The Corporate Startup

How established companies can develop successful innovation ecosystems

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vakmedianet

PRAISE FOR

The Corporate Startup

Big companies need to innovate or die. The question is how. Companies need a playbook; a process by which they can start the process of transforming their organizations into innovation engines. *The Corporate Startup* is that playbook. It provides a proven methodology — applying Lean Startup principles and more — for building a culture of innovation.

Ben Yoskovitz, Co-Author of *Lean Analytics* and Founding Partner at Highline BETA.

Nothing's harder than creating innovation, and the most valuable creations are exactly those which shrivel under typical corporate management. The authors' approach is to focus on creating an ecosystem that allows innovation to flourish on its own; addressing health of the soil rather than micro-managing the plants. If you want to avoid some of the common traps and give your internal entrepreneurship the best shot, this book will help.

Rob Fitzpatrick, Author of *The Mom Test*.

In a world full of innovation hype and clichés, *The Corporate Startup* manages to provide useful answers and solutions to a complex question — how can corporations innovate faster and better? The book delivers a clear roadmap for creating a strategy, governance structures and implementing an innovation practice. This makes it an absolute must-read for all corporate strategists and innovators and has become "the way we think and talk" about corporate innovation in Copenhagen Fintech

Thomas Krogh Jensen, CEO at Copenhagen Fintech.

With innovation now a strategic imperative, you are going to need a playbook to help develop practical and scalable approaches to innovation in your company — simply put, you are going to need this book!

Paul Brown, Founder at Rokket Digital.

This book is timely addition to the corporate innovation space. It is a must read for anyone working on innovation in medium-size and large companies. The principles and practices, if well implemented can save a company from the disruption death march.

Tim Deeson, Managing Director at Deeson Group.

In this wonderful book, we have found frameworks and methods that are extremely relevant and helpful in our efforts to structure our open innovation. We are beginning to use Corporate Startup tools and methods to better qualify investment decisions, as well as secure continued board-level understanding and buy-in to the strategy.

Ole Madsen, Senior Vice President at Spar Nord Bank.

The 21st century organization, we're told, needs to be innovative, creative and customer centered. That's all very well if you're a disruptive startup. But what if you're an established organization based on 20th century principles of Taylorism? How do you make your big company as innovative as a small startup? If you want practical advice from people who have been there and done that, there's no better source than this book. Reading this book is like shadowing the authors on a consulting assignment as they coach you on what works and what doesn't.

David Travis, User Experience Consultant and Managing Director of Userfocus.

The authors have clearly spent time in the trenches helping big and small companies transform through applying lean startup principles. This book is full of insightful nuggets you immediately grasp and a simple yet effective framework you can start implementing right away.

Justin Coetsee, Co-Founder at Ignitor.

In this remarkable book, the authors challenge us to take the 'Red Pill' of sustainable innovation: a system of frameworks that work together to generate superior results. If you want to keep yourself in the black, take the authors' 'Red Pill' and follow their advice.

Luke Hohmann, Founder/CEO at Conteneo and Author of *Innovation Games*.

Lean thinking for business and product development requires the practitioner to strip away misconceptions about how an idea becomes a successful new business. It requires a 're-training' of the brain to suppress those misconceptions and focus on the fastest path to testing the assumptions held about the customer's needs. This book is your 're-training' manual.

Peter Pascale, Vice President of Product Management at Pearson VUE.

Established companies need to innovate or risk losing market share. This book provides a great playbook that managers can use to learn about lean startup methods and apply them within their company. It is a must read for any executive thinking about creating an innovation ecosystem within their business.

Klaus Wagner, CEO at Josera Petfood GmbH & Co. KG.

We have found the Corporate Startup model and the thoughts on the innovation ecosystem very useful in designing our innovation strategy. This book is a must read for all corporate leaders that want to transform their companies to be more innovative.

Erik Kongsvik-Ibsen, Vice President of Strategy and Business Development at Egmont.

The Corporate Startup bridges two worlds that are normally regarded to be quite the opposite. Corporations can learn a lot about startup methodologies and how they apply to their organizations from reading this book. Startup founders should also read it to understand the challenges that large companies face and how to better collaborate with them. I highly recommend this book.

Rune Theill, Co-Founder and CEO at Rockstart Accelerator.

I believe the next wave of entrepreneurship and innovation will belong to the established corporation. *The Corporate Startup* provides a structured and practical approach to help companies make their new business model building machine a reality.

Dr Marc Sniukas, Author of *The Art of Opportunity*.

A book crammed full of real examples and pragmatic (not dogmatic) frameworks for bringing entrepreneurship to corporate dinosaurs. A must read.

Tristan Kromer, Founder at Kromatic and Editor of *The Real Startup Book*.

Tendayi, Dan and Esther are some of the most knowledgeable and engaging members in the startup and corporate innovation community. Not only is their personal knowledge and experience very valuable, I've experienced them to generate profound impact through their engagement with several of our, and others' grassroots initiatives. This book allows anyone in the intrapreneurship field to access that knowledge and create the same impact.

Leon Pals, Chairman at Startup Foundation.

As the role of corporate innovator seems to be getting more complex, what else to wish for than a roadmap that makes things simple and clear? Tendayi and Dan have done a wonderful job creating exactly such a roadmap with this book, and I'm sure it will support you in getting to your goals, faster.

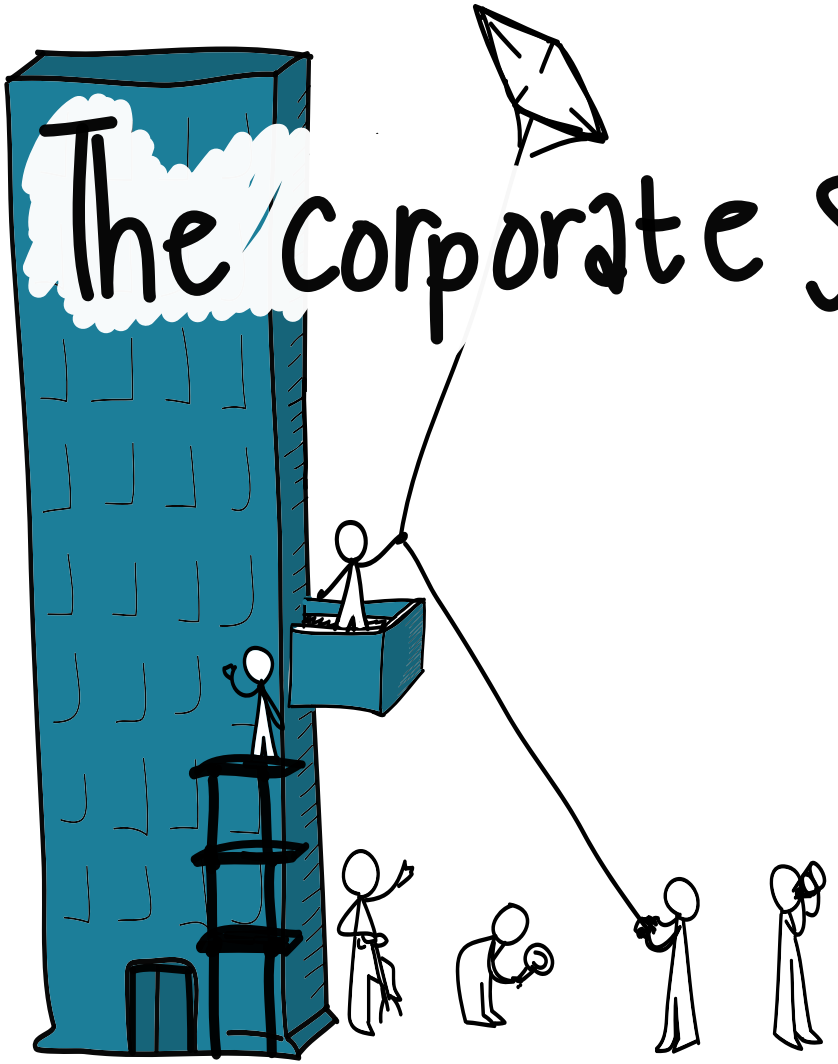
Hans Balmaekers, Director at Intrapreneurship Conference.

This wonderful book helps companies apply practical and innovative business model development methods using new ways of collaboration, based on an ecosystems approach. *The Corporate Startup* provides a great way of implementing innovation practices for companies to cope in today's hectic and ever changing world.

Corine van Winden, CEO at Global Pets Community.

In my experience the biggest topic that is not covered well for large corporations is the art of managing the innovation process and output. *The Corporate Startup* provides a concrete framework to manage innovation at the strategy, management and practice levels. It connects the topics you likely know such as business model design and lean startup to the bigger corporate picture.

Bob Jansen, Founder at Firmhouse.



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For Elizabeth, Jacob,
Eli and Ben. My reasons.

Tendayi Viki

For having a compass.

Dan Toma

For Anniko and Aaron.
For their future.

Esther Gons

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PART 2

PRACTICE

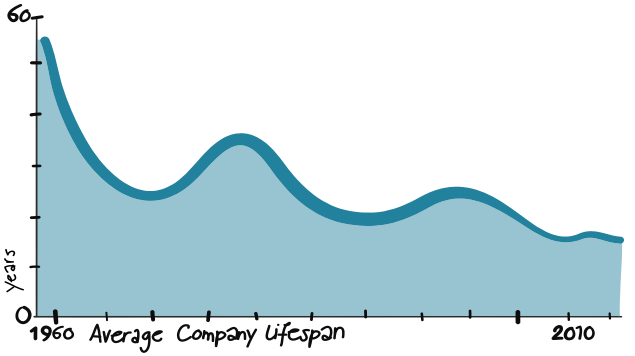
‘The basic problem confronting an organization is to engage in sufficient exploitation to ensure its current viability and, at the same time, devote enough energy to exploration to ensure its future viability.’

