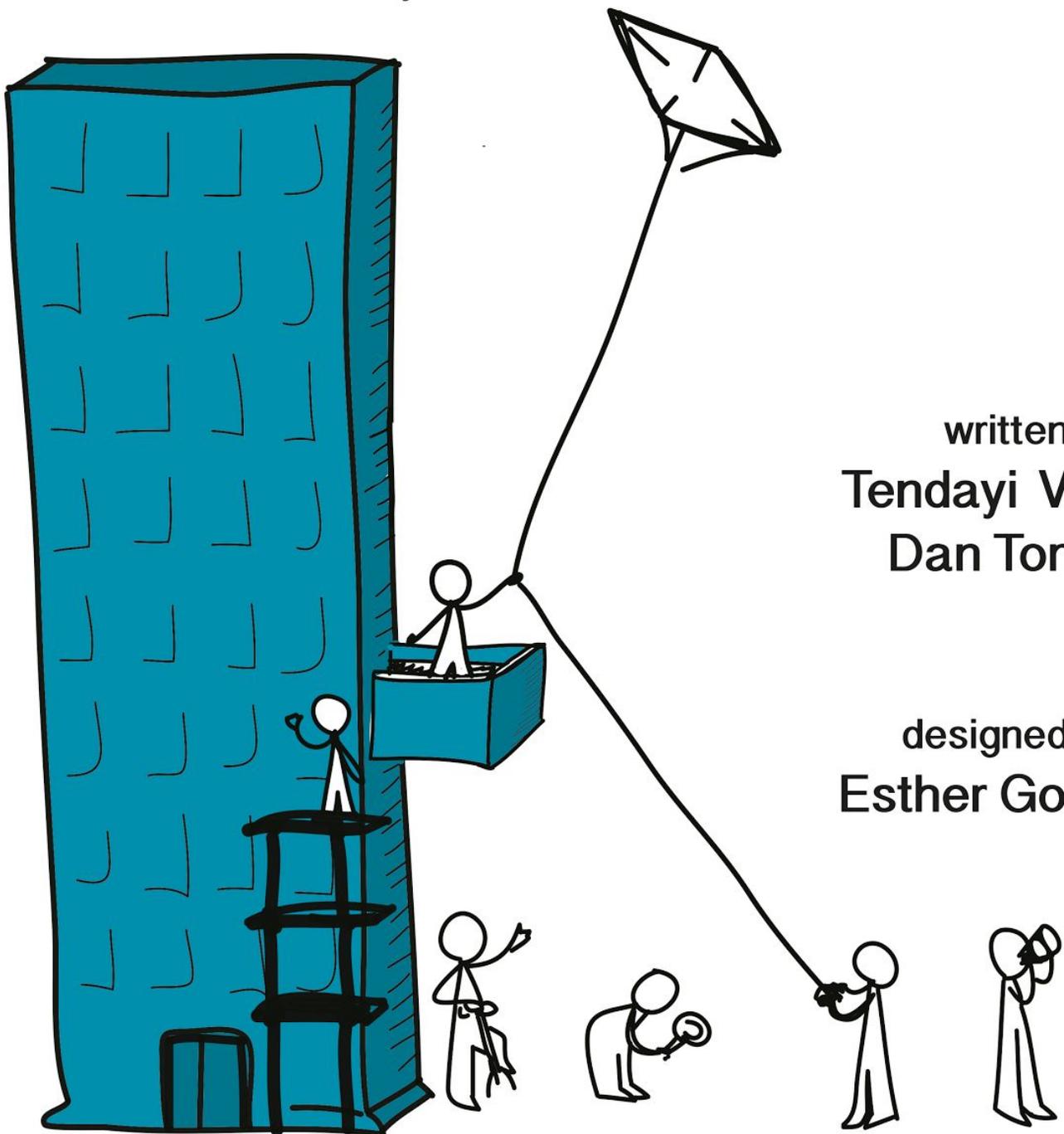


# The Corporate Startup

How enterprises can develop successful innovation ecosystems



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**PREFACE**



# INTRODUCTION

## Innovation Paradox

*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

In 2015, Microsoft got its groove back<sup>1</sup>. But before the comeback Microsoft, earlier that same year, 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.<sup>2</sup> The writedown was viewed as another example of Microsoft's struggles in the smartphone business. It's partner in this historic moment was Nokia; a parallel business story that provides powerful lessons about corporate innovation. It seems that successful established companies often get trapped by their previous successes 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 large parts of 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 not see how these changes are impacting their businesses. There is no longer the option to keep our heads in the sand. 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.

