

BEATING THE ODDS OF DISRUPTION

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Only 16% of companies are successful at responding to disruption

Beating The Odds Of Disruption

Large firms have always struggled to prosper in the face of market disruption. There is a long history of firms from Blackberry and Kodak to Nokia and EMI that see disruption coming but fail to act successfully. Digital technologies and business models have simply made the odds of beating disruption even smaller.

Decoding the Startup Playbook

In recent years, large firms have invested time and money turbo-charging corporate innovation, seeking to replicate the success of startup Unicorns. Helpfully, methodologies like 'Design Thinking' and 'Lean Startup' have started to decode the secrets of the startup playbook. The goal is to help large corporates innovate at the speed of Silicon Valley.

Many firms have enthusiastically adopted these '*Lean Agile*' techniques. But, have these techniques moved the needle towards building disruptive new businesses? Are incumbents any better placed to beat disruption? And, if some are, what can we learn about how they've succeeded where others have failed?

Fads or Facts

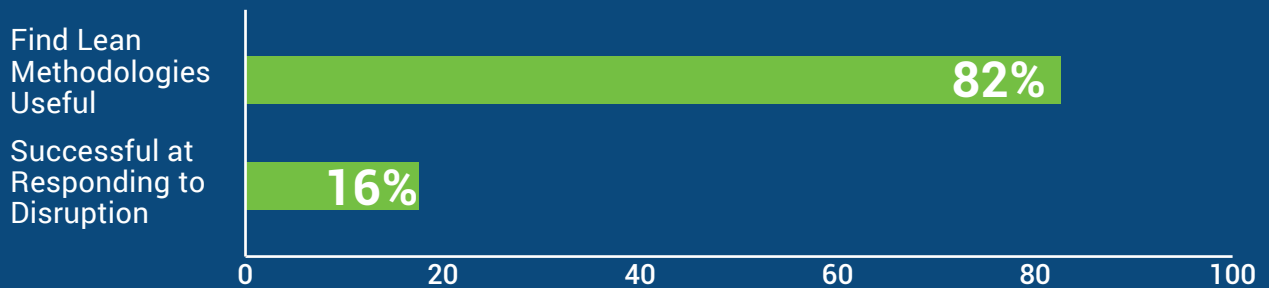
Lean Startup and Design Thinking are fashionable management theories. They promise to fast track a firm's innovation capability. What we lack is evidence that these techniques help firms to beat the odds of disruption.

So we conducted our own research to find the answers. Working with our founders and academic partners, *Professor Charles O'Reilly at Stanford Graduate School of Business*, and *Professor Michael Tushman from Harvard Business School*, we interviewed 30 firms and gathered survey data from over 150 executives.

It Takes More Than Lean Agile to Beat Disruption

We discovered that only 16% of our sample – our *Corporate Disruptors* – were successful at beating the odds and achieving something others did not. But why?

The Disconnect Between Lean Startup and Disruptive Innovation



More than Lean Agile

In our research, we gathered evidence to help guide executives making decisions about how to launch a new or manage an existing innovation project. Key to this was finding out what are the predictors of success.

We learned there is *no direct correlation* between adopting *Lean Agile* methods and being successful at disruptive innovation. We found that 4 out of 5 companies find Lean methodologies useful in their innovation efforts, but fewer than 1 in 5 companies are successful at responding to disruption. If Lean Agile is a part of the answer, it is not enough on its own.

Predictors of Success

Our research identified 5 factors which differentiate the most successful firms from the least successful at disruptive innovation. Some of these factors are core to lean agile methods and we can confirm their importance. Others are new practices that organizations need to learn.

