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# Developing Leaders Quarterly

MAKING ORGANIZATIONS MORE HUMAN

# Innovating Innovation

## Catalyzing your leadership practice

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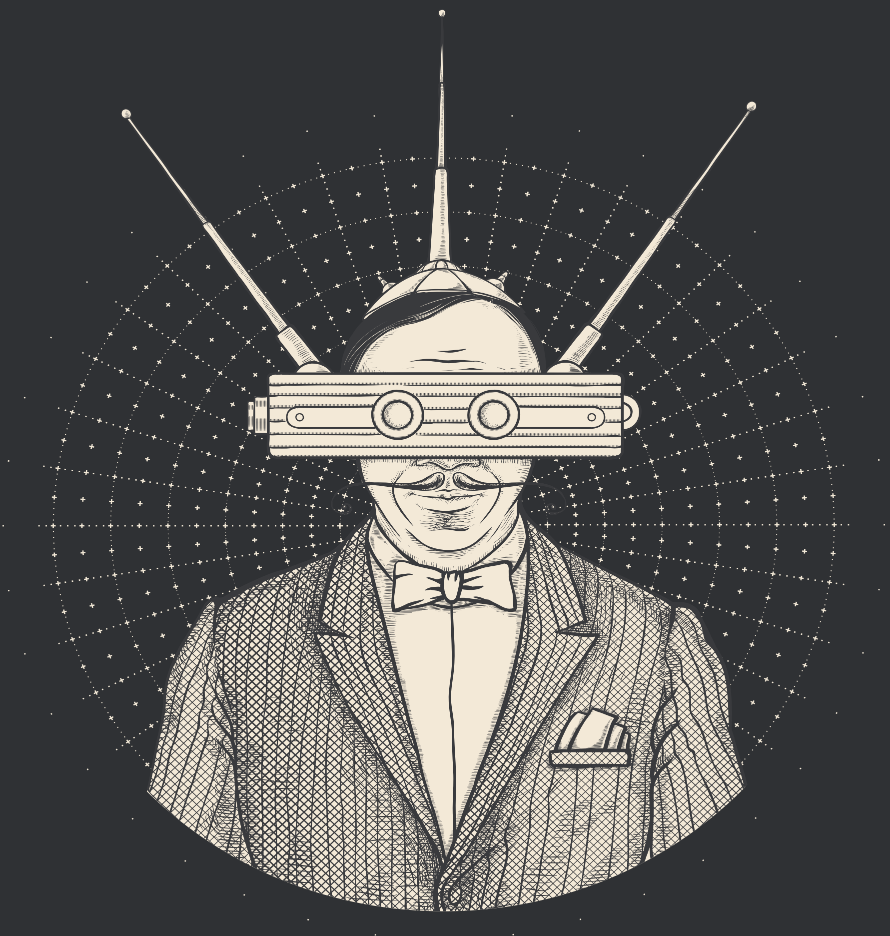
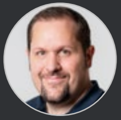




By Michael Nichols

# Corporate Innovation: Quo Vadis?

## Incubate and Accelerate Exploratory Innovation

Can corporates innovate? Should they? These questions haunt both corporate executives and academics practicing and studying corporate innovation. While the temptation is to respond with a resounding affirmation and even with a sense of duty to society, the answers to these two fundamental questions are not as clear as practitioners and theoreticians would like to believe.

Starting with the first question, it is not difficult to find examples of companies which have successfully innovated in their core business and beyond. The Ball


Photo by Museums Victoria on Unsplash

Corporation transformed from a producer of glass jars to a packaging and even an aerospace company. Amazon started as a web shop for books and has transformed into a dominant web and cloud services company. Some even predict it will become a dominant logistics company. Hilti changed its business model from a producer of tools to one that provides a tool-on-demand service.





***One would not have to look far for an entire graveyard of corporates which failed to innovate and were either cast into the dustbin of history or have been drastically downsized from their former glory.***

Such examples of successful business model innovation come readily to mind, but more often, the story resembles the infamous downfall of Kodak. One would not have to look far for an entire graveyard of corporates which failed to innovate and were either cast into the dustbin of history or have been drastically downsized from their former glory.