This challenge of having to respond to change is not new. As long ago as 1942, [Joseph Schumpeter](#) wrote about *Creative Destruction* as a process that refreshes economies by

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<sup>1</sup> Ulanoff, L (2015). In 2015, Microsoft got its groove back. *Mashable*:  
<http://mashable.com/2015/12/17/2015-microsoft-is-back/#9E7dahMO7mqn>

<sup>2</sup> Wingfield, N. (2015). A \$7 Billion Charge at Microsoft Leads to Its Largest Loss Ever. New York Times:  
[http://www.nytimes.com/2015/07/22/technology/microsoft-earnings-q4.html?\\_r=0](http://www.nytimes.com/2015/07/22/technology/microsoft-earnings-q4.html?_r=0)

injecting new blood in the form of innovative new technologies and companies. In contemporary times, the sheer pace of change in social trends, economic factors and technology has been remarkable.<sup>3</sup> At a churn rate of 75%, it is predicted that the entire S&P 500 index will be replaced by 2027.<sup>4</sup> 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.

### **The Disadvantage of Incumbency**

In contrast, traditional long standing companies appear to be struggling. It seems that being a successful company can be the achilles heel for innovation. 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 is no chance that the iPhone is going to get any significant market share. No chance!”<sup>5</sup>*

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 in 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”.<sup>6</sup>*

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<sup>3</sup> Furr, N. & Dyer, J. (2014). *The Innovator's Method: Bringing the Lean Startup Into Your Organization*. Boston: Harvard Business Review Press.

<sup>4</sup> Foster, R., & Kaplan, S. (2011). *Creative Destruction: Why Companies That Are Built to Last Underperform the Market And How to Successfully Transform Them*. New York: Random House.

<sup>5</sup> Metz, C. (2014). Tech Time Warp of the Week: Watch Steve Ballmer Laugh at the Original iPhone. *Wired Magazine*. <http://www.wired.com/2014/09/tech-time-warp-of-the-week-watch-steve-ballmer-laugh-at-the-original-iphone/>

<sup>6</sup> Wilhelm, A. (2013). Ballmer’s Biggest Regret Is Missing Out On “The New Device Called The Phone”. *Techcrunch*. <https://techcrunch.com/2013/09/19/ballmers-biggest-regret-is-missing-out-on-the-new-device-called-the-phone/>

Nokia had to go 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<sup>7</sup>. 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”*<sup>8</sup>

Nokia’s poor response to the emergence of smartphones is closely connected to Microsoft’s largest quarterly net loss. But these two companies were not alone in underestimating the potential disruption that would be caused by smartphones. A similar mistake 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<sup>9</sup>. 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. Some leadership teams in successful companies become *climate change deniers*. They can see the changes happening in the business world, but they deny their relevance to the company. This climate change 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

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<sup>7</sup> Statista (2016). Global market share held by Nokia smartphones from 1st quarter 2007 to 2nd quarter 2013  
<http://www.statista.com/statistics/263438/market-share-held-by-nokia-smartphones-since-2007/>

<sup>8</sup> Huy, Q. (2014). What could have saved Nokia and what can other companies learn? *INSEAD Knowledge*:  
<http://knowledge.insead.edu/strategy/what-could-have-saved-nokia-and-what-can-other-companies-learn-3220>

<sup>9</sup> Hesseldehl, A. (2012). How Garmin Failed to See the iPhone Threat. *All Things D*:  
<http://allthingsd.com/20120612/how-garmin-failed-to-see-the-iphone-threat/>

the company is currently making large profits from these products, then the hubris that comes with that success can create blind spots.

Nokia's former CEO remarks that established companies can only change when they have a charismatic leader or a crisis. We respectfully disagree. By the time a crisis or a charismatic leader arrives it is often too late to respond. We 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*".<sup>10</sup> In other words, death is not inevitable. Companies that are able to respond to change, can survive and thrive.