5 Predictors of Success

- 1.** Set a *Scale of Ambition* equal to that of the opportunity or threat of disruption
Great entrepreneurs want to change the world—they are driven by a purpose. A corporate manager often finds it is safer to meet a short-term revenue goal. Because corporate managers often find it safer to meet a short-term revenue goal, Leaders need to set a scale of ambition equal to the opportunity. Otherwise, rational managers may stick with the safer, less ambitious choice.
- 2.** *Generate Better Ideas, not more ideas*
The most successful disruptors open themselves to ideas that challenge the assumptions of today's business using techniques, such as Design Thinking, Open Innovation, and Access to Startups.
- 3.** Build capability across all 3 innovation disciplines: *Ideation, Incubation, and Scaling*
The Corporate Disruptors do more than generate great ideas—they test and validate them and then build them into revenue generating businesses. That may sound obvious, but surprisingly few firms have an end-to-end approach. Instead, they have many ideas with a weak commitment to building a future business.
- 4.** Learn to run *Business Experiments*
Companies led by technical experts often struggle to adopt the mindset of naïve inquiry. They build solutions based on what they know and then find people that fit this mindset. Experiments invert that logic. We identified 3 key success factors for running business experiments that can help validate ideas successfully.
- 5.** Give new units *Autonomy to Scale*
New units need to operate outside the usual rules and constraints of the core business, without losing access to the assets and resources that enable them to go faster than a startup.

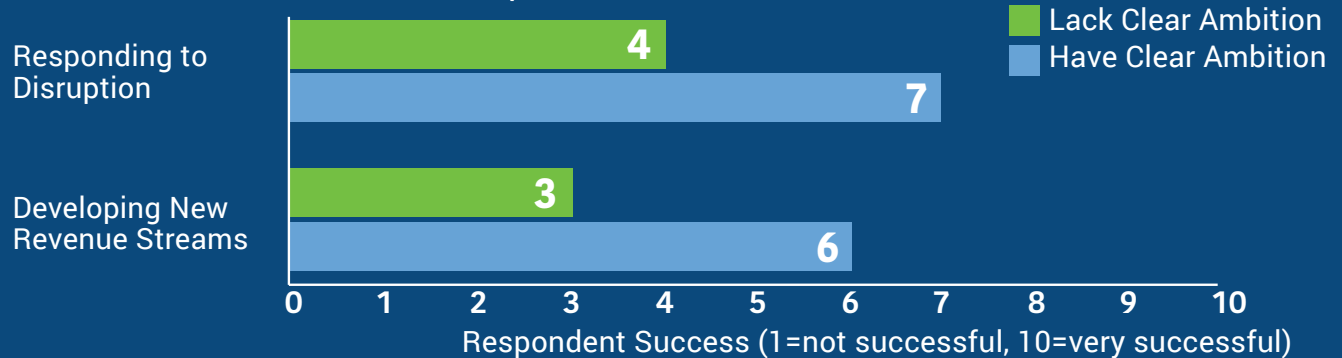
80% of firms focus on incremental not radical innovation, even in the face of disruption

Set the Scale of Ambition

A significant differentiator between Corporate Innovators and the rest is the scale of ambition they set for innovation efforts. Firms that have a clear ambition are twice as likely to respond successfully to disruption. They know what they want and to be famous for creating and what impact they want to have on the world.

If you go small, you will get small ideas. Managers get ahead in large corporations by hitting targets. That equals the pursuit of smaller, incremental goals. They default to incremental, not radical innovation.

A Bold Ambition Enables Disruptive Innovation



A scale of ambition equal to the opportunity or threat facing the company gives managers license to be bold. It changes the decision-making parameters, and they become more willing to explore ideas that challenge conventional wisdom.

Case Study: Escaping Intel's Black Hole

Many successful corporate innovators set ambitions that at first may seem abstract or beyond the firm's reach. Technology firm Nvidia's goal to move from being a leader in graphic processors to Artificial Intelligence and Autonomous Driving at first seemed absurd. Now with a market value six times that of five years ago, the shift seems obvious.

