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STRATEGY

When and Why Do Investors Prefer Copycats?

by Mokter Hossain

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Investing in copycat companies can be a strategic move for investors, as these firms often lead to their own success.

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Investors, particularly venture capitalists, often face the challenging decision of where to allocate their resources. Among the various options, they might encounter original ideas, innovative startups, and companies that are essentially "copycats." Copycat companies imitate the business models, products, or services of successful firms. Despite the initial negative connotation, investing in copycats can be a strategic move for investors. This article explores the circumstances under which investors prefer copycats, examining market dynamics, risk assessment, potential for growth, and strategic advantages.

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Market Dynamics and Proven Models

One primary reason investors might prefer copycat companies is the proven nature of the business model (Walter et al., 2016). When a company successfully establishes a new product or service, it often validates a market need or demand. Copycat companies leverage this proven model, reducing the uncertainty associated with untested ideas (Fu & Tietz, 2019). For example, when Airbnb demonstrated a substantial market for peer-to-peer lodging, numerous similar platforms emerged. Investors saw the success of Airbnb as a market validation, making them more comfortable investing in similar startups, such as Lyft in the USA (following Uber), Mobike in China (following Ofo), and GrabFood in Singapore (following Foodpanda). These follower business model copycats have received millions of dollars in investments. Some accelerators, like Rocket Internet, specialize in fast follower business model copycats (Baumann et al., 2018). Sometimes, such copycats dethrone incumbent business models. Understanding market dynamics and proven models can significantly enhance a company's ability to navigate competitive markets and achieve sustained growth. A strategy that works well in one region may need adjustment to fit another, involving tailoring offerings to local tastes, complying with regional regulations, and addressing unique competitive pressures.

Reduced Risk and Predictability

Investing in a copycat can significantly reduce the risk associated with new ventures. Copycats operate in a known environment where the demand and business operations have already been established, making it easier for investors to forecast returns and plan exit strategies. For example, the tech industry has seen numerous social media platforms following the blueprint laid out by Facebook. Investors feel more secure investing in these platforms because they can draw parallels to Facebook's trajectory. Copycat businesses offer significant advantages in terms of reduced risk and increased predictability. Following a proven blueprint allows these ventures to avoid many pitfalls and uncertainties, focusing on execution and adaptation to local markets. One of the main reasons for reduced risk in copycat businesses is the validation of the original model. When a business concept has already demonstrated success, it provides a clear roadmap for replication, including insights into market demand, customer preferences, pricing strategies, and operational processes. For instance, food delivery services like DoorDash and Uber Eats set precedents that many international startups could follow, reducing the guesswork involved in launching a similar service. Established business models come with a wealth of data and performance metrics that new entrants can leverage. This data offers insights into expected growth trajectories, revenue streams, and potential challenges, helping copycat businesses create more accurate financial projections and strategic plans, which are essential for attracting investors and securing funding. Additionally, the reduced risk extends to customer acquisition and market penetration. Familiarity with the original brand and concept can help copycat businesses gain traction more quickly. However, it is essential for copycat businesses to innovate within the framework of the copied model to address local needs and preferences. While the foundational concept reduces risk, success often depends on how well the business adapts to its unique market environment.

Growth Potential in Emerging Markets

Emerging markets offer unique opportunities for copycat companies (Fu & Tietz, 2019). What might be a saturated market in one region could be untapped in another. Investors often seek out copycats that adapt successful models to local contexts. For example, the Chinese market has seen many successful copycats of Western businesses. Alibaba and Baidu are often considered equivalents to Amazon and Google, respectively. Investors recognize that these companies can capitalize on local market conditions, cultural preferences, and regulatory environments to achieve substantial growth. Emerging markets offer significant growth potential, particularly for copycat businesses that replicate successful models from developed economies. For instance, e-commerce giants like Alibaba and Flipkart successfully adapted the business models of Amazon and eBay to the specific needs and preferences of Chinese and Indian consumers, respectively. Companies like Grab in Southeast Asia and Gojek in Indonesia have leveraged the ride-sharing model pioneered by Uber to create multi-service platforms catering to the unique needs of their local markets. The regulatory environment in emerging markets can also be more conducive to growth. While challenges such as political instability and fluctuating regulatory frameworks exist, there are also opportunities. Governments in these regions often welcome foreign investment and this openness can provide copycat businesses with the flexibility and support needed to scale rapidly. To thrive, these businesses need to adapt their models to local tastes, preferences, and conditions, involving not just straightforward replication but a thoughtful adaptation that considers the unique aspects of the market.

