financing methods. In this context, Steve Blank revealed in an article in Harvard Business Review „Why the Lean Start-Up Changes Everything” that „Lean start-up techniques were initially designed to create fast-growing tech ventures. But I believe the concepts are equally valid for creating the Main Street small businesses that make up the bulk of the economy. If the entire universe of small business embraced them, I strongly suspect it would increase growth and efficiency, and have a direct and immediate impact on GDP and employment” [1]. Eric Ries, the American entrepreneur that was the author of the book „The Lean Startup”, explain the choice of this name for his entrepreneurial movement: „I like the term because of two connotations: 1. Lean in the sense of low-burn. Of course, many startups are capital efficient and generally frugal. But by taking advantage of open source, agile software, and iterative development, lean startups can operate with much less waste. 2. The lean startup is an application of Lean Thinking. I am heavily indebted to earlier theorists, and highly recommend the books Lean Thinking and Lean Software Development” [2].

Summarizing the book of Ries, Allen Cheng shows that „the ideas in The Lean Startup came about when Eric got frustrated working on products that failed to get traction. As an engineer, he initially thought they failed due to technical problems, but this was never the right answer. In reality, they

just spent a lot of time building things nobody wanted. [...] One inspiration was Steve Blank's idea of Customer Development: a rigorous methodology for the business and marketing side of a startup. Another inspiration was Japan's lean manufacturing systems, made famous by Toyota" [3]. Yoo, Huang and Arifoglu underline in their research: „from a broader perspective, the Lean Startup is a paradigm regarding the need to test hypotheses about various components of the business model, which includes learning not only about consumers, but also suppliers, costs, and more" [4].

Referring to the limits of the method, Ted Ladd assumed that „the popularity of the lean startup method is well deserved. But, as is true of any business process, the method must be tailored and employed with reflection and constraints, not blind allegiance" [5].

In terms of the approach of Romanian researchers, the paper named „Identifying entrepreneurship readiness for the application of the Lean Startup practices in the service industry – Case study Romania" shows that „Based on the interviews taken for this research, the conclusion is that private company owners and managers face great challenges but also important opportunities to develop their business and change the economic life of a nation towards sustainable growth. Even though not entirely understood and still looked upon with distrust, Lean Startup is seen as an interesting methodology by Romanian entrepreneurs in the service sector who responded to this study"[6]. In another research, the authors compared two ways of starting business – Lean start up and classical method, but didn't offer real examples and practical solution to apply the method in Romania [7]. The research of Kullmar and Lallerstedt highlighted „the findings show that the lean startup method

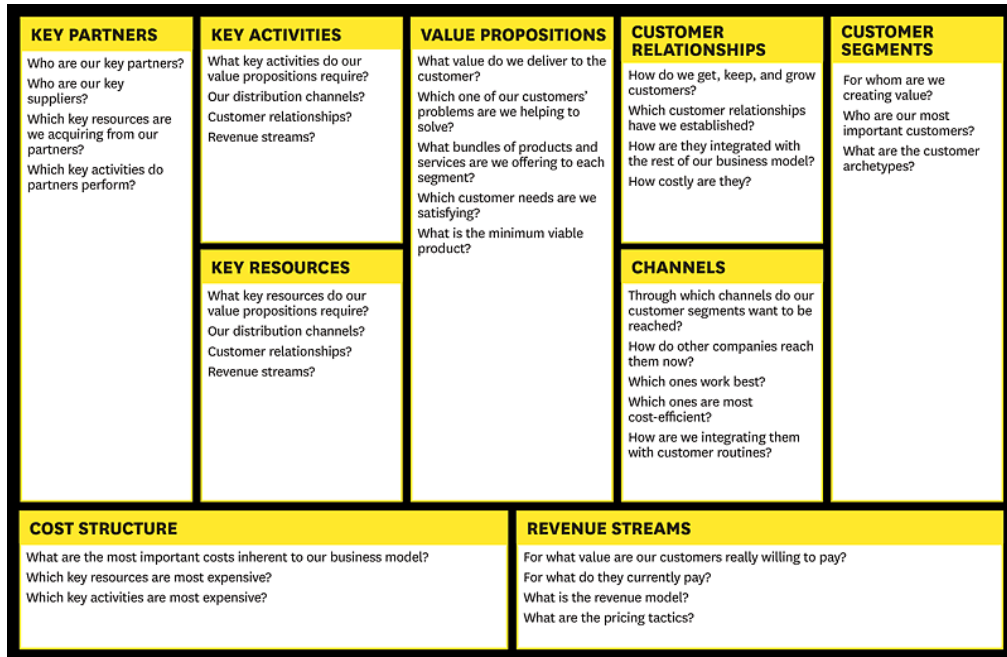
advocates a sound entrepreneurial mindset and it provides a great set of tools and hands-on recommendations that can help startups understand how to build and measure success" but „also show that the method might not be suited for all types of companies, which is something Eric Ries clearly claims in his book. Instead it seems as if it can have a negative effect on the long-term planning of the startup, be hard to apply for high-tech companies and even be discouraging toward visionary cases of radical innovation" [8].