James G. March, Stanford Professor

Innovation Paradox

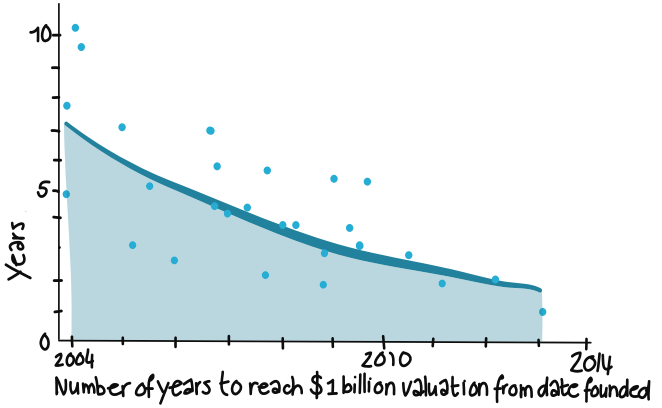
In 2015, Microsoft got some of its groove back[1]. But earlier that same year, Microsoft reported its largest-ever quarterly net loss. The loss was the result of a $7.5 billion writedown from the purchase of Nokia's handset unit[2]. The writedown was viewed as another example of Microsoft's struggles in the smartphone business. Nokia's own smartphone struggles are a parallel business story that provides powerful lessons about corporate innovation. It seems that successful established companies often get trapped by their previous success in a manner that limits their capacity to innovate.

We are living in an era where innovation is imperative. It is undeniable that the world around us is changing. Technology and software have transformed business, and continue to do so in more and more dramatic ways. Corporate leadership would have to be in a special kind of denial to overlook how these changes are impacting their businesses. Keeping their heads in the sand is no longer an option. Corporate leaders have to respond. Innovation can no longer be viewed as a sideshow. It is now *the* way to do business in the 21st century and a key driver of sustainable growth.



Source: Foster, R. & Kaplan, S. (2011). *Creative Destruction.* New York City: Random House.

The challenge of having to respond to change is nothing new. As long ago as 1942, Joseph Schumpeter wrote about *Creative Destruction* as a process that refreshes economies by injecting new blood in the form of innovative new technologies and companies. What is remarkable about our time is the sheer pace of change in social trends, economic factors and technology[3]. The average lifespan of companies is getting shorter. At a churn rate of 75%, it is predicted that the entire S&P 500 index will be replaced by 2027[4]. We have also seen the emergence of startups that quickly become billion dollar companies such as Microsoft, eBay, Google, Amazon, Facebook, Twitter, Dropbox, Uber and Airbnb. Driven by technology, these companies have transformed traditional industries and business models.



Source: Deloitte Canada (2014). *Age of Disruption: Are Canadian firms prepared?*[5]

The Disadvantage of Incumbency

In contrast, traditional long-standing companies appear to be struggling. It seems that being an already successful company can be the Achilles' heel for innovation. In 2007, when Steve Jobs introduced the first iPhone at MacWorld, Steve Ballmer who was then the CEO of Microsoft, was not that impressed. He mockingly declared that:

"There's is no chance that the iPhone is going to get any significant market share. No chance!" [6]

Fast forward to 2014. In an interview with Charlie Rose, Steve Ballmer admitted that one of his greatest regrets from his time as CEO of Microsoft, was not getting in early on the mobile phone hardware business. When Charlie Rose asks Ballmer why Microsoft did not move into the phone business, Ballmer's response is telling:

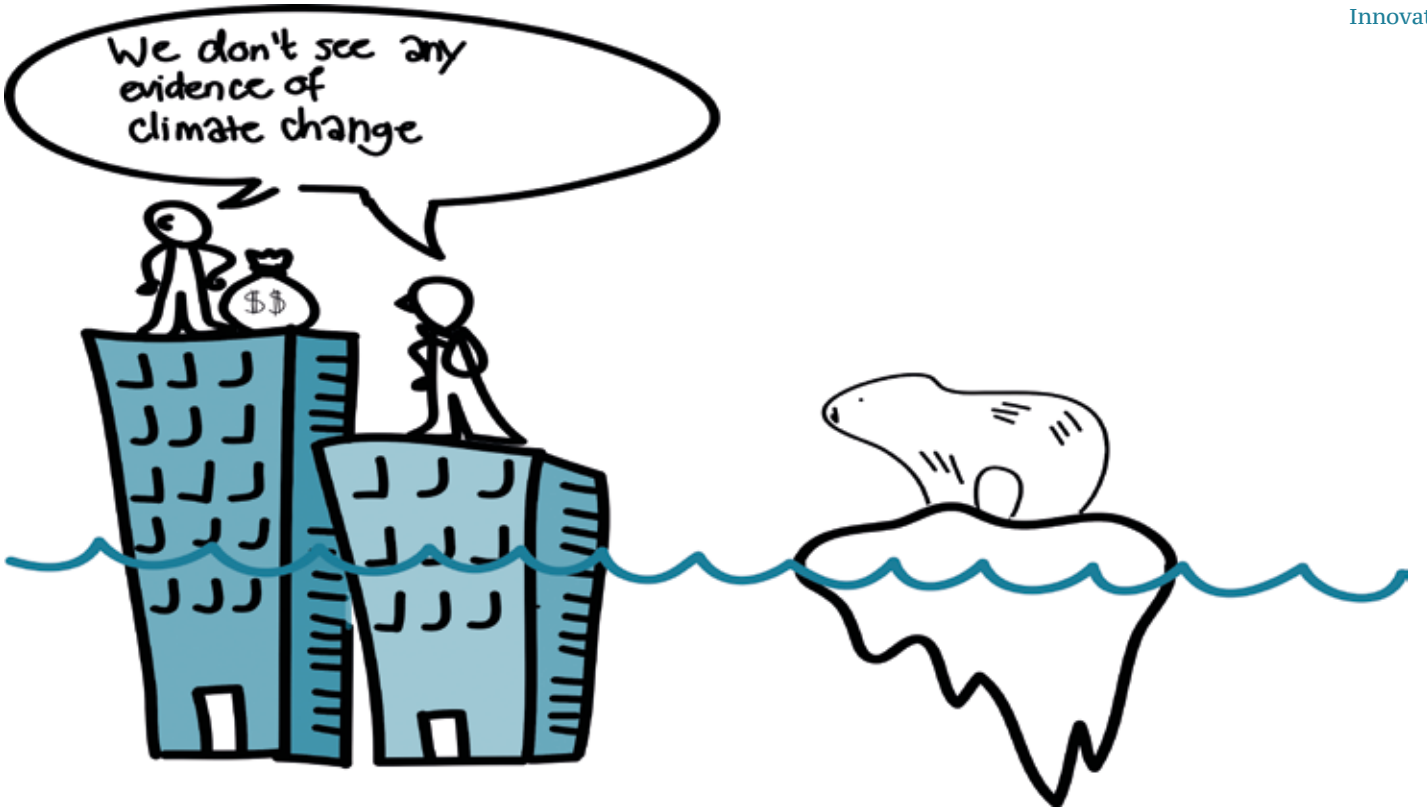
"When the name of your company is Microsoft and your formula works...
Our formula was working, we were software guys...
So for us it was kind of like a religious transformation." [7]

Nokia was going through its own religious transformation. At one point it was the largest mobile phone company in the world, with more than 50% of the global market share. But Nokia lost in the smartphone battles so badly that by the time Microsoft purchased its mobile phone unit in 2013, it only had 3% of the smartphone market[8]. In a candid interview with INSEAD Olli-Pekka Kallasvuo, the former CEO of Nokia, admitted that:

"It is sometimes difficult in a big successful organization to have the sense of urgency and hunger. No company can defend only. If you have a high market share and you are a market leader, if you start defending you cannot sustain." [9]

Nokia's poor response to the emergence of smartphones is closely connected to Microsoft's historic quarterly net loss. But these two companies were not alone in underestimating the potential disruption that would be caused by smartphones. A similar misjudgment was made by Garmin's CEO Min Kao. During an interview with Forbes in the summer of 2003, he dismissed mobile phones as a commodity business that he would like to avoid[10]. However, as smartphones have gotten better and smarter, Garmin have had to adapt their business model. There is some irony in the fact that Garmin now builds apps for the iPhone and Android.

The comforts of incumbency can indeed be a disadvantage. Leadership teams in successful companies can become 'climate change deniers'. That is to say, they can see the changes happening in the business world, but deny their relevance to the company. This denial is most intractable when the weather is good. In most successful large companies, the focus is on the high revenue



- high profit cash cow products. If the company is currently making large profits from these products, then the hubris that comes with that success can create blind spots. For publicly traded companies, there is further pressure on executives to meet short-term market expectations for returns.

Nokia's former CEO remarks that established companies can only change when they have a charismatic leader or a crisis. We respectfully disagree with this notion. By the time a crisis or a charismatic leader arrives it is often too late to respond. We instead agree with Schumpeter that even in the process of creative destruction, there is always a chance for companies that would otherwise perish to weather the storm and live on "*vigorously and usefully*"[11]. In other words, death is not inevitable. Companies that are able to respond to change can survive and thrive.

Using The Right Lens

In order to survive and thrive, however, established companies have to become clear-eyed about the challenges they are facing. Historically, management teaching has tended to focus on strategy as a method for finding long term competitive advantages. Once a competitive advantage has been found, it becomes the job of managers to devote their energy to protecting it, through good financial management and operational excellence. In contrast, contemporary management thinking recognizes that the idea of a stable and long term competitive advantage is a fallacy. Companies should be managed to quickly exploit current competitive advantages and move on to the next advantage[12].