### **Using The Right Lens**

But in order to survive, established companies have to become clear eyed about the challenges they are facing. Most traditional MBA 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.<sup>11</sup>

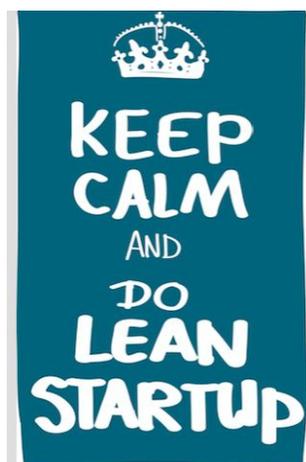
In order to do this, companies need to use the right frameworks. It is too simplistic to advise established companies to act like startups. Large companies are not startups, nor should they strive to be. Most established companies we work with complain that the expectation of acting like a startup is 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

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<sup>10</sup> Schumpeter, J. A. (1942). *Capitalism, socialism and democracy*. New York: Harper and Brothers.

<sup>11</sup> McGrath, R. G. (2013). *The End of competitive advantage: How to keep your strategy moving as fast as your business*. Harvard Business Review Press: Cambridge.

problem 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.



It is important to realise that, even as entrepreneurs have become rockstars, startups still fail a lot. When examined over a period of three years or more years, 9 out of 10 startups fail.<sup>12</sup> Among the entrepreneurs who do succeed, over 90% do so in a business that is different from what they originally planned.<sup>13</sup> Most founders rarely get it right at the beginning and have to iterate their way to success.<sup>14</sup> The Lean Startup movement arose from a need to stop startups from failing so much. The clear message is that being a startup is not about painting colorful walls, using post-it notes, buying bean-bags and setting up foosball tables. And neither is innovation! 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.<sup>15</sup> A startup is a temporary organization whose goal is to *search* for a

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<sup>12</sup> Marmer, M., Herrmann, B.L., Dogrultan, E. & Berman, R. Startup Genome Report.

[https://s3.amazonaws.com/startupcompass-public/StartupGenomeReport1\\_Why\\_Startups\\_Succeed\\_v2.pdf](https://s3.amazonaws.com/startupcompass-public/StartupGenomeReport1_Why_Startups_Succeed_v2.pdf)

<sup>13</sup> Bhidé, A. (2000). *The origin and evolution of new businesses*. Oxford University Press on Demand.

<sup>14</sup> Livingston, J. (2007). *Founders at Work: Stories of Startups' Early Days*. New York: Apress.

<sup>15</sup> Blank, S. & Dorf, B. (2012). *The Startup Owner's Manual*. K&S Ranch: California.

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 ecosystems 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 ecosystem*, 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.

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 profits, ROI, NPV and ARR. 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.<sup>16</sup> 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.

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<sup>16</sup> O'Reilly, C. A., & Tushman, M. L. (2004). The Ambidextrous Organization. *Harvard Business Review*, 82, 74-83.

## What Is This Book About?

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

- What are the principles for developing a corporate innovation ecosystem?
- If established companies are setup 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 working on 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 the 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 this ecosystem is brought to life through product development best practices.

## Is This Book For You?

This book is about to 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 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 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 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 if these methodologies can be implemented within large and medium-sized enterprises.

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

## PART ONE:

# ECOSYSTEM

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.

# CHAPTER ONE

## Innovation Ecosystem

*"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

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 largest mobile phone company in the world? Now look at them! We need to innovate like startups boss. 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 investments 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. However, 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 understand innovation. These managers are also incentivised to behave in a manner that stifles innovation. People can not get any innovation done within a company that expects a 30 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 theatre 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 successful 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 'sure bet' products for current markets.