Gaffeny et al highlighted that „the underlying principle that drives the lean methodology is to improve efficiency. In a startup, efficiency means knowing exactly what your customers will want, how much they will pay and exactly what the product will look like. Without knowing these things, time and money will be wasted following the wrong track" (Gaffeny et al, 2014) [9].

Presentation of the Lean Start Up methodology

Investopedia website defines in everybody's language the Lean Start Up methodology like "a method used to found a new company or when an existing company introduces a new product. The lean startup method advocates developing products that consumers have already demonstrated they desire so that a market will already exist as soon as the product is launched rather than developing a product and then hoping that demand will emerge" [10]. This method is described by using „a business model based on hypotheses that are tested rapidly. Data does not need to be complete before proceeding; it just needs to be sufficient. When customers do not react as desired, the startup quickly adjusts to limit its losses and return to developing products consumers want. Failure is the rule, not the exception"[10].

Fig. 1 Business model Canvas concept developed by A. Osterwalder and Y. Pigneur



Source: www.businessmodelgeneration.com/canvas.

The Lean Start Up methodology is based on five principles [3] to be applied by entrepreneurs such as:

1) Entrepreneurs are everywhere: startups are defined as “a human institution designed to create new products and services under conditions of extreme uncertainty”.

2) Entrepreneurship is management: this principle involves the elimination of instinctual entrepreneurial actions and their replacement with rational, principled management actions.

3) Validated Learning: observing and analyzing the clients and products they want are essential and represents a learning process on scientific basis.

4) Build-Measure-Learn: the learning loop thus defined allows continuous

improvement of client and product-related tactics and strategies.

5) Innovation accounting: a critical principle in this methodology in order to measure progress by a range of chained leading indicators.

The Lean Start Up methodology is based on three key components [1]. The first component, called “Vision,” delimits entrepreneurial and startup concepts to attach them to a progress measurement procedure called “validated learning.” The second component, called “Steer,” is about going through an iterative feedback loop that is highlighted by the built-metered-learned circle. The third component, ‘Accelerate’, is characterized by increasing the speed of action within the learning loop.

Fig. 2 Differences between Lean and Traditional Start Up methodologies Fig. 2 Differences between Lean and Traditional Start Up methodologies

Lean	Traditional
Strategy Business Model Hypothesis-driven	Business Plan Implementation-driven
New-Product Process Customer Development Get out of the office and test hypotheses	Product Management Prepare offering for market following a linear, step-by-step plan
Engineering Agile Development Build the product iteratively and incrementally	Agile or Waterfall Development Build the product iteratively, or fully specify the product before building it
Organization Customer and Agile Development Teams Hire for learning, nimbleness, and speed	Departments by Function Hire for experience and ability to execute
Financial Reporting Metrics That Matter Customer acquisition cost, lifetime customer value, churn, viralness	Accounting Income statement, balance sheet, cash flow statement
Failure Expected Fix by iterating on ideas and pivoting away from ones that don't work	Exception Fix by firing executives
Speed Rapid Operates on good-enough data	Measured Operates on complete data

Source: Visual Library of Harvard Business Review

Lean Startup is defined as a scientific methodology applied to initiate startups and promote new products and is adaptable to any type of business or industry expected by entrepreneurs, developers, or business leaders.