In order to do this, companies need to use the right management frameworks. It is too simplistic to advise established companies to act like startups. Large companies are not

startups, nor should they strive to be. Most established companies we work with complain that the expectation of acting like a startup is unrealistic given that their day-to-day work involves running an already successful and profitable business. Startups can generally focus on one idea without the legacy of an older business. This is the perennial challenge that has always faced established companies; how to engage in sufficient *exploitation* to ensure current viability, while devoting enough energy to *exploration* to ensure future viability[13].

It is important to realize that, even as entrepreneurs have become rockstars, startups still fail a lot. When examined over a period of three or more years, nine out of ten startups fail[14]. Among the entrepreneurs who do succeed, over 90% do so in a business that is different from what they originally planned to do[15]. Most founders rarely get it right at the beginning and have to iterate and pivot their way to success[16]. The Lean Startup movement arose from a need for startups to stop failing so much. The clear message is that being a startup is not about painting colorful walls, using sticky notes, buying bean-bags and setting up foosball tables. In its essence, entrepreneurship is management. And so is innovation!

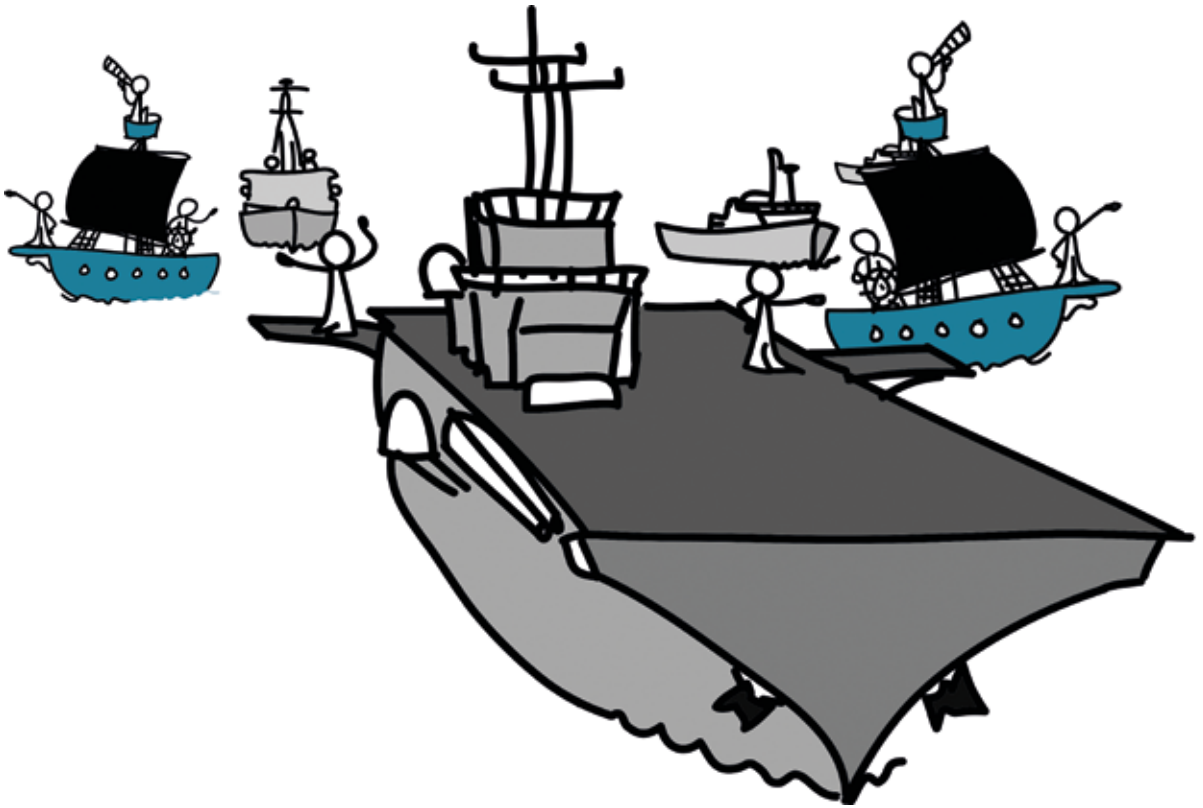
In one of the great management insights of the 21st century, Steve Blank distinguished *searching* versus *executing* as the key differences between startups and large companies[17]. A startup is a temporary organization whose goal is to *search* for a sustainable and profitable business model. On the other hand, an established company mostly *executes* on a known business model that addresses the known needs of known market segments. This distinction is a powerful metaphor for startups to know where they are on their journey. But for established companies to innovate successfully they have to figure out a way to be *searching while they are executing*. Corporate innovation is a war that is fought on two fronts.

As such, large companies need to stop thinking and acting as if they are single monolithic organizations with one business model. Instead, large companies should take an ecosystem approach to their businesses. Every contemporary company has to be a balanced mix of established cash cow products and new products that are currently searching for profitable business models. This *innovation portfolio*, and the products within it, has to be managed appropriately. The right management tools have to be applied depending on where products are on their innovation journey.


Search
Execute

The management practices for creating new products are different from the practices for managing already successful products. Executing on known business models can mostly be managed using traditional accounting methods, cost optimizations and operational effectiveness. Success can be measured using traditional metrics such as profit, return on investment (ROI), accounting rate of return (ARR) and net present value (NPV). In contrast, searching has to be managed using startup methodologies such as design thinking, customer development and experimentation. Success is measured by examining how well the innovation teams are doing in their search for profitable business models (i.e. innovation accounting).

This capacity to *search while executing* is the hallmark of the ambidextrous organization[18]. It is not simply a choice between being in the navy or being a pirate, as Steve Jobs put it. Established companies have to develop processes that allow their innovators to become *pirates in the navy.* This is the innovation paradox.



What Is This Book About?

In this book, we address the questions that underlie the innovation paradox:

- What are the principles for developing a corporate innovation ecosystem?
- If established companies are set up to execute on known business models, then how can they develop startup practices within the same organization?
- What is the role of strategy and how can companies develop and apply an innovation thesis?
- What are the best frameworks to use for innovation portfolio management?
- How can large companies manage their investments in innovation in a manner that is similar to modern startup ecosystems?
- What are the right metrics and KPIs to track for different types of innovation?
- In what ways can large enterprises apply modern startup methodologies such as *Lean Startup, Business Model Design, Customer Development* and *Design Thinking*?
- How can companies begin creating their innovation ecosystems right away?

There are several complexities involved in the innovation process. *The Corporate Startup* provides the principles, methods and tools that companies can use to manage and benefit from these complexities. Each chapter in this book will be focused on the principles and practices of corporate innovation. How these principles and practices come together will be illustrated by examples, innovation activities and case studies. The book has two main parts. Part I outlines the five core principles that established companies can use to build their innovation ecosystems. Part II focuses on how these ecosystems are brought to life through innovation practice.

Is This Book For You?

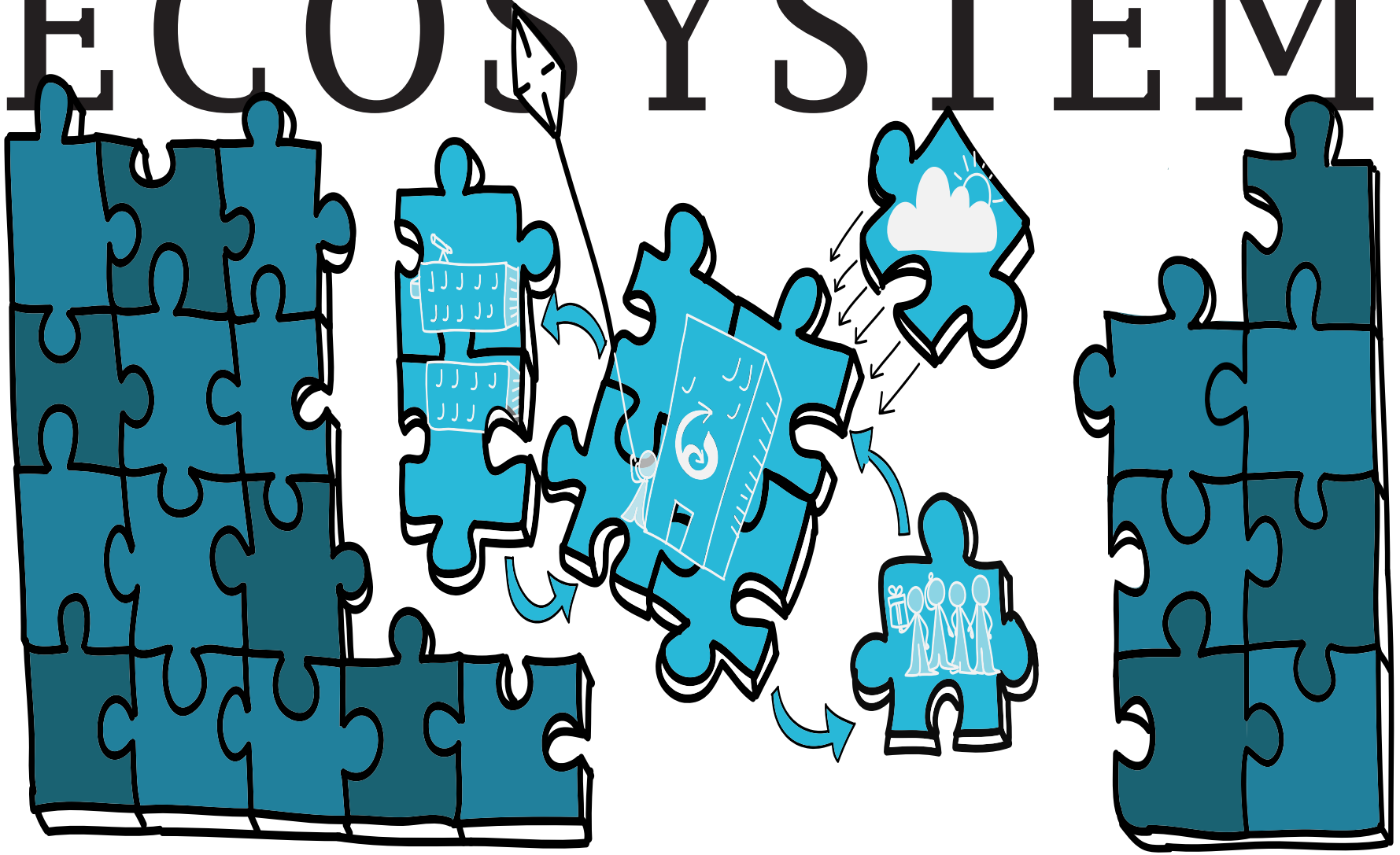
This book is about developing, managing and sustaining innovation within established companies. The book is mainly targeted at large and medium-sized organizations, although the insights can be useful for small companies and startups too. If you fall into any of the following categories, this book is definitely a must-read for you:

- An executive in an established company that is looking to spark growth through innovation.
- An intrapreneur, innovation manager, product owner or employee looking to apply modern startup methodologies in an established company but facing challenges in terms of where to start and how to do it.
- A management consultant working with established companies to help them with innovation.
- An entrepreneur looking to 'pivot' your career to the enterprise in your quest for even greater challenges, but not knowing what to expect, what challenges you would face in the corporate world and how to manage them.
- A lean innovation and customer development enthusiast and/or practitioner, looking to learn how these methodologies can be implemented within large and medium-sized companies.

Our hope is that, after reading this book, managers and employees will have the knowledge and tools necessary to manage innovation within established companies.

PART 1

ECOSYSTEM



ECOSYSTEM

[ek-oh-sis-tuh m, ee-koh-]

A system, or a group of interconnected elements, formed by the interaction of a community of organisms with their environment.
Any system or network of inter-connecting and interacting parts, as in a business.[19]

In order to succeed at innovation, established companies do not have to act like startups. Every startup's aspiration is to become a successful company! So, abandoning business model execution practices and applying searching methods on an already successful business model is a form of waste. We strongly believe that operational excellence is still an important management practice, even in times of rampant disruption. Our cash cow products are how we get the money to invest in innovation.

The challenge comes when companies act as if they are single institutions with a single business model. If they view themselves this way, then the false choice of acting or not acting like a startup becomes 'real'. The best way to innovate is for a large company to view itself as an *innovation ecosystem* with various products, services and business models. A company can then apply the right management tools to products that have validated business models versus those that are still in search mode.

This is how a company becomes an ambidextrous organization that is, in practice, excellent at both *searching* and *executing*. The chapters in this section describe the core principles for building innovation ecosystems.

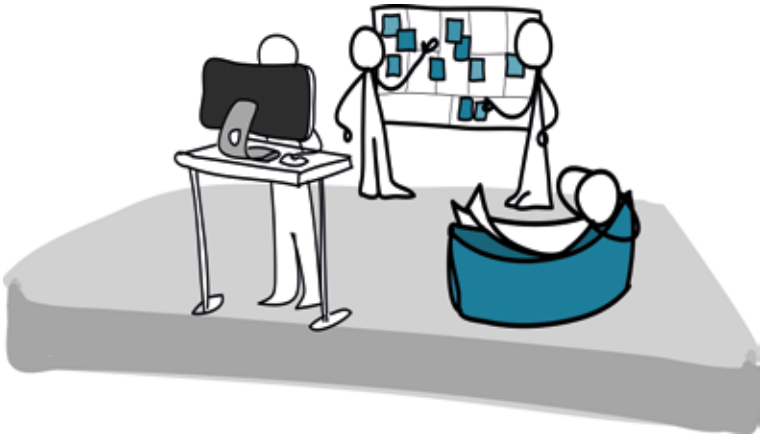
‘Innovation has nothing to do with how many R&D dollars you have… It’s about the people you have, how you’re led and how much you get it.’

Steve Jobs, Founder and former CEO of Apple

CHAPTER ONE

Innovation Ecosystem

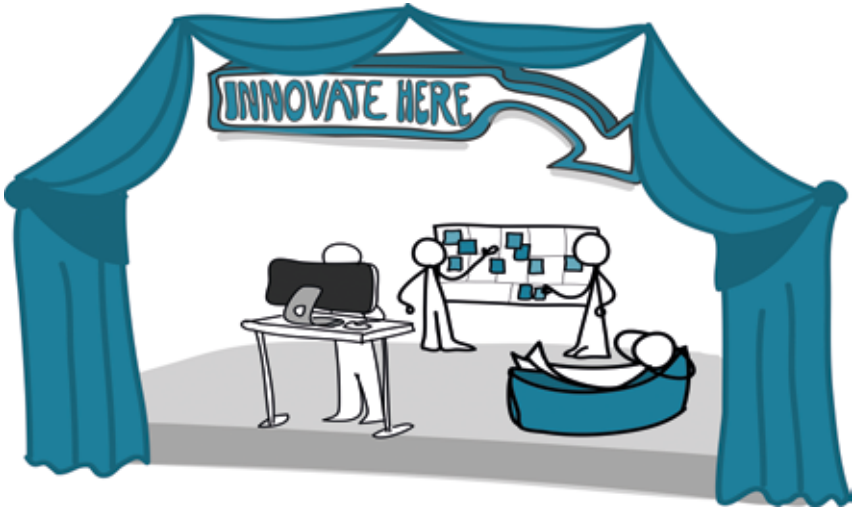
Most senior executives can relate. It usually starts with some startup types within the company telling them scary stories about how startups are coming to eat their lunch. Look at Facebook, Uber, Twitter and Airbnb! Oh, look what happened to Blockbuster, don't let that happen here. Do you know Nokia used to be the largest mobile phone company in the world? Now look at them! We need to innovate like startups! We need to set up an incubator, an accelerator and put more money into R&D.



While there is often agreement that there should be more investment in innovation, the debate is always about where and how those investments should be made. Depending on who they talk to, corporate leaders will often get conflicting advice. Should innovation units be physically separated from the main business, or can innovation be managed within the same company? This is a sensible discussion to have. But much of the advice that leaders get is filled with polemics.

Each side takes an extreme view. One commonly cited problem is that traditional managers with MBAs are too stuck in their ways to understand innovation. These managers are also incentivized to behave in a manner that stifles innovation. People cannot get any innovation done within a company that expects a thirty page business case before it funds any idea. Ultimately, such a company will always invest in sure bets; which means that the company always works on the same types of products.

This is indeed a challenge. But it is equally true that setting up separate innovation labs does not guarantee that any successful products will emerge from there. For the most part these are places where *innovation theater* takes place. Look-a-here! We are doing lean startup, design thinking, customer development, business model canvas and minimum viable products... Sure. Whatever. None of these techniques in themselves represent innovation. The ultimate measure of success is the development of new products with sustainably profitable business models.