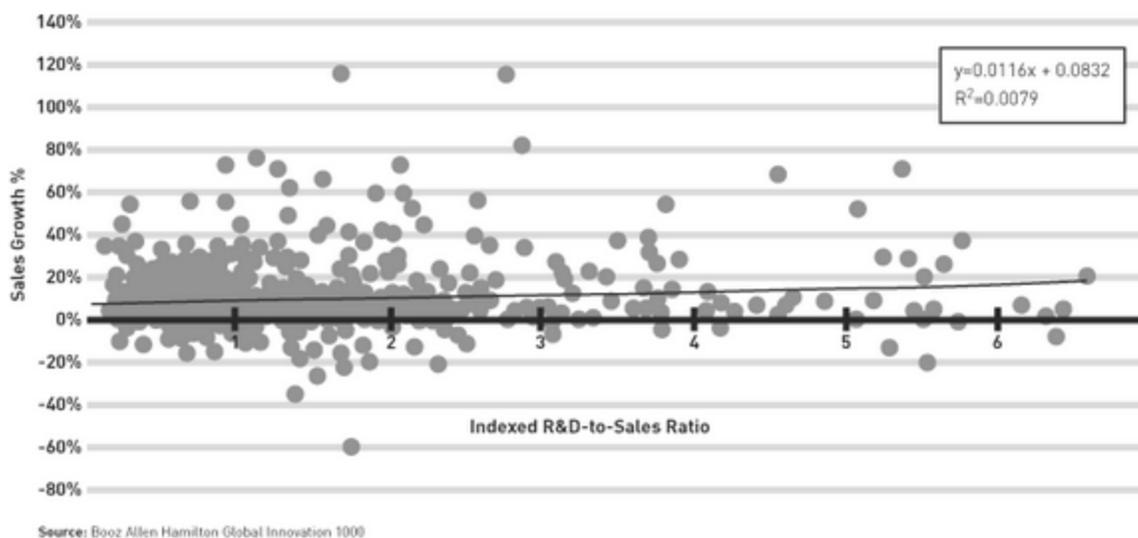
The feeling is that by creating innovation labs, managers can separate innovators from the toxic environment within the company. But these labs fail because companies fail to build any management processes around them, allowing innovators to work on whatever they want. There is a common tendency to conflate creativity with innovation.<sup>17</sup> 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 the 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&, a business unit within PriceWaterhouseCoopers, has been publishing an annual report of the top 1000 most innovative companies in the world for over 12

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<sup>17</sup> Nielsen, T. (2015). Novelty is not innovation. *ThoughtWorks*.  
<http://www.thoughtworks.com/insights/blog/enterprise-needs-lean-product-development>

years. In that time, they have found that there is no statistically significant relationship between R&D spending and sustained financial performance.<sup>18</sup> This finding applies to total R&D spend, as well as R&D spending as a percent of revenues.<sup>19</sup> Spending on R&D is not related to growth in sales or profits, increases in market capitalization or shareholder returns.<sup>20</sup> In every annual report that Strategy& have published, the top 10 most innovative companies are often not the top 10 spenders on R&D.



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. Very few products from corporate innovation labs 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; creating a discouraging and uninspiring environment for future innovators.

<sup>18</sup> Alison Smith (2014). [R&D spending unlinked to financial performance, study shows](#). The Financial Times.

<sup>19</sup> Barry Jaruzelski, John Loehr, and Richard Holman (2014). [The Global Innovation 1000: Proven Paths to Innovation Success](#). s+b.

<sup>20</sup> Barry Jaruzelski, John Loehr, and Richard Holman (2012). [The Global Innovation 1000: Making Ideas Work](#). s+b.

We have learned that companies need a great process in place to manage innovation. Without that 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 innovation. Innovation is often simply defined as a novel creation that produces value.<sup>21</sup> From our perspective 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. This part of the journey involves making sure that our novel creations meet customer 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.