Advantages and limitations of Lean Start Up methodology

There are a range of critics as well as praises and good opinions about the methodology and its application in practice from

which the author wanted to extract only a few points below.

A female entrepreneur, Helen Walton, a co-founder and Marketing Director of Gamevy, a tech start-up which won the PitchICE award, says about the caveats of Lean Start Up method: „a) smaller is not necessarily better and viable is not always the right measure; b) validated learning sounds great – but barriers to entry may force you to develop a product blind and without experiments. Blind progress may be better than open-eyed stasis; c) pivot points do not only

come from customer feedback – there are many other types of serendipity that may intervene and offer a choice. That choice is never easy because almost every trade-off hurts; d) all the metrics and hypotheses in the world will probably not help you when reality bites. Since luck plays such a major role in what occurs, try to keep this as light-weight as all your other planning; e) no process or discipline can guarantee success. There are always new, exciting and unforeseeable ways to fail” (Walton, 2015) [11].

The same author underline that „in 2004, when Eric Ries co-founded IMVU, it was still relatively cheap to acquire customers online. Those costs have since increased significantly as the online environment matches other media in marketing budget requirements” and „for start-ups, high barriers to entry can make the size of the MVP so large that there is little point in calling it a ‘little bet’. Instead, we should apply the common sense principles of avoiding waste and attempting to set up experiments to validate underlying business assumptions as soon as possible [...]” (Walton, 2015) [11]

On the same website of Walton, Ramdane Mir, Expert in Lean Startup Methods, says: „The weak points of the Lean Startup method is that it relies upon humans to execute it, and far too many don’t and say they are. This gives Lean Startup a bad reputation as a methodology and perpetuates bad practices in its execution, which in turn leads to more failures while practicing “lean start-up.” (Walton, 2015) [11]

As a professor of internet economics and a research fellow at the Center for Disruptive Innovation at the Hult International Business School, USA, Ted Ladd considers the positive and the negative aspects of the method:

„[...] the good news: In general, the lean start-up method works. We measured success by looking at how teams performed in a pitch competition in front of a panel of industry experts at the end of the accelerator program (a proxy, albeit an imperfect one, for long-term financial performance). Teams that elucidated and then tested hypotheses about their venture performed almost three times better in the pitch competition than teams that did not test any hypotheses. [...] the bad news: There was no linear relationship between the number of validated hypotheses and a team’s subsequent success. In short, more validation is not better. I also found that teams that conducted both open-ended conversations and more formalized experiments with customers actually performed worse in the competition than teams that conducted either one or the other during the early stages of venture design” [5].

A good opinion is expressed by Dan Kaplan a contributor to the website techcrunch.com: „The Lean methodology is the closest thing to a scientific approach to start-up creation that we have. [...] Of course, in order for you to make a claim on the truth, the tests you use and the results they generate must be repeatable by others – and not just those you’ve paid off. In the world of start-up creation, the Lean methodology doesn’t quite achieve the rigor of repeatable tests, but it is certainly one of the most effective, cost-efficient ways to develop and test hypotheses about your product and your market” [12].

As a professor at UC Berkeley, Jon Burgstone says that „it sounds like straightforward enough advice to build a better business, but the approach has serious flaws” and one major critic is linked to the innovation accounting principle: „another key lean

start-up principle is the idea that standard accounting practices are not helpful measures of progress in the dynamic days of an early-stage company. Instead, the thinking goes, start-ups should rely upon “innovation accounting,” or more creative metrics. So instead of, say, measuring the number of customers a start-up has, you measure instead the “engagement” of those customers. [...] Innovation accounting sounds good—but accounting is accounting. Standard accounting simply needs to be interpreted differently for early-stage ventures, not ignored or deemed irrelevant” [13].

Entrepreneur and blogger Patrick Vlaskovits shows that „The following are meant to be constructive critical observations of various facets of lean startup and customer development. [...] Pivot, Persevere or Portfolio: Lean Startup may be optimized for investors, not entrepreneurs. Natural Limitation on Hypothesis Testing: Some environments are too complex and too chaotic for meaningful hypotheses to be formed and tested. Lean Startup itself is the Resistance: Coming up with perfect experiments is the perfect excuse not to take action. People versus Process: Lean startup is just another battle in the never-ending People vs Process war. Startup Cult-Building is next to Impossible with Lean Startup: Hard to get people fired up to fight in the startup trenches when upon a pivot, you decide that this isn’t a war to fight for” [14].