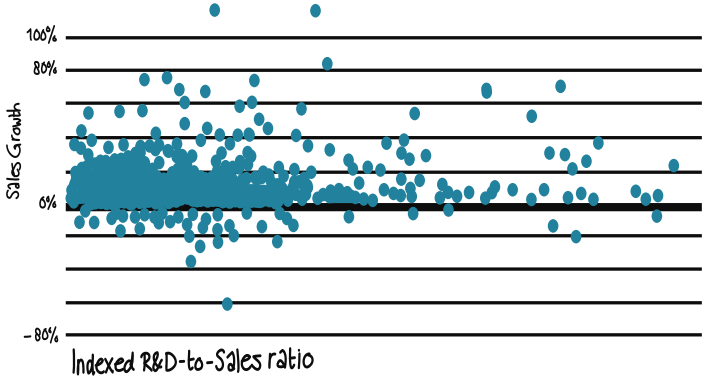


Why Innovation Fails

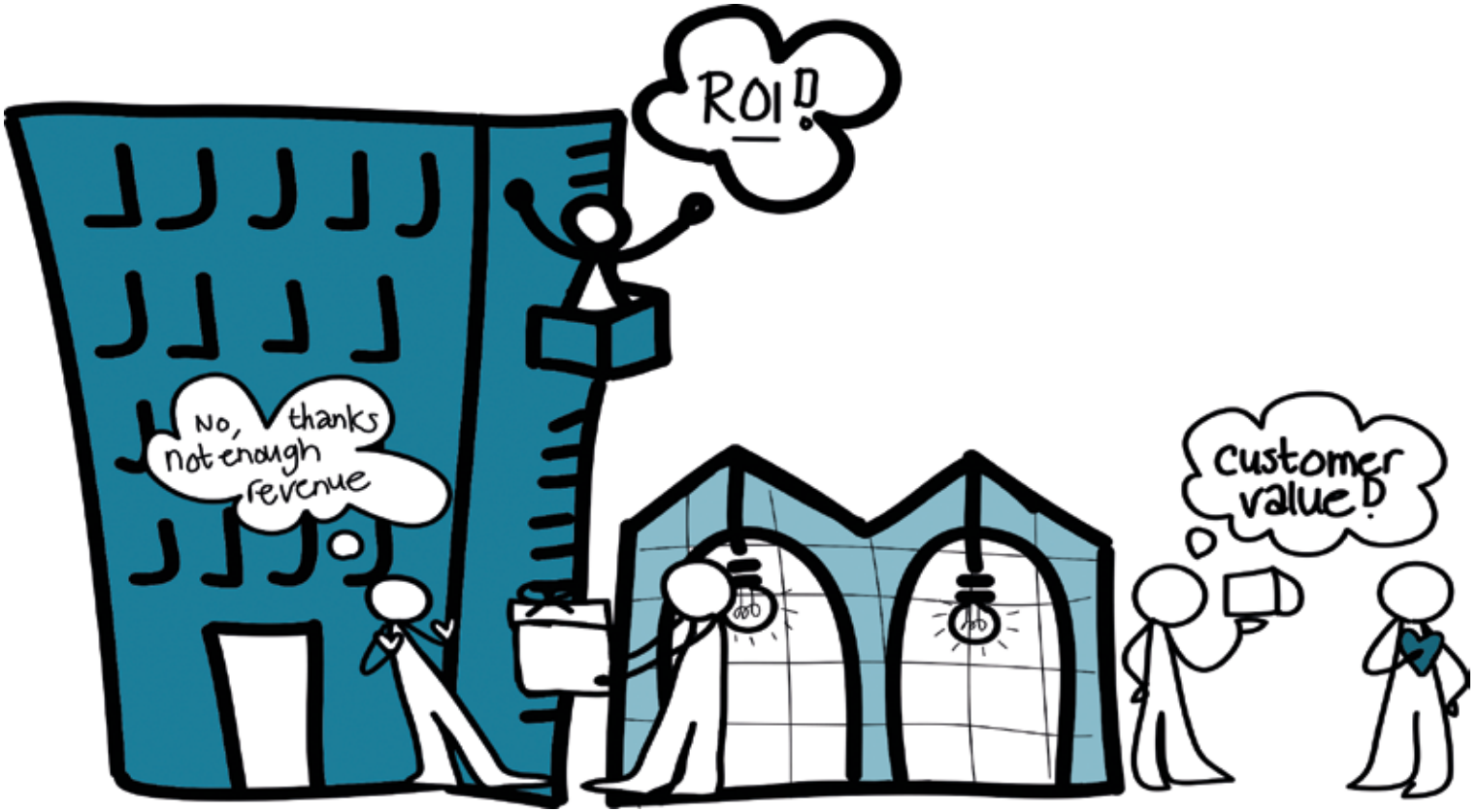
Such polemical debates fail to get at the core of why innovation in established companies succeeds or fails. Ultimately, *innovation* fails when a large company decides to use the same processes it uses to manage its core products to manage its innovation projects. Business planning does not work for innovation. All estimates of ROI, NPV and ARR are fiction. Investments based on such numbers are usually bets made on faith. As already noted, this approach also encourages managers to develop a tendency to invest in 'surebet' products for current markets.

The feeling is that by creating innovation labs, managers can separate innovators from the toxic environment within the company. But these labs fail because companies do not build any management processes around them, allowing innovators to work on whatever they want. There is a common tendency to conflate creativity with innovation[20]. Management sees successful startups coming up with great new products and this motivates managers to pursue the development of similarly cool new shiny products via R&D labs, incubators and accelerators. But creating great new products is *not* innovation.

The investments that are spent on innovation labs often generate poor returns. Strategy & Business, a unit within PricewaterhouseCoopers, has been publishing an annual report of the top 1000 most innovative companies in the world for over twelve years. In that time, they have found that there is no statistically significant relationship between R&D spending and sustained financial performance[21]. This finding applies to total R&D spend, as well as R&D spending as a percentage of revenues[22]. Spending on R&D is not related to growth in sales or profits, increases in market capitalization or shareholder returns[23]. In every annual report that Strategy & Business have published, the top 10 innovative companies are often not the top 10 spenders on R&D.



Source: Strategy+Business. The Global Innovation 1000: http://www.strategyand.pwc.com/innovation1000



What R&D spending seems to generate is an increase in the number of patents held by a company. However, the number of patents held is not the same as innovation. The US patent office is filled with thousands of patents that have never achieved commercial success. Only a few products from corporate innovation labs will have validated business models, or any alignment with the company's strategic vision. We have seen successful innovators with great products that wither on the vine because there are no managers in the company willing to pick up the products and take them to scale. These products become orphans that are eventually abandoned, thus creating a discouraging and uninspiring environment for future innovators.

We have learned that companies need to put a great process in place in order to manage innovation. Without a clear process, innovators will not get the right level of support. It is hard to succeed when innovation is run as a covert operation that flies under the radar of executives. In that situation, there are often no clear exit criteria for the integration of innovative new products into the main business. There are also no clear career paths for employees working in innovation labs. The truth is that, no matter what you do or where you start, innovative products will always need someone from the main business to make a decision about their future. How those people view the new innovations will ultimately determine those products' mortality rates.

A Corporate Startup Definition Of Innovation

A good place to start developing a management process is by providing a clear definition of what innovation is. Innovation is often simply defined as a novel creation that produces value[24]. From our perspective, the concept of innovation as distinct from creativity involves three important steps. The first step involves the novel and creative ideas that are generated through various methods that trigger insights. The second step is ensuring that our ideas create value for customers and meet their needs. The final step involves finding a sustainable business model. This part of the journey involves ensuring that we can create and deliver value to customers in a way that is sustainably profitable.

These steps make clear that it is the combination of *great new ideas* and *profitable business models* that defines successful innovation. As such, our corporate startup definition of innovation is:

The creation of *new* products and services that deliver *value* to customers, in a manner that is supported by a *sustainable* and *profitable* business model.

This definition lays bare what the role of innovation in any organization should be. It is not to simply create new products and services. New products may be part of the equation but the ultimate outputs of innovation are sustainable business models. A business model is sustainable when our novel creations deliver value to customers (i.e. when we are making stuff people want); and when we are able to create and deliver this value profitably (i.e. we are making some money). Without these two elements, a new product cannot be considered an innovation. It is simply a cool new product. It might be the coolest thing since sliced bread - the most creative product ever made - but if it doesn't deliver value to customers and bring in profits, it is *not* innovation.

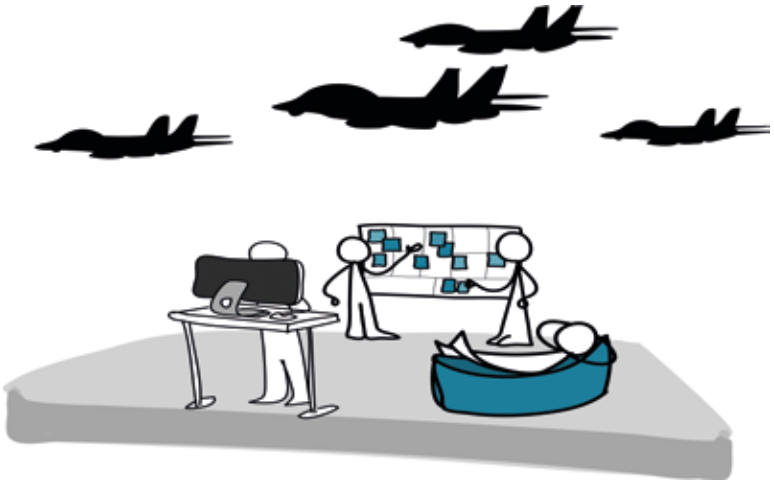
Our definition of innovation also provides us with a clear job description for corporate innovators. *Your job is to help your company make money by making products that people want*. The sweet spot is when your creativity meets customer needs and you can make money from serving those needs. It is also important to clarify that not all forms of innovation will be focused on new products or services. It is possible to innovate around internal business processes that are not directly experienced by customers. This form of innovation is not an explicit focus of this book. But, even for these forms of innovation, the delivery of sustainable value is still an important principle.

Red Pill - Blue Pill

From the definition above, it is clear that the only indisputable fact is that innovation should be managed via different processes to those that are used to manage core products. How these processes are instantiated depends on the company, how much management buy-in you have and the innovators' appetite for corporate politics. Sometimes it can be very clear that you will never get full executive endorsement for innovation. The executives are too focused on cash cow products and the best you can hope for is support from a handful of visionary leaders within your business. In these cases, innovators might consider leaving the company for greener pastures.