Nvidia had built a dominant position in semiconductors that power computer graphics. Unfortunately, as Intel started to add this functionality to their core processors, Nvidia was sucked into head to head competition with the industry's leading player. It needed to escape the black hole of Intel by reinventing itself.

CEO Jen-Hsun Huang set a bold ambition for Nvidia to dominate the emerging field of artificial intelligence. He challenged his company to develop ways to solve key emerging problems using AI, such as autonomous driving and deep computing.

The result was not only new hardware, but a software platform, and ecosystem partnerships. Nvidia redefined its position in the market with a bold ambition that enabled multiple innovations.

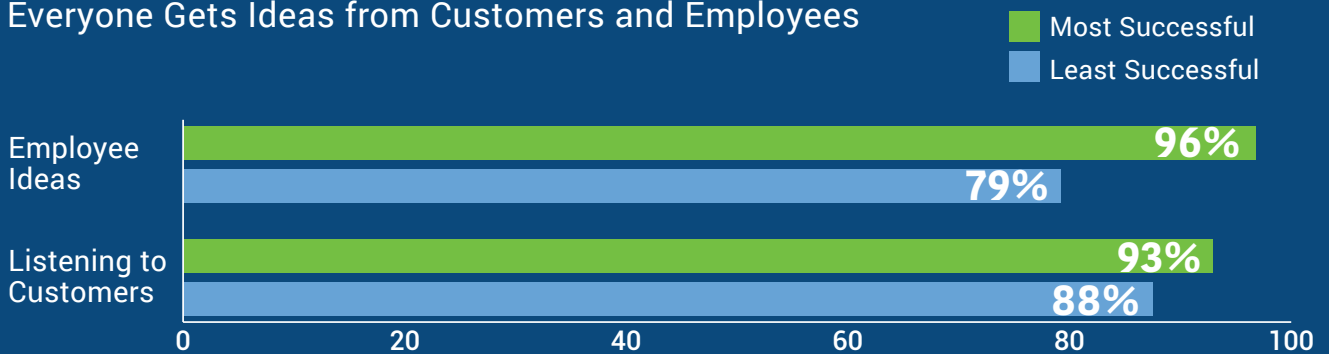
82% of firms have enough or too many ideas for disruption

Generate Ideas - Not More

Conventional wisdom says that innovation is a numbers game. More ideas lead to more, better ideas, and that increases the chances of finding truly disruptive opportunities.

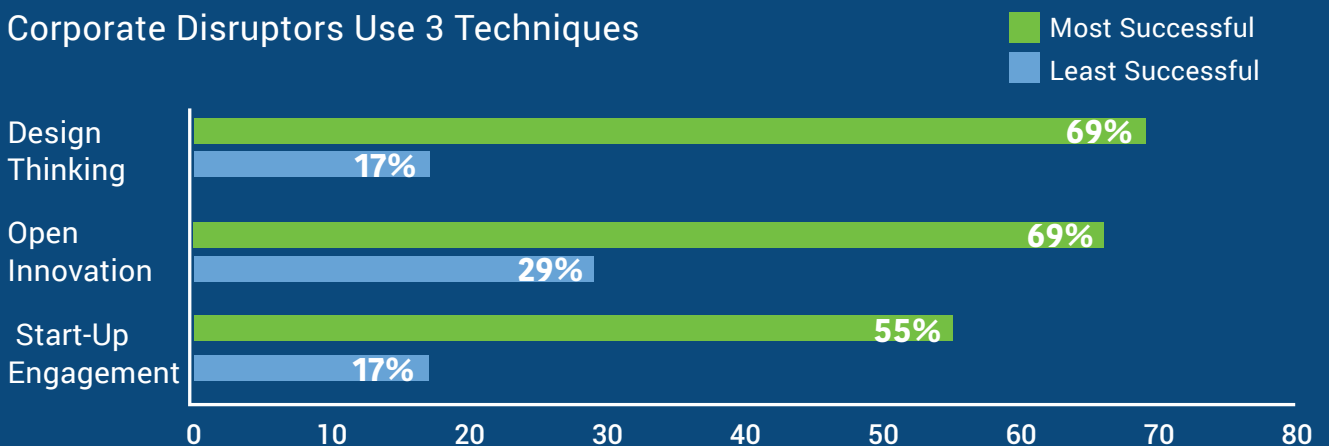
Our research challenges this wisdom. Most firms responded that they have enough or too many ideas. We found no correlation between quantity of ideas and success at generating new revenue streams. What makes a difference is where the ideas come from, as some are more likely to create disruptive opportunities. Almost all the firms in our survey get new ideas from customers and employees. They know a company's business best of all and know what you need to do to improve. The downside is that they may bias you towards incremental innovation – doing what you do today better, faster, cheaper.