From the point of view of corporates hoping to sustain their success, the data seem to confirm that the situation is deteriorating, not improving. While the past is certainly no predictor of the future, the trend lines of chart 1 suggest that corporate lifespans are shrinking over time. Why? For one, the amount of capital needed to challenge incumbent business models is getting smaller and smaller. Startups which can demonstrate early traction have access to almost unlimited capital, and new technologies make the capital requirements needed to threaten incumbent players less burdensome. Another reason is that – also thanks to technology - the borders which used to delimit an established market vertical are either blurring or vanishing entirely.

Consider the automotive industry which for most of its history has had seemingly insurmountable barriers to entry. A startup would have to put up massive amounts of capital for hardware development, factories, warehouses, and logistics. All of that does not even include the necessary go-to-market capabilities, such as an established network of suppliers, strong branding, franchisees, and more. These entry barriers are fast eroding as the industry faces multiple existential threats from unpredictable angles.

For starters, software – a very different industry vertical - is increasingly dominating the game. Some may categorize Tesla even as a software company, given the company's software-defined-vehicle approach. This trend has forced the traditional automotive players to compete in a space which is not their home turf. The jury is out on whether they will be able to transform themselves, but successful business model innovation is rare, especially when the DNA of the company is hardware, not software, and the formerly protective barriers to entry have become a sort of self-imposed prison the incumbents have a hard time breaking out of.

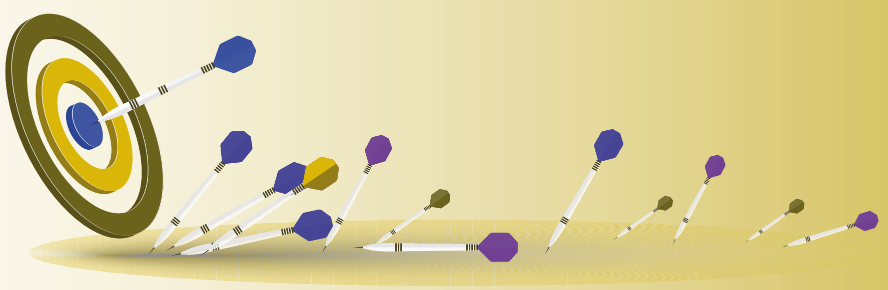
Adding to this challenge, young customers seem to have begun moving away from an ownership model to a just-get-me-from-A-to-B model. Uber - yet again from another vertical - has forever changed how we all conceive of mobility. What happens to established automotive companies when drivers transition to riders, when they no longer care to own vehicles, when the only brands they care about are ride-share companies?

If corporates hope to survive, then they must innovate.

## Should Corporates Innovate: Two Competing Ideologies

Before asking how corporates can best innovate, the fundamental question remains: Should they be the vehicle to do so?

Two competing schools of thought have emerged in this context. One follows the logic Clayton Christensen laid out so well in *The Innovator's Dilemma*. To summarize it crudely: corporates cannot innovate beyond their core business and should spin out any potentially disruptive business model. Why? Because corporates are exploitation engines. They know how to squeeze every bit of cash, efficiency, and productivity out of known business models or known systems. Every KPI, every structure, and even the culture itself has evolved to serve this purpose - but it only works for the current model. Once an organization deviates from the established model – so the theory - the probability of success plummets to near zero



*The world is much grayer and messier than the theories. Innovation is a game of probabilities in which nobody can safely pick winners. The players must launch many unsuccessful shots to have a chance of scoring the winning goal.*

The second ideology does not deny Christensen's logic but argues that it is possible to exploit existing business models while exploring new ones - provided it is done carefully and with the right organizational setup. Success may be rare, but we know this so-called dual approach is possible because it has been done. This thinking is better known under the theory of the ambidextrous organization put forth by O'Reilly, Tushman, and others.

To summarize, one approach believes that disruptive innovation within corporations is essentially hopeless. Consequently, disruptive business models need to be spun out, and the focus lies on inorganic growth vehicles such as M&A or perhaps external venture builders. The other one claims that innovation is not hopeless, but very difficult, and it can work by leveraging core competences and focusing on internal venturing such as incubators and R&D.