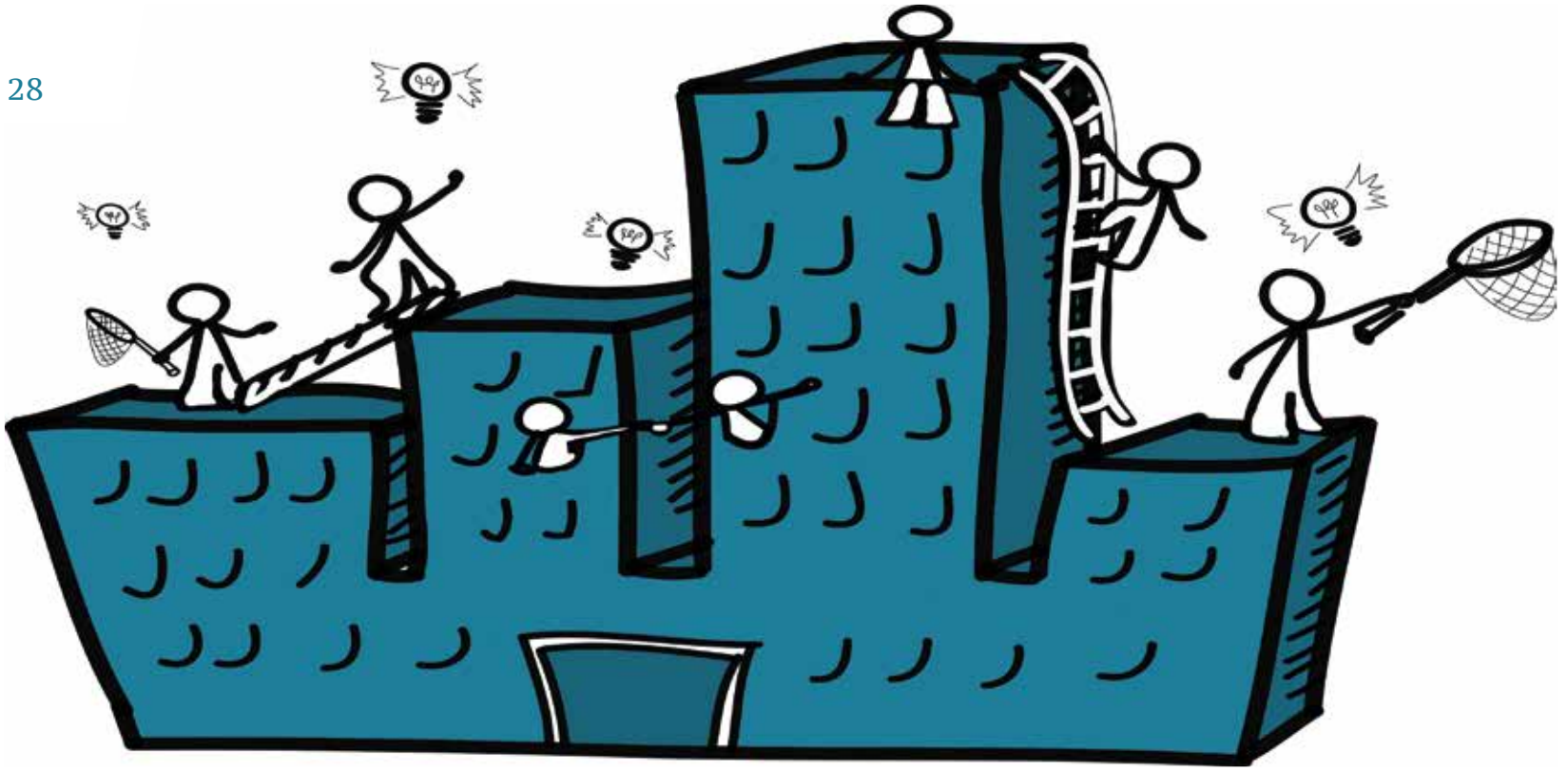
Alternatively, innovators can start a guerilla movement. A corporate innovation insurgency, so to speak. Tristan Kromer[25], who is a great innovation ecosystem designer, has two recommendations on how innovation ecosystem designers could manage such a movement. First, Tristan suggests that innovators should *lower the costs of innovation*. If they do this successfully, then they will hardly ever need high level budget approvals. The lean startup, design thinking and customer development toolbox provides great methods for lowering the costs of innovation.

Every now and again, innovators will need to surface within the company in order to get investment for their ideas to be taken to scale. It is also possible that things will get to the point where the costs of innovation can no longer be kept low. For this, Tristan recommends that innovation teams find *diplomats*. These are individuals who will do the hard work of corporate politics and smoothing the path for innovation projects. A diplomat is usually someone who is well-connected and respected in the business, who can work outside of normal bureaucratic channels to call in favors and get things done. Without a diplomat, most guerilla projects are dead on arrival.



Guerilla movements have been known to succeed, sometimes. Nevertheless, this is our least favored method. We have found that guerilla movements are too difficult. Teams are always watching their backs for unexpected impediments to their work. And if they lose their management sponsor or diplomat, then their innovation efforts are easily placed in jeopardy. So while guerilla tactics can work, they also have a really high mortality rate for product ideas. This is the reason we favor a *full frontal assault* on the company to change its ways of working.

With a full frontal assault, innovators tackle the hard questions upfront. Long-term sustainable innovation is only possible within a supportive ecosystem. As such, it is important to get top level executive and middle manager buy-in. This *aircover* will help in future situations when there is need for support and resources. Regardless of whether the innovation lab is external or part of an internal process, strategic alignment is key. Innovation ecosystems can only be created when we do the hard work of changing and adapting the company's capabilities to ensure that they fully support our chosen innovation approach. The principles for building this innovation ecosystem are the focus of this book.



The Five Principles of a Corporate Innovation Ecosystem

Successful innovation necessitates interactions among multiple actors from multiple parts of a company[26]. In the journey from ideation, product creation, first customer sales, growth and scale, multiple parts of the organization are inevitably involved in innovation. This is why organizational alignment around innovation is critical. Companies need to create an internal process that:

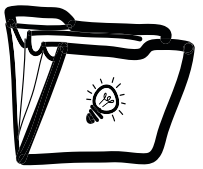
1. Facilitates the serendipity that creates sparks of creative ideation.
2. Captures and tests the outputs of this creative ideation.
3. Transforms ideas into successful products with profitable business models.

This means that organizations need to be designed to create and benefit from serendipity. The goal of this book is to articulate the principles that inform how organizations manage these innovation complexities. We strongly believe that *principles trump tactics*. It is, ultimately, up to each organization to adapt these principles and apply them to its business, strategic goals and context. The five principles for building corporate innovation ecosystems are as follows:

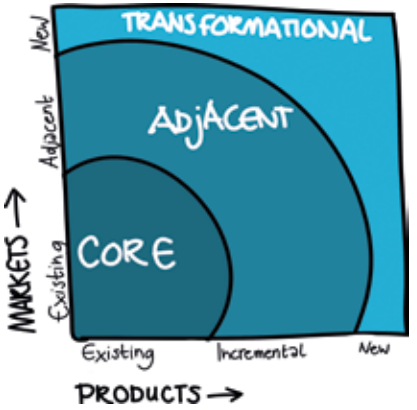
INNOVATION THESIS

We believe that innovation must be part of, and aligned with, the overall strategic goals of the company. This is important when it comes to later transitioning innovation projects into the core product portfolio. Just like venture capital investors have investment theses that specify the types of startups and markets they invest in[27], every large company must have an innovation thesis. An innovation thesis clearly sets out a company's view of the future and the strategic objectives of innovation. For example, an established software company can take the view that driverless cars are the future and they want to get in that market early. Their innovation thesis will be that they invest mostly in new ideas that bet on that future (i.e. software products for driverless vehicles). In this regard, an innovation thesis sets the boundaries or guard rails concerning the innovation projects the company will or will not consider. In addition to this deliberate strategy, the company must also use its innovation process as a source of emergent strategy that is responsive to changes in the market.

INNOVATION PORTFOLIO

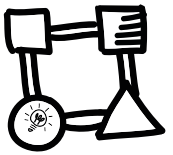


To achieve its innovation thesis and strategic goals, an established company should then set itself up as a portfolio of products and services. This portfolio should contain products that cover the whole spectrum of innovation; i.e. those that can be classed as *core*, *adjacent* and *transformational*. The portfolio should have early stage products, as well as mature and established products. A company may also consider having in its portfolio disruptive products that are aimed at lower-end or emerging markets. The goal is to have a balanced portfolio in which the company is managing various business models that are at different stages of their lives. The balance of the product portfolio should be an expression of the company's overall strategy and innovation thesis.

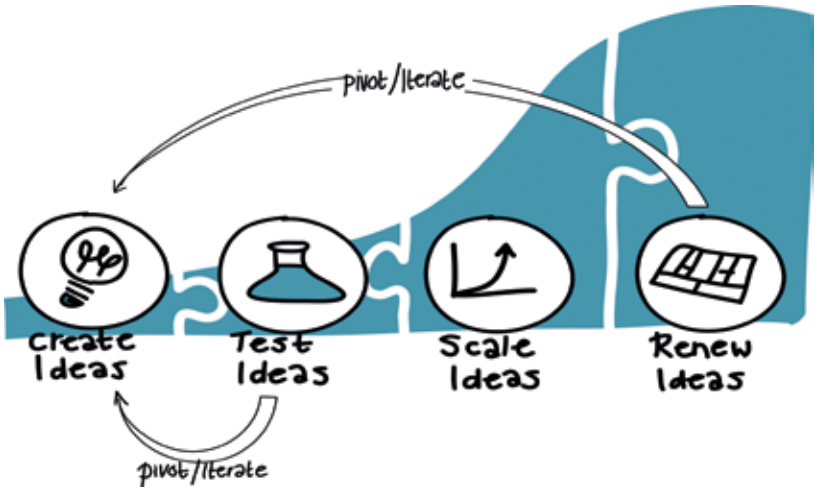


Source: Nagji, B. & Tuff, G. (2012).
'Managing your innovation portfolio.' *Harvard Business Review*, 90(5), 66-74.

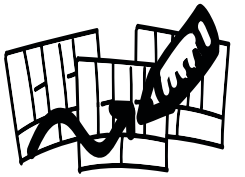
INNOVATION FRAMEWORK



In order to execute on its thesis and manage its portfolio of products and services, the company needs a framework for managing the journey from *searching* to *executing*. There are several examples of innovation frameworks; for example Ash Maurya's *Running Lean* framework[28] and Steve Blank's *Investment Readiness* model[29]. At Pearson, Tendayi has been part of a team that has developed the *Lean Product Lifecycle,* which is an award winning innovation management framework[30]. All these frameworks can be synthesized into the three simple steps for innovation; *creating ideas*, *testing ideas* and *scaling ideas*. Every now and again, a company may decide to refresh the business models of its existing products through *renewing ideas*. Having an innovation framework provides a unifying language for the business. Everybody knows what phase each product or business model is in. This then provides the basis for how a company can manage its investment decisions and product development practices.