Everyone Gets Ideas from Customers and Employees



The most successful Corporate disruptors use Employees and Customers even more than the rest. But, they go beyond these sources of insight, using techniques like Design Thinking, Open Innovation, and engagement with Startups to generate ideas that challenge the status quo.

Corporate Disruptors Use 3 Techniques



3 Action Implications for Idea Generation

Ideation gets all the attention in many innovation programs. It is exciting to get employees involved in thinking about how to create a better future. Our research suggests three key insights about how to make these activities more productive.

1. *Avoid the "Innovation Zoo"*

More ideas can just mean lots of small, under-funded projects competing for attention. Creating too many innovative initiatives can drain resources and sap commitment—resulting in an "innovation zoo" with many small examples but no major breakthrough ideas. Make selections on which ideas to test early and put the rest in the backlog for another round.

2. *Challenge Assumptions*

A recent study on Open Innovation at NASA showed that the best breakthrough ideas comes from someone who has deep expertise in a field completely different from the problem being tackled. Beware of conventional thinking.

3. *Outside-In*

Real challenge comes from naïve inquiry with customers and users. They are really good at bursting a corporate bubble. Corporate Disruptors gather these insights systematically and use techniques like Design Thinking to generate ideas that reflect customer's unmet needs.

Ideate...then Incubate and Scale

Idea generation may get most of the attention, but it generates relatively little value compared with the harder disciplines of Incubation and Scaling.

Even a good idea based on challenging insights from customers rests on untested assumptions. Incubating a new idea means running lots of experiments to learn which of your assumptions are accurate. Scaling means finding the customers, capability, and capacity to turn your validated idea into a real business.

Most firms stop at Ideation because they cannot master Incubation and Scaling, which are harder and more resource intensive.

All 3 Disciplines Matter



In our interviews, we learned that firms that succeed are good at three disciplines: ideation, incubation, and scaling. The survey data supports this view and we see a clear correlation between this end-to-end approach to innovation and creating new revenue streams from disruptive ideas.

As we already observed, ideation gets most of the attention, even though it generates relatively little value compared with the harder disciplines of Incubation and Scaling. Incubating a new idea means running lots of experiments to learn which of your assumptions are accurate. Scaling means finding the customers, capability, and capacity to turn your validated idea into a real business.

In part, firms stop at Ideation because Incubation and Scaling are harder and more resource intensive. Doing these steps well requires an ability to make fast, fact-based decisions on which initiatives to stop, pivot, or pursue. This can run counter to corporate cultures that struggle with making clear-cut decisions. Ideas that come from highly democratic participative approaches can be hard to stop for fear of demotivating employees.

Firms like Amazon have managed to blend participation – everyone can propose an idea – with rigorous selection – only the best advance. Another difficulty with participation is that disruption often runs counter to how things are done today. The more deliberate the process for moving from Incubation and into Scaling, the more likely new ventures are to survive.

Case Study: Amazon's New Business Energy

Amazon has built a series of new businesses beyond its original core as an online retailer. Ventures like Amazon Web Services, Kindle, and third-party fulfillment emerged from a disciplined approach to Ideation, Incubation and Scaling.