However – as corporate innovators, do we have to choose between the two? Like with many ideologies, the world is much grayer and messier than the theories. Innovation is a game of probabilities in which nobody can safely pick winners. The players must launch many unsuccessful shots to have a chance of scoring the winning goal. As with many theories in social science, things depend on context and circumstances. So, why limit ourselves to only one set of vehicles? Let us try them all and see which shots on goal land in the net.

## Inorganic or Organic Innovation – or Both?

Now, let us turn to the more practical question of how to approach corporate innovation. Here, the answer depends on the strategic growth gap, i.e. how much growth is wanted or needed. If a large company wants to increase its market share by 20% or more, it must grow by billions of dollars. In most cases, this cannot be done with business as usual, so the company must think about strategic innovation: which strategic arena to focus on, which customers to target, with which value propositions, which business models? Which capabilities to leverage, and - even more important - what not to do? Once these questions have been addressed, the company must decide which vehicles it will deploy to achieve its growth ambitions.

There are various options to consider when trying to fill the strategic growth gap, and each of them has its tradeoffs. All are fraught with high failure rates when it comes to innovating outside of the core business. Even M&A, often seen as a panacea, suffers from high integration failures of up to 80%. To reiterate the message from above, do not limit yourself artificially to one set of tools, but rather view them as a portfolio of tools which can be deployed to achieve the desired growth, each with its own risk profile and contribution to the growth.

I have been working for the last 9 years in corporate incubators, accelerators, and venture capital at both a large multi-business German corporate (Robert Bosch GmbH) and a more focused family-owned German SME (MANN+HUMMEL); it has allowed me to experience success factors and challenges in practice.



## Organic growth/innovation

| Type | Strengths | Weaknesses |
|---|---|---|
| **Technological Advances (R&D)** | ▶ IP protected<br>▶ Create products based on deep customer knowledge and existing IP | ▶ Expensive<br>▶ Slow<br>▶ Too tech-centric with insufficient business model validation<br>▶ Integration into business units very difficult if too exploratory |
| **Internal Ventures (Incubation/ Acceleration)** | ▶ Create new business using existing talent and resources<br>▶ Talent attraction and identification<br>▶ Use existing advantage of core business (e.g. sales channels) | ▶ Channels often inaccessible to venture teams<br>▶ Inappropriate governance applied by inexperienced executives (e.g. put profit targets before more qualitative metrics to measure traction)<br>▶ Integration into business units very difficult if too exploratory |

## Inorganic growth/innovation

| Type | Strengths | Weaknesses |
|---|---|---|
| **M&A** | ▶ Lower market risk since target has proven traction<br>▶ Avoid slow, expensive R&D<br>▶ Faster expansion | ▶ High integration failure rates<br>▶ Misaligned cultures<br>▶ Pervasive overvaluation<br>▶ Insufficient value creation |

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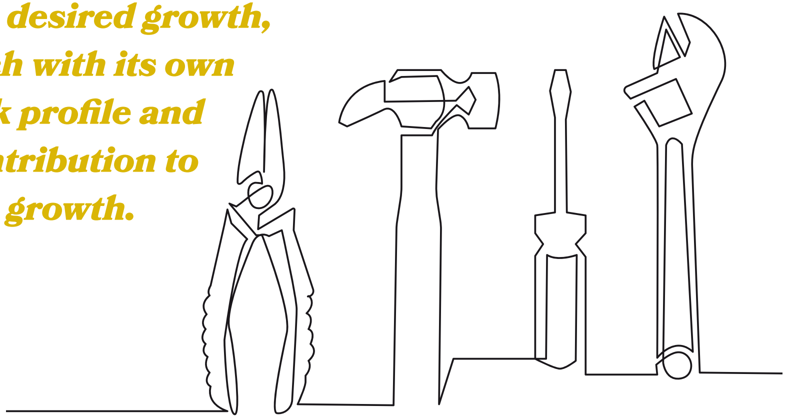