INNOVATION ACCOUNTING

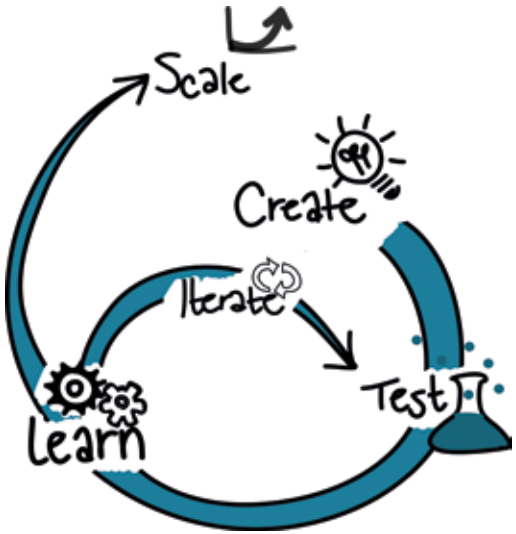


With an innovation framework in place, the company now needs to make sure they are using the right investment practices and metrics to measure success. Traditional accounting methods are great for managing core products. However, when managing innovation, different sets of tools are needed. We propose that companies should use incremental investing based on the innovation stage of their products. This approach is based on Dave McClure's Moneyball for Startups[31]. We also propose three sets of innovation KPIs that companies should be tracking:

- *Reporting KPIs* focus on product teams, the ideas they are generating, the experiments they are running and the progress they are making from ideation to scale (e.g. assumptions tested and validated).
- *Governance KPIs* focus on helping the company make informed investment decisions based on evidence and innovation stage (e.g. how close are the teams to finding product-market fit).
- *Global KPIs* focus on helping the company examine the overall performance of their investments in innovation in the context of the larger business (e.g. percent of revenue in the last three years).

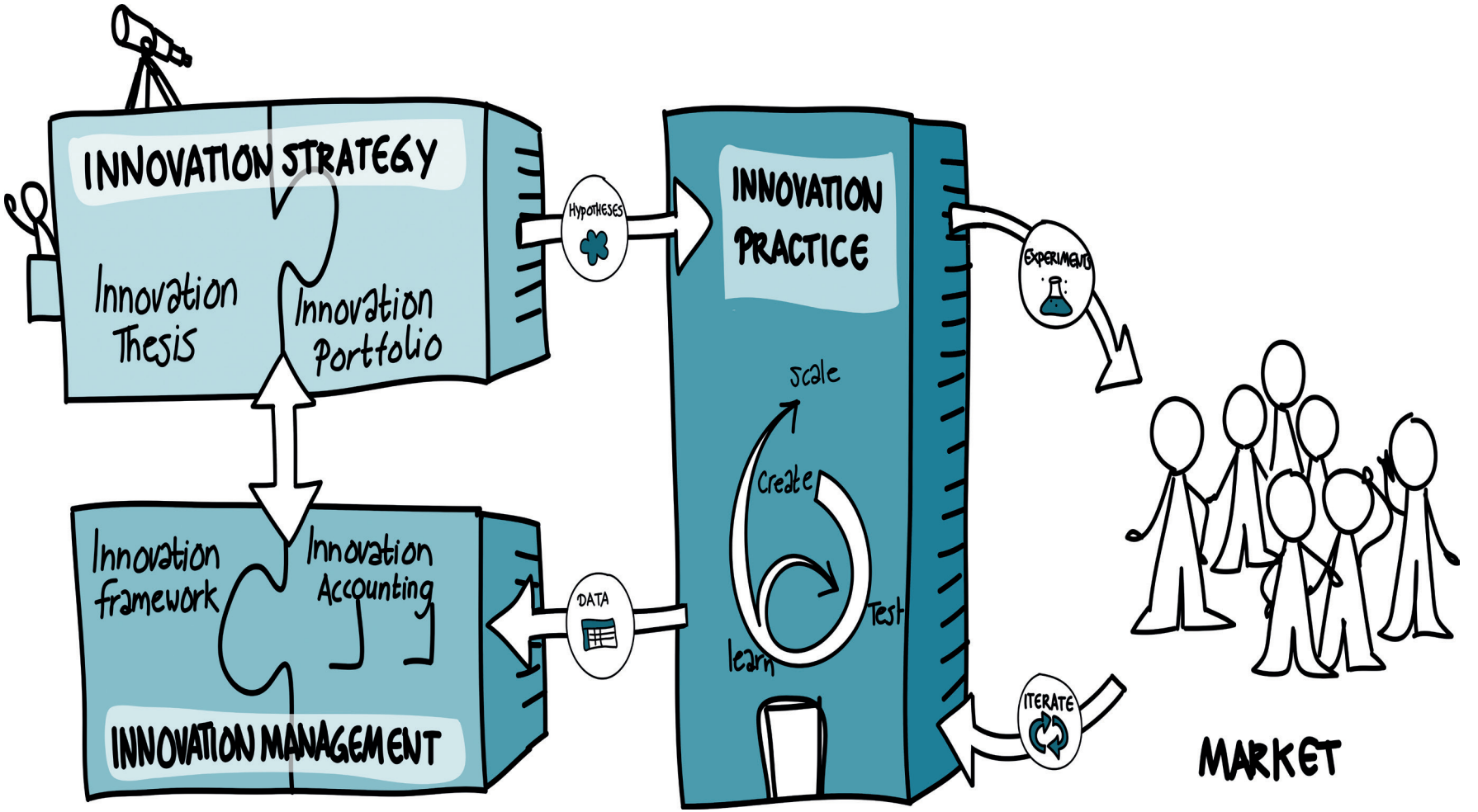
INNOVATION PRACTICE

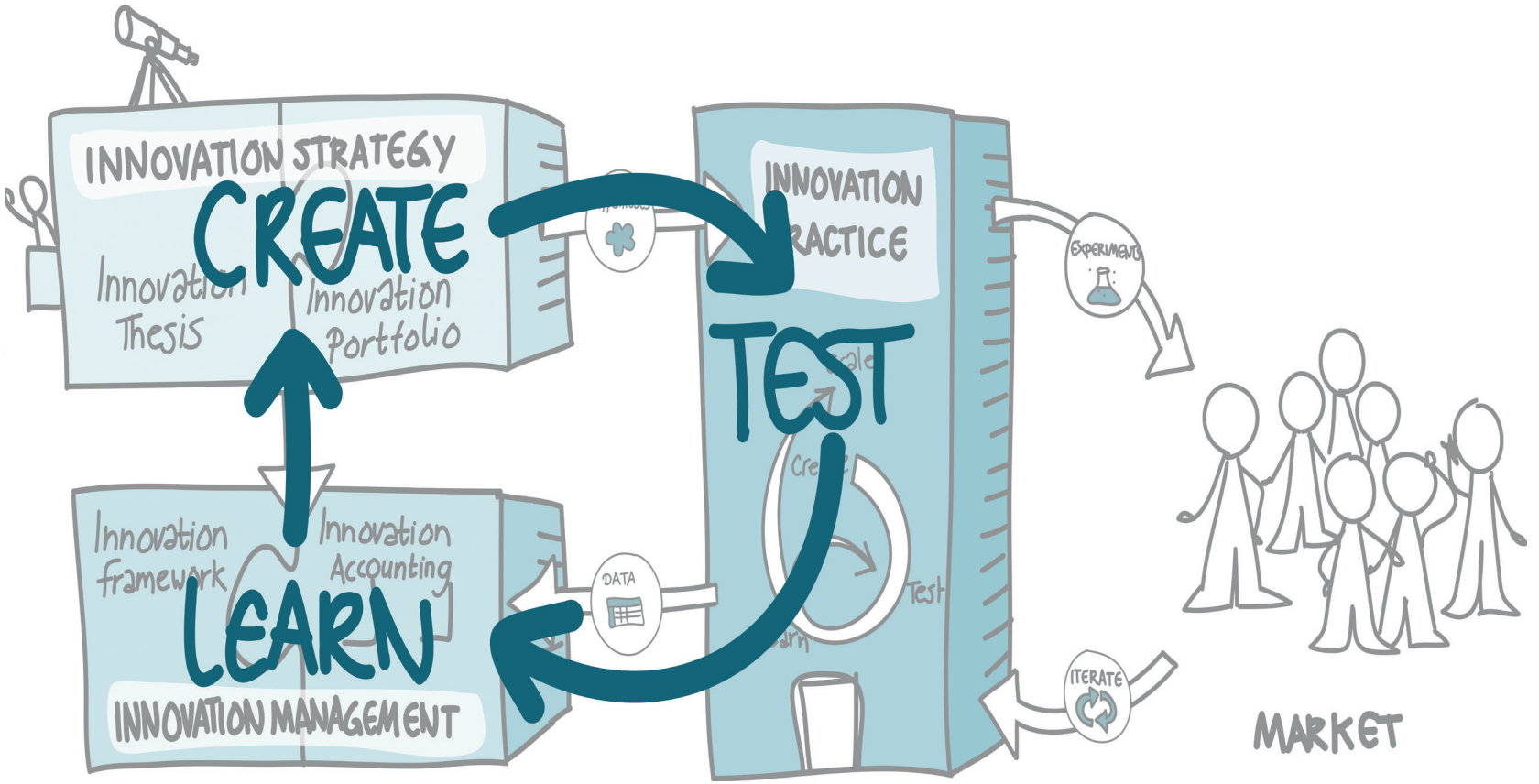
In addition to correctly managing investments in innovation, the way in which product teams develop their products has to be aligned to the innovation framework. Pearson's Lean Product Lifecycle[32] is accompanied by a great playbook that provides guidance to product teams as they search or execute on their business models. Adobe's Kickbox provides similar guidance, tools and resources[33]. The core principle for innovation practice is simply that no product can be taken to scale until it has a validated business model. As such, during the search phase the job of innovators is to validate their value hypotheses (i.e. does our product meet customer needs?) and their growth hypotheses (i.e. how will we grow revenues and customer numbers?). This process requires that teams validate both the attractiveness of the product to customers and the potential profitability of the business model. A key part of this innovation practice is the idea of a network or community. Companies have to create and support communities of practices that interact regularly and share lessons on best practice. This ensures that innovation skills are shared and developed as a human capability across the company.