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

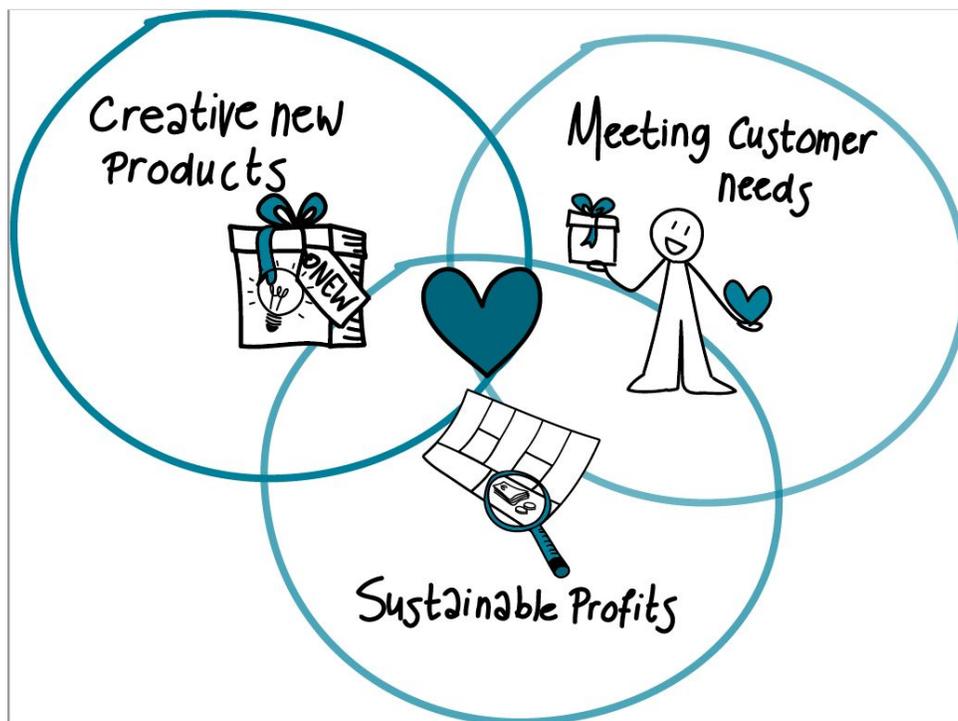
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<sup>21</sup> Nagji, B., & Tuff, G. (2012). Managing your innovation portfolio. *Harvard Business Review*, 90, 66-74.



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. making stuff people want); and we are able to create and deliver this value profitably (i.e. 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 important to make clear here that not all forms of innovation will be focused on new products or services. It is also 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. However, even for these forms of innovation, the delivery of value and sustainability are still important principles.



### 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 process are instantiated depends on the company, how much management buy in you have and the innovators' appetite for corporate politics. Sometimes it is 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 this case, innovators might consider leaving the company for greener pastures.

Alternatively, innovators can start a guerrilla movement. An innovation insurgency, so to speak. Tristan Kromer<sup>22</sup>, who is a great innovation ecosystem designer, has two main 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

<sup>22</sup> See more at Tristan's blog: <https://grasshopperherder.com/>

approvals. The lean startup, design thinking and customer development toolbox provides great methods for lowering the costs of innovation.

However, 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. However, this is our least favoured method. We have found that guerrilla 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 in jeopardy. So while guerrilla tactics can work, they also have a really high mortality rate for product ideas. This is the reason we favour a *full frontal assault* on the company to slowly 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 *air-cover* 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.<sup>23</sup> 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 content. 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<sup>24</sup>, 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. A thesis also sets the boundaries or guard rails concerning

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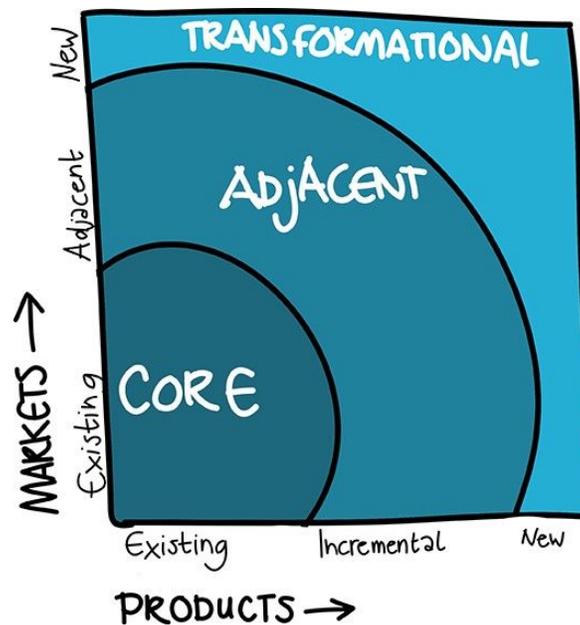
<sup>23</sup>Garud, R., Gehman, J., & Kumaraswamy, A. (2011). Complexity arrangements for sustained innovation: Lessons from 3M Corporation. *Organization Studies*, 32, 737-767.