## Hybrid growth/innovation

| Type | Strengths | Weaknesses |
|---|---|---|
| **Partnering** | ▶ Avoid expensive in-house development<br>▶ Focus on strength of organization | ▶ Difficult to align internal and external partners with an appropriate incentives<br>▶ Slow negotiations<br>▶ Unclear ownership |
| **External Ventures (Incubation/ Acceleration)** | ▶ Lower market risk<br>▶ Independent from existing business units<br>▶ Lighter, more appropriate venture governance<br>▶ Experienced entrepreneurs | ▶ Unclear whether revenue or valuation is the target<br>▶ Unclear mandate in the eyes of shareholders (i.e. can invest their own money for better returns) |
| **Corporate Venture Capital** | ▶ Lower market risk<br>▶ Test new business models without having to build them<br>▶ Market sensing<br>▶ Zero-cost business development | ▶ Difficult to balance strategic impact and portfolio return<br>▶ Maturity mismatch between startups and core business units<br>▶ Long-term returns with small short-term impact |

***If companies are set up correctly to address these conflicts, incubators and accelerators offer huge untapped potential and the opportunity to build the capacity to innovate on innovation itself.***

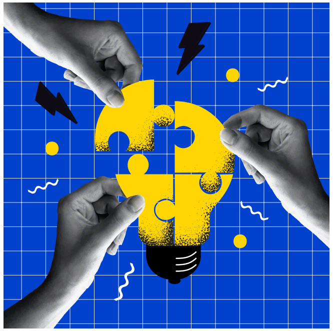
## Corporate Accelerators and Incubators: The What

Incubators and accelerators are often used as synonyms, but they differ in the maturity level of the venture. An incubator typically focuses on very early-stage ventures which have an idea and need to validate its potential for a repeatable, scalable, and profitable business model by testing it with real customers using demos, MVPs, or other experiments. Based on the feedback they receive from the market, ventures may have to change directions multiple times or give up. The largest risk at this stage - and the top reason new ventures fail - is that new ventures are unable to find a sufficiently severe customer problem that makes customers change their behaviour and even pay for a solution.

Accelerators, on the other hand, focus on the stage after incubation in which ventures have found early traction and want to accelerate this traction by concentrating on early productization and creating a repeatable sales process. They also have high rates of failure due to the







difficulty of industrializing and going to market, challenges which are often underestimated.

Incubators and accelerators can be internal or external. Internal ones focus on building corporate ventures with corporate assets. External ones focus on providing programs for external startups, perhaps granting them access to internal resources. There are also hybrid models in which internal and external teams work together to validate their ventures.

## Corporate Accelerators and Incubators: The Why

Incubators or accelerators will not close the entire strategic growth gap of a corporation. Nevertheless, they are an excellent vehicle for testing and de-risking new business models.

In theory, a company can leverage the comparative advantage it has amassed in its core business to explore new business models, which is nothing less than creating the foundation for the ambidextrous organization. In practice, ambidexterity runs into obstacles the moment a new venture should be integrated into the existing business. The reasons for this are manifold and well known: channel conflicts, conflicting financial KPIs, the perception of innovation as a cost, no well-defined strategy, no upfront commitment of resources.

However, if companies are set up correctly to address these conflicts, incubators and accelerators offer huge untapped potential and the opportunity to build the capacity to innovate on innovation itself.

## Corporate Accelerators and Incubators: The How

To run an effective incubator or accelerator with a chance of producing winners, companies must have several critical pieces in place:

### *Strategic Innovation Theses*

To run an effective incubator or accelerator, the strategic innovation theses must be documented and crystal clear, which includes laying out the growth goals, the search fields - or hunting zones as some call them,





***The probability of failure, which is already astronomical for new ventures, is almost certain if governance or process are missing.***

acceptable business models, a theory for value which might raise eyebrows, since innovation is supposed to be about divergence. However, in practice, divergence from the company strategy is certain death for an innovation project. If you do not have a clear strategic perspective, stop the project before you start, because it will be a monumental waste of resources, talent, and morale.