Adaptation and Innovation on Existing Models

Copycat companies are not merely clones; they often introduce innovations and improvements to existing models. This adaptability can create significant value. Investors might prefer copycats that enhance an existing business model by incorporating new technologies, better customer service, or more efficient operations. For instance, Instagram started as a photo-sharing app similar to many that came before it but succeeded by focusing on simplicity and user experience. Investors are keen on such companies because they combine the reliability of a proven model with the potential for disruptive innovation. Adaptation and innovation are crucial for copycat businesses that seek to succeed by emulating existing models (Pisano & Teece, 2007). While copying a proven concept can reduce risk and increase predictability, true success often hinges on the ability to adapt and innovate, tailoring the model to fit the unique conditions of the new market. Adaptation involves modifying the original business model to align with local market dynamics, consumer preferences, and regulatory environments. For instance, while ride-sharing services like Uber have a standardized model, regional counterparts such as India's Ola have made significant adaptations. Ola integrated features like auto-rickshaw bookings and wallet-based payments, which are more suited to the Indian market. These adaptations enhance user experience and increase market penetration by catering to local transportation habits and payment preferences. A notable example is Grab, a Southeast Asian company that started as a ride-hailing service similar to Uber. Grab innovated by expanding its services to include food delivery, digital payments, and financial services, evolving into a comprehensive super app. Adapting and innovating also involve leveraging local insights and technological advancements. For instance, MercadoLibre, often dubbed the "eBay of Latin America," has innovated by incorporating robust fintech solutions to address the region's unique challenges with financial inclusion and digital payment adoption.

Branding and Differentiation

Copycat companies can differentiate themselves through branding and market positioning. Investors look for businesses that can carve out a niche or appeal to specific demographics within a proven market (Van Horen & Pieters, 2017). This differentiation is crucial in saturated markets where standing out can lead to significant customer loyalty and market share. For instance, when Apple entered the smartphone market dominated by companies like Nokia and Blackberry, it was essentially following an existing model but differentiated itself through superior design and user experience, creating a strong brand that attracted investors. Branding and differentiation are critical strategies for copycat businesses aiming to establish a unique identity and gain a competitive edge in the market. While these businesses start by emulating successful models, their long-term success often depends on how effectively they build a distinctive brand and differentiate themselves from both the original model and local competitors. Branding involves creating a strong, recognizable identity that resonates with consumers. For copycat businesses, this means more than just adopting the visual and conceptual elements of the original model; it requires crafting a brand narrative that appeals to local tastes and values (Teece, 1998). For example, Xiaomi, often referred to as the "Apple of China," initially mirrored Apple's product aesthetics and marketing strategies. However, Xiaomi distinguished itself by focusing on affordability and localizing its brand message to align with the preferences of Chinese consumers, fostering strong brand loyalty. Differentiation involves offering unique features or value propositions that set a business apart. This could be through superior customer service, innovative product features, or localized offerings. Take the example of Flipkart in India, which started as an e-commerce platform similar to Amazon. Flipkart differentiated itself by understanding and addressing local market nuances, such as introducing cash-on-delivery options and building a robust supply chain tailored to India's diverse geography. Effective branding and differentiation can also stem from emotional and cultural connections. Brands that tap into local cultural themes, values, and aspirations can create a deeper bond with consumers. For instance, Turkey's Yemeksepeti, an online food delivery service, capitalized on local cuisine and dining habits, creating marketing campaigns that emphasized traditional and cultural culinary experiences, resonating strongly with Turkish consumers. Leveraging digital marketing and social media can significantly enhance branding efforts. Engaging with customers through localized content, influencers, and community initiatives helps build a relatable and trustworthy brand image. This approach can also facilitate real-time feedback and adaptations, ensuring the brand stays relevant and appealing.