Implications of using the Lean Start Up methodology in Romania

As a new vision and methodology of creating new businesses, Lean Start Up could be an important method for Romanian

entrepreneurs. Like any procedure or methodology to set up a new business, it needs to take into account the economic developments, although the main asset of the Lean Start Up method is precisely that, under difficult conditions of financing and variations in economic growth, is a viable way of thinking and action for future entrepreneurs.

Romania has seen in the years after the negative effects of the international financial crisis a continuous economic outlook, with slight variations, being among the first countries with a high indicator of economic growth. Over the past two years, as a result of the effects of government economic policy decisions, the economic situation, although rising, is experiencing significant deterioration in some areas of activity and areas of action.

The Romanian economist Iancu Guda, president of the Association of Banking and Financial Analysts in Romania, states in an article (Cicovschi, 2018) [15] that Romanian micro-enterprises are currently facing ten major problems, which can be translated into future projects for setting up startups. As major problems one can reveal: modest efficiency of the workforce, modest profitability growth, liquidity assurance, modest capitalization, high indebtedness, long-term investment declines, low asset efficiency, slower debt collection, increased availability and diversification of inventories above the equilibrium level. As the interviewee explain: „the deterioration of the financial situation of microenterprises in Romania has significant adverse long-term effects on the business environment: [...]improving the competitive environment, [...] strong individualization of the products and services offered by SMEs, [...] generating new jobs, [...] increased

receptivity to the needs of the market due to the direct contact with it (Cicovschi, 2018) [15].

A research conduct at the University of California, Berkeley in 2014 reveals how an enterprise can benefit from Lean Startup Methodology highlighting the followings:

„1. Empower every employee to propose and work on new ideas outside their existing work; 2. Evaluate and filter ideas methodically and use the appropriate business process: traditional or lean startup processes; 3. Ensure corporate-level support and protection/isolation for the selected ideas; 4. Provide a mechanism to measure success using innovation accounting outside the normal company objectives; 5. Define investment readiness stages using clear guidelines and provide appropriate resources with the progress through each stage; 6. Devise an incentive structure to enable innovators to have a career path and share in the success” (Gaffney et al., 2014) [9].

In this context, the author for this paper has some arguments regarding the implications of using this by the Romanian potential entrepreneurs such as:

- The psychological structure of the Romanians, as well as the tradition and the culture of labor can be impediments to the application of this methodology in Romania; care must be taken not to be used as a screen for good intentions, but poor results in the practice or even non-application of the method as such;

- The application of the methodology in Romania may be favorable to certain areas (IT, e-commerce, Internet-related business) and disadvantageous to others;

- The launch of a new business is similar to the take-off of an airplane - it depends

on what type of airplane and runway is used (startup financing assets and mode), which is the length of the take-off runway (business start time) where the airport is located - at the mountain or at sea or at the plain and atmospheric conditions (macroeconomic situation and product demand on the market); thus, the conditions of this type are very crystalized in Romania;

- The idea of Lean Start Up is, in fact, only a takeover of Japanese quality management techniques (which it recognizes by specifying the application of Toyota’s methodologies and production procedures) in a new iterative cycle that wants to consider Precise customer wishes and expectations for the product you create; as such, Romanian entrepreneurs have to show a permanent concern for the market research, the clients and the products made for them, which is somewhat difficult in the conditions of an entrepreneurial culture still in the beginning.

Conclusions

The final conclusions are based under the previous assumptions in this paper. Like any procedure or methodology to set up a new business, it needs to take into account the economic developments, although the main asset of the Lean Start Up method is precisely that, under difficult conditions of financing and variations in economic growth, is a viable way of thinking and action for future entrepreneurs. So, as a new vision and methodology of creating new businesses, Lean Start Up could be an important method for Romanian entrepreneurs. In order to implement the methodology on Romanian start-ups, the author underline there are also positive and negative aspects with strong impact in that regard.

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