<sup>24</sup>Wilson, F. (2009). Thematic vs Thesis Driven Investing. *AVC*. <http://avc.com/2009/11/thematic-vs-thesis-driven-investing/>

the innovation projects the company will or will not consider. In addition to 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

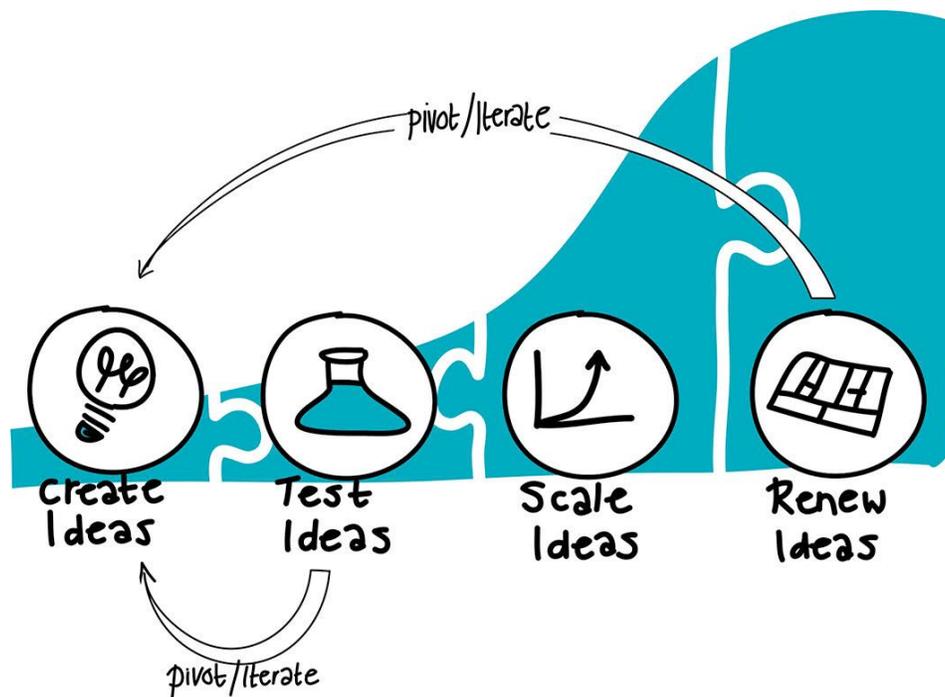
To achieve its innovation thesis and strategic goals, an established company should then set itself up as a portfolio of products and services. This portfolio should contain products that cover the whole spectrum of innovation; i.e. *core*, *adjacent* and *transformational*. The portfolio should have 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 life. The balance of the product portfolio should be an expression of the company's overall strategy and innovation thesis.



### 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 example innovation frameworks; for example Ash Maurya's *Running Lean* framework<sup>25</sup> and Steve Blank's *Investment Readiness* model<sup>26</sup>. At Pearson, one of us has been part of a team that has developed the *Lean Product Lifecycle* which is an award winning innovation management framework<sup>27</sup>. 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 it 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 of 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

<sup>25</sup> Maurya, A. (2012). *Running Lean: Iterate from plan A to a plan that works*. California: O'Reilly Media.

<sup>26</sup> Blank, S. (2013). It's Time to Play Moneyball: The Investment Readiness Level. <https://steveblank.com/2013/11/25/its-time-to-play-moneyball-the-investment-readiness-level/>

<sup>27</sup> The Lean Product Lifecycle: <http://learn.leanplc.com/>

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 philosophy is based on Dave McClure's Moneyball for Startups<sup>28</sup>. We also propose three sets of innovation KPIs that companies should be tracking. *Reporting KPIs* are designed to track the activity and work being done on new ventures as they move from idea through to scale (e.g. validation velocity). *Governance KPIs* help paint a better picture for the company as to whether or not to continue investing in particular ideas (e.g. how close are the teams to finding product-market fit). *Global KPIs* examine the overall performance of innovation within the context of the larger business (e.g. percent of revenue in the last 3 years).