Lower Customer Acquisition Costs

Proven business models often come with established methods for customer acquisition and retention. Copycat companies can leverage these methods to reduce their marketing and customer acquisition costs. Investors are particularly attracted to this aspect as it directly impacts the company's bottom line and accelerates the path to profitability. For example, e-commerce platforms that followed the model of Amazon could utilize similar strategies for customer acquisition, reducing the trial and error associated with attracting and retaining customers. Socio-cultural alignment and localization are pivotal for the success of copycat businesses in new markets. Socio-cultural alignment is essential for building trust and acceptance among local consumers. Effective localization also requires understanding local regulations and business practices. For instance, ride-hailing services like Didi in China and Ola in India have developed strategies to navigate complex regulatory landscapes, ensuring their business models align with local transportation laws and regulations (Hossain, 2021).

Potential for Strategic Acquisitions

Investors might prefer to invest in copycats with the expectation of a lucrative exit through acquisition(Carow et al., 2004). This acquisition potential provides investors with a clear and profitable exit strategy. An example is Facebook's acquisition of Instagram, where a company that started as a copycat of existing photo-sharing platforms became a valuable asset for a tech giant. Copycat businesses, by replicating successful models, often position themselves uniquely for strategic acquisitions (Luo et al., 2011). Their potential for strategic acquisitions is enhanced by their ability to quickly capture market share, leverage proven business models, and demonstrate robust growth in emerging or underserved markets. Firstly, copycat businesses can rapidly capture market share by entering markets with an already validated demand. For instance, when a copycat business successfully adapts a proven e-commerce model to a new region, it can quickly attract a significant user base. This was evident when Walmart acquired Flipkart, leveraging Flipkart's strong presence and deep understanding of the Indian market to gain a competitive edge. The successful adaptation and local optimization of these models demonstrate the viability of the business, making them more enticing for strategic buyers. For example, Alibaba's acquisition of Lazada was driven by Lazada's successful implementation of the e-commerce model in Southeast Asia. Additionally, the robust growth trajectory of copycat businesses in emerging markets can lead to strategic acquisitions. Copycat businesses that establish a strong foothold can become valuable assets for larger companies aiming to diversify their portfolios and enter high-growth regions. The acquisition of Tokopedia by Gojek is a case in point, where both companies saw mutual benefits in consolidating their operations to dominate the Indonesian market. Furthermore, strategic acquisitions of copycat businesses allow larger corporations to acquire local expertise, cultural insights, and established customer bases.

Leveraging Existing Ecosystems

Copycats can thrive by integrating into existing business ecosystems (Frankenberger & Stam, 2020). They can form partnerships, utilize existing supply chains, and adopt established technologies, which reduces operational complexities and costs (Agarwal & Kapoor, 2023). Investors appreciate this efficiency as it translates to better scalability and faster growth. For instance, fintech startups that mimic successful models in the payment industry can leverage existing financial networks and technologies to scale rapidly. Leveraging existing ecosystems is a strategic advantage for copycat businesses, enabling them to capitalize on the infrastructure, technology, and market presence already established by successful models. Copycat businesses can adopt and adapt technology frameworks developed by the original companies, saving substantial time and resources. For instance, ride-sharing apps like Uber and Lyft have created sophisticated algorithms and user interfaces that other companies can emulate. Companies like Ola in India and Grab in Southeast Asia have effectively leveraged these technological blueprints, tweaking them to meet local needs while benefiting from the robust foundation laid by their predecessors. Copycat businesses can integrate into these pre-existing systems to enhance efficiency and reliability. By studying the successes and failures of established companies, copycat businesses can refine their strategies, avoid common pitfalls, and tailor their offerings to better fit local market dynamics. Furthermore, copycat businesses can benefit from existing marketing and distribution channels.