These five principles combine to help create an innovation ecosystem. The first two principles (thesis and portfolio) focus on innovation strategy, the next two principles (framework and accounting) focus on innovation management and the last principle is where rubber meets the road and the company begins interacting with customers and validating business models. Most innovation labs have tended to just focus on this last part (innovation practice). But the truth is that without a supportive ecosystem in place, products coming out of innovation labs will have high mortality rates. This is why applying all five principles is important.

As you can see, these elements are interconnected; each representing a *create-test-learn* loop of its own. To the extent that strategy informs investment decisions, the success of these decisions in turn informs strategy. To the extent that investment decisions impact innovation practice, innovation practice produces learnings that inform investment decisions and, in-turn, inform strategy. This is an innovation ecosystem at work. Each interconnected piece is responding to data from the other pieces. Such a holistic approach allows companies to innovate like startups, without having to act like startups. We will now describe each principle in detail in the following chapters.


INNOVATION STRATEGY
Innovation Thesis
Innovation Portfolio
Hypotheses
INNOVATION PRACTICE
Scale
Create
Test
learn
Experiment
DATA
Innovation framework
Innovation Accounting
INNOVATION MANAGEMENT
ITERATE
MARKET


INNOVATION STRATEGY
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ITERATE
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CONVERSATIONS ON INNOVATION

Tristan Kromer

LEAN STARTUP COACH AND ADVISOR

Tristan Kromer is a thought leader in the lean innovation space. He coaches startups and intrapreneurs on adopting Lean Startup principles and putting them into practice. He has worked with companies as early stage as $0 revenue to larger enterprises with over $12 billion in revenue. Tristan is also an expert at developing innovation ecosystems within established companies. He has developed an innovation ecosystem model (a.k.a. 'the ecosystem sandwich'), which he uses as a framework when he advises and consults with companies.

CS: IN YOUR THINKING, WHAT IS AN INNOVATION ECOSYSTEM?

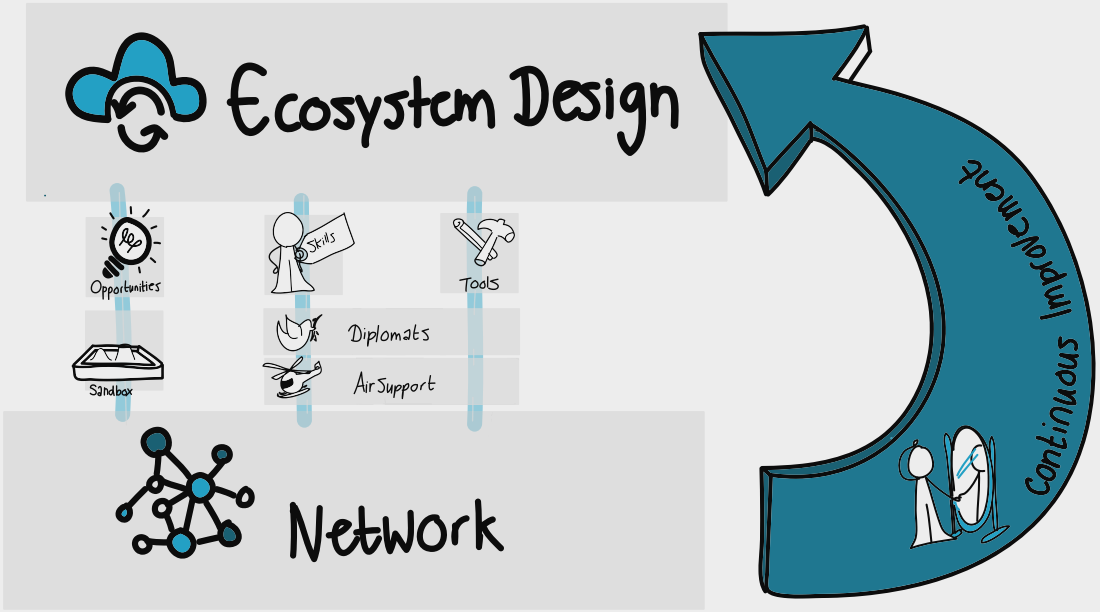
TK: An innovation ecosystem is to an innovator what the savannah is to a lion. It's the environment that intrapreneurs work within. The ecosystem is composed of individuals, organizations, and resources that generate new ways of creating value. Intrapreneurs and entrepreneurs rely on certain inputs in order to be able to create new business models and value streams. These inputs range from things like human capital (or skills) to tools (such as 3D printers) to financial capital and co-founders.

CS: WHY DO COMPANIES NEED TO CREATE AN ECOSYSTEM? ARE INDIVIDUAL CAPABILITIES NOT ENOUGH ON THEIR OWN?

TK: Individuals tend to move to the most favorable environment just as deer might abandon a drought stricken area. If a company can't create an innovative environment for intrapreneurs, they may quickly find the intrapreneurs have quit to build their own startups and only the bureaucrats are left. Then the company's pipeline of new products and revenue dries up completely! The goal of an innovation ecosystem is to have an equilibrium where innovation is a constant output and not fluctuating wildly or collapsing entirely.

CS: PLEASE TALK US THROUGH YOUR INNOVATION ECOSYSTEM MODEL AND HOW THE DIFFERENT ELEMENTS JOIN TOGETHER?

TK: In the middle of the 'sandwich' is where all the action is. There are a lot of specific elements here that allow us to manipulate a company's ecosystem. For example, if the company is lacking certain *Skills*, we can do skill training workshops. If the company is mired in red tape, we can provide *Tools* to help cut through that and expedite innovation processes.



The top and bottom hold the ecosystem together. At the top is the *Ecosystem Design* itself, meaning that someone needs to be actively monitoring and improving the ecosystem as part of a larger vision. Without that, the innovation funnel tends to get bottlenecked due to uncoordinated improvements. For example, increasing innovation by sponsoring company hackathons can be great. But if all the focus is on that first stage of generating ideas, then employees may be discouraged when none of those ideas are subsequently sponsored. *Ecosystem Design* helps systematically build the level of innovation at every stage by balancing efforts to improve the ecosystem in a coherent strategy.

At the bottom, the *Network* allows for peer-to-peer learning within the organization. Without a stable network of intrapreneurs, the company may train teams that work on a project, but then are disbanded and the skills atrophy and disappear. So companies wind up in a cycle of constant workshops with no long term impact. With a network, knowledge is retained and passed on from intrapreneur to intrapreneur.

Lastly, the Network needs to be feeding observations and insights back to the Design level so that the entire ecosystem is being continually improved! A lot of companies lack this and stick with a four-year one shot transformation program which ultimately does not deliver the promised benefit.

CS: CAN YOU DIG IN A BIT MORE INTO THIS MIDDLE PART OF THE 'SANDWICH'?
TK: The middle can be divided into three phases. The first step is just to generate ideas. Intrapreneurial activity in an ecosystem is the result of Opportunities divided by Fear. *Opportunities* are created by intrapreneurs with free time to be creative and pursue innovative projects (or even think of them). The *Opportunities* will also improve if intrapreneurs can interact with teammates from different disciplines to find spontaneous collisions of ideas that may inspire something novel. Fear of failure, embarrassment, or financial pressures inhibit idea generation. If there is a lot of fear, we can address this by providing a *Sandbox* for intrapreneurs to play in (e.g. an incubator or 20% innovation time). A sandbox is meant to protect the intrapreneur from the company and allow them to make a mess without being blamed. This reduces the debilitating fear that can prevent intrapreneurs from even proposing a project.

In the second phase, projects must get around the *create-test-learn* loop at least once. The major obstacle here may be a lack of *Skills*. For example, a team may lack a designer they need to build a landing page. We can either create a team with a complete skill set or provide training for small gaps. Alternatively, innovation teams can also rely on *Diplomats* who know how to move between silos to get things done. These people can barter and call in favors to borrow some time from the design department to help with the landing page. Similarly, getting *Air Support* and getting funding for innovation projects would allow the team to hire a contract designer. *Air Support* is usually from a business sponsor who provides resources and also some political cover from other stakeholders.

In the last phase, innovation projects have to continue around the create-test-learn loop at speed. A major and common obstacle to innovation is red tape and bureaucracy which can be solved with better *Tools & Processes*. For example, if a team is not allowed to use the 3D printer that another department owns due to some arcane regulation that has existed for twenty years, this restriction can be removed. Again, Diplomats can help hack around these regulations and Air Support could allow the team to buy their own 3D printer.

CS: THE CONCEPTS OF DIPLOMATS AND AIR SUPPORT ARE VERY INTERESTING. IF YOU HAVE ONE DO YOU NEED THE OTHER?

TK: I don't think you absolutely must have both, but the healthiest and most stable innovation ecosystems seem to have both Diplomats and Air Support. Sometimes the roles are even served by the same person at first. Diplomats are perhaps more useful when just getting started. Typically, you don't need a lot of money when just getting an initial idea off the ground. You need favors. There's always someone in the company who manages to wheel and deal favors to get things done. Having someone who can talk to the legal department outside of official company process and get approval to launch a small pilot of five customers is going to be a lot more valuable to an early stage project than a wad of cash.

CS: IF I AM WORKING IN A LARGE COMPANY AND WANTING TO SET UP AN ECOSYSTEM TOMORROW, WHERE SHOULD I START?

TK: Always start with discovery. Your intrapreneurs have problems. What are they? What is stopping an intrapreneur from proposing a new project? From building a team? Is there red tape in the way? Is there a network where intrapreneurs can learn from one another? Discovering the problems is a much better bet than jumping into a solution like, "let's run a hackathon!" There's nothing worse than a hackathon where a hundred great ideas are created and all of them are orphaned. Maybe the real problem wasn't coming up with ideas, it was finding a business sponsor to fund them.