### *Upfront Resource and Capital Commitment*

In line with a clear strategy, commit resources and capital *upfront* in case one of the ventures successfully exits the program. Too often, budget allocation depends on a successful exit. That's a mistake. While it is prudent to make the release of budget to the venture dependent on successful traction and exit by stage, do not wait to allocate this budget to the portfolio holder who runs the incubator or accelerator. The mechanism matters. Off-cycle budgeting is just as - if not more - important than the methods and tools used in the incubator or accelerator. Equally important, do

not attach budgets to single ventures, because that creates the perverse incentive to keep them alive even when there is no traction. Remember, failure rates are high, and throughput is critical. Make sure the budget sits at the portfolio level to foster better incentives for the entire funnel.

### *Strong Portfolio Governance and Innovation Process*

At first glance, governance and process seem antithetical or even inimical to innovation. However, experience demonstrates that without them the probability of failure, which is already astronomical for new ventures, is almost certain if governance or process are missing. Why? Without portfolio governance, too much money is tied up in losing ventures which eat up all the cash that could be placed in other, more promising ventures. Running a

***A true culture of innovation is built by doing innovation, treating it just as seriously as the core business, not by going through motions or creating the semblance of innovation.***

portfolio requires dispassionately terminating ventures without traction or without fit. Failure to do leads to insufficient bets being placed to have a chance of producing the rare winners.

Accordingly, the corporation must have a strong process in place that ensures testing the right hypotheses at the right time in a capital-efficient manner. The stages a venture goes through are well known, and how much should be invested at each stage is equally well known. Corporates would do well to be as strict as venture capitalists are in their evaluation and tracking of startups.

### *Proper Organizational Structure, Sales Channel Alignment*

Assuming a company has somehow managed to do all the above correctly, what happens if a venture eventually exits these programs successfully? Where does it go? Do you integrate it into the core? Do you set it up as an independent unit? Do you spin it out? Some have the temptation to say, 'wait and see.' While nobody can pick winners upfront or know exactly what the final business model may look like, the answers to these questions are crucial - so crucial that if you do not have an answer, you should not start the incubation or acceleration process.

Let's look at one of these options in more detail: - integrating into the core. While this seems to be the most obvious route, it might be the most difficult of all. If the venture was not planned for, budgets may not be available. If the venture is not mature enough for the KPIs of the core business, it will surely be killed within the core. If the venture's sales model differs even slightly, the established sales channels will either refuse to work with it or will not be properly incentivized. All that can mean certain death for a new venture. Therefore, it is imperative that the willingness and commitment to integrate the venture are aligned in advance, and this means dedicated budgets, headcount, sales channel incorporation and incentives.

## A Final Remark: Tear Down the Innovation Theatre

Many leaders mistake entrepreneurship for the festivities and rituals that accompany it - pitch events, hackathons, agile sprints, and more - believing that these events are good for culture building. But in reality they create only the pretense of innovation. Their actual effect is the demoralization of your talent once they figure out it was a show and nothing more. Worse, they may leave with





your IP. A true culture of innovation is built by *doing* innovation, treating it just as seriously as the core business, not by going through motions or creating the semblance of innovation.

## Conclusion

If I look at my innovation experience with a large multi-business corporation such as Bosch or at a smaller, more focused SME like MANN+HUMMEL, size does not make a significant difference. Success depends on how ingrained the core business is into the thinking, the KPIs, the culture, the processes, whether there is a willingness to experiment, and how innovation is perceived. Many see it purely as a function of technology development; I see it as foremost a social phenomenon. Ultimately, innovation is a people and leadership challenge.

I may have posed more questions than I have given answers, because the practice of innovating is subject to innovation itself. Try things, do not get stuck on one method or tool, and *act* - you cannot innovate unless you start.

***Michael Nichols*** *joined MANN+HUMMEL in 2022 where he is Director of Corporate Ventures. From 2014-2022 Michael worked at Bosch, where he was responsible for the Bosch Accelerator Program and for the implementation of a Bosch-wide innovation process.*

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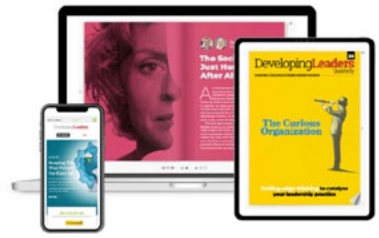

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