Socio-Cultural Alignment and Localization

In many cases, copycats succeed by aligning closely with local socio-cultural dynamics. Investors prefer companies that can tailor a proven model to fit local preferences, regulations, and market conditions. This localization often leads to higher acceptance and growth rates. For example, Ola, an Indian ride-sharing company, adapted the Uber model to cater to the unique needs of the Indian market, including cash payments and localized customer service. Investors saw this alignment as a significant advantage, making Ola an attractive investment. Socio-cultural alignment and localization are pivotal for the success of copycat businesses in new markets. While emulating successful models from established companies provides a foundational strategy, aligning with local socio-cultural contexts and effectively localizing offerings ensure that the business resonates with the target audience and meets their unique needs. Socio-cultural alignment involves understanding and integrating into the social norms, values, and cultural practices of the target market. This alignment is essential for building trust and acceptance among local consumers. For instance, when McDonald’s entered the Indian market, it adapted its menu to exclude beef and pork products, offering a variety of vegetarian options instead. This alignment with Indian dietary preferences and cultural practices helped McDonald’s gain widespread acceptance and success. Localization goes beyond mere translation of language; it encompasses the adaptation of products, services, marketing strategies, and even business operations to fit local conditions. A prime example is Netflix, which, upon expanding into new markets, invests heavily in creating and promoting local content. By producing shows and movies that reflect local stories, languages, and cultural nuances, Netflix effectively engages with local audiences, driving subscription growth and brand loyalty. Additionally, localization involves tailoring marketing campaigns to resonate with local sentiments and traditions. For example, during the Lunar New Year, many companies in East Asia launch special promotions and campaigns celebrating the holiday, aligning their brand with a significant cultural event and fostering a deeper connection with consumers. Effective localization also requires understanding local regulations and business practices. Companies must adapt to local legal frameworks and business environments to ensure compliance and smooth operations. For instance, ride-hailing services like Didi in China and Ola in India have developed strategies to navigate complex regulatory landscapes, ensuring their business models align with local transportation laws and regulations.

Benchmarking and Performance Metrics

Copycat companies offer a unique advantage in terms of benchmarking and performance metrics. Investors can compare the performance of a copycat with the original and other similar companies to accurately assess its potential. This benchmarking provides a clearer picture of what to expect in terms of growth, customer acquisition, and profitability. Benchmarking and performance metrics are essential for copycat businesses aiming to replicate successful models while ensuring optimal performance and competitive advantage. Benchmarking involves comparing a copycat business's performance against established standards or industry leaders. For instance, a copycat e-commerce platform might benchmark its website traffic, conversion rates, and customer satisfaction against industry giants like Amazon. By doing so, the copycat can pinpoint areas where it lags behind and adopt strategies that have proven successful for the market leader. Key performance metrics (KPIs) play a crucial role in assessing the effectiveness of a copycat business model. Common KPIs for copycat businesses include customer acquisition cost (CAC), lifetime value (LTV), churn rate, and gross merchandise value (GMV). CAC is a vital metric indicating how much a business spends to acquire each new customer. Keeping CAC low is essential for maintaining profitability, especially for copycat businesses entering competitive markets. By analyzing CAC, businesses can optimize their marketing and sales strategies to attract customers more cost-effectively. LTV measures the total revenue a business can expect from a single customer over their entire relationship. A high LTV indicates strong customer loyalty and recurring revenue, critical for sustainable growth. Copycat businesses can improve LTV by enhancing customer experience, offering personalized services, and implementing effective retention strategies. Churn rate, the percentage of customers who stop using a service over a specific period, is another crucial metric. A low churn rate suggests high customer satisfaction and retention. Monitoring churn rate helps copycat businesses identify issues early and take corrective actions to retain customers. GMV measures the total value of goods sold through the marketplace. Tracking GMV helps assess overall sales performance and market penetration.

Conclusion

Copycat companies present a compelling case for investors. The reduced risk, proven business models, potential for growth in emerging markets, and strategic advantages make them attractive investment opportunities. By leveraging existing ecosystems, aligning with local market conditions, and introducing innovations, copycat companies can achieve significant success. Investors, recognizing these benefits, often prefer copycats when making strategic investment decisions, balancing their portfolios with a mix of proven models and innovative ventures.

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Mokter Hossain Follow

Mokter Hossain is an Associate Professor at the Center for Entrepreneurship, College of Business and Economics, Qatar University. Previously, he worked at Manchester University, Aalborg University, Aalto University, and Imperial College London. He has a PhD in strategy and venturing, an MBA in International Business, an MBA in Marketing, and a Postgraduate Diploma in Finance. His research interests lie at the intersection of entrepreneurship, innovation, and strategy on topics such as frugal innovation, open innovation, crowdsourcing, crowdfunding, sharing economy, etc.