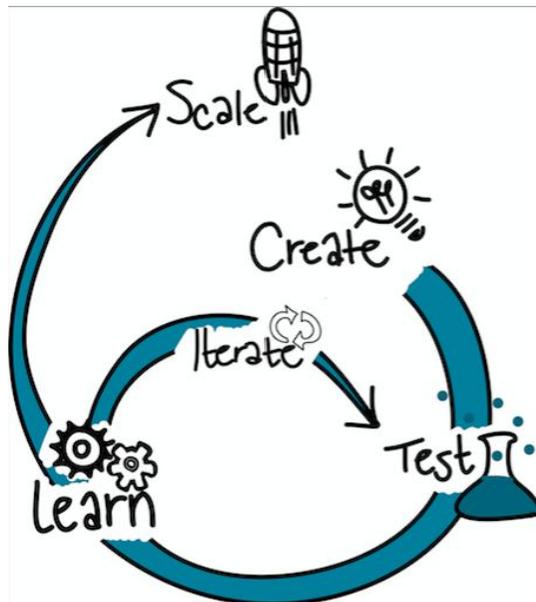
### **Innovation Practice**

In addition to managing investments in innovation the right way, the way product teams develop products has to be aligned to the innovation framework. Pearson's Lean Product Lifecycle is accompanied by great playbook that provides guidance to product teams as to the right behaviors to engage in during searching versus executing. Adobe's Kickbox provides similar guidance, tools and resources<sup>29</sup>. 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.

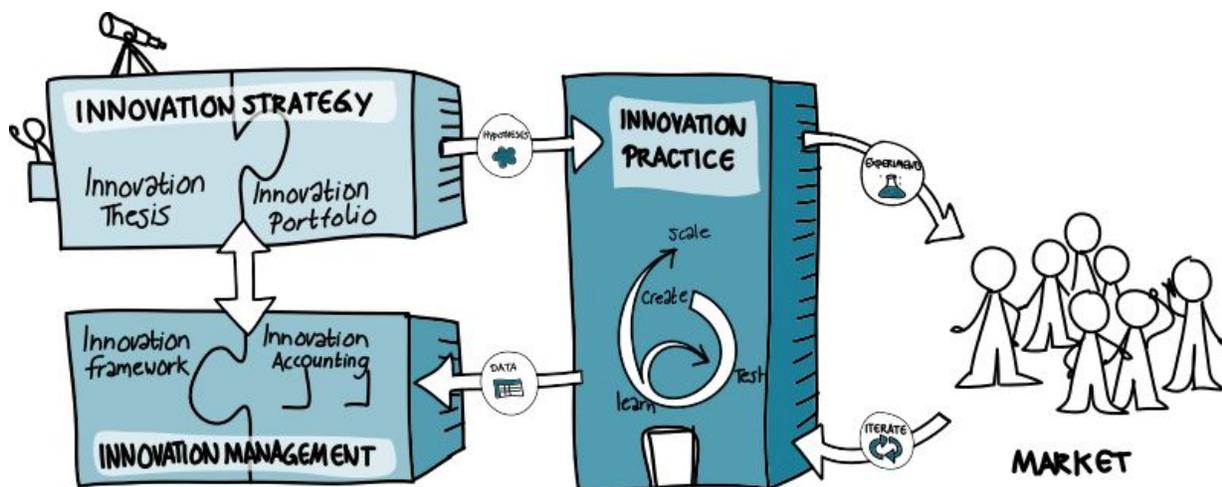
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<sup>28</sup> McClure, D. (2010). MoneyBall for Startups: Invest Before Product/Market Fit, Double-Down After. <http://500hats.typepad.com/500blogs/2010/07/moneyball-for-startups.html>

<sup>29</sup> See here for Adobe's Kickbox: <http://kickbox.adobe.com/>



These five principles combine to help create an innovation ecosystem. The first two principles (i.e. thesis and portfolio) focus on innovation strategy, the next two principles (i.e. 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 tend to just focus on this last part (i.e. innovation practice). However, 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 above, these elements are interconnected; each representing a *build-measure-learn* loop of its own. To the extent that strategy informs investment decisions, the success of these decisions in turn inform 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 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 upcoming chapters.