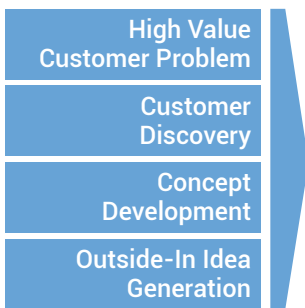
Employees propose ideas with the PR/FAQ (a one-page press release and a six-page set of FAQs), working backwards from a customer problem to solve. Adopted ideas go through a series of small-scale experiments with a two-pizza team (i.e., no bigger than can be fed by two pizzas!). Scaling at Amazon is made easier by the open API model that assumes assets should be leveraged for new ventures. There is a culture of 'the institutional yes'.

Ambidexterity: Three Innovation Disciplines

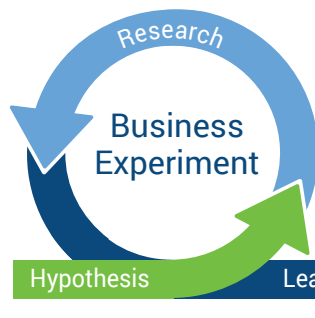
To explore into new markets, you must master 3 disciplines - ideate, incubate, and scale - to successfully convert good ideas into winning business strategies.



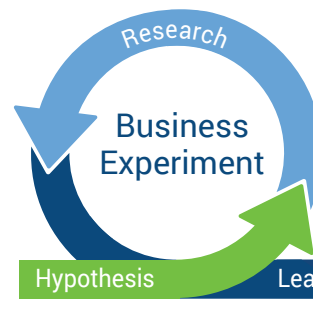
Ideate



Incubate



Scale



Emerging Business

Three Disciplines of Innovation

Ideate

Set an ambition for exploration and generate new business concepts with the potential to realize these goals. This involves defining high-value customer problems to solve and ideas for solving them that could become new, disruptive businesses.

Incubate

Use evidence to make decisions on when to invest in a new business, when to kill it and when to learn more. This means running business experiments to test all of your assumptions about how customers view your solution, how they they like to buy it, and whether they are likely to spend money. The outcome is a validated business model.

Scale

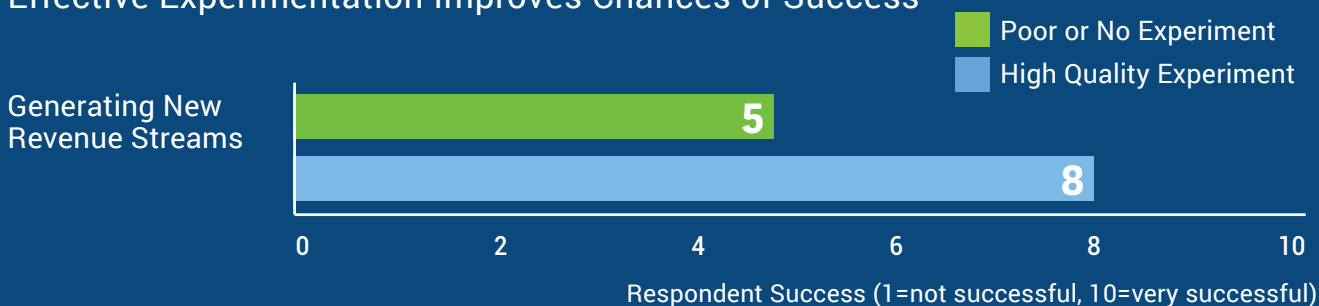
Convert an experiment into revenue generating business that generates sustainable growth for the company. Commercializing innovation is the hardest of the three steps, though it often attracts the least attention. You need to find a path to acquiring or building the customers, capability, and capacity to support the growth of the new venture.

Learn to Run Business Experiments

The core skill of incubation is running business experiments. Learning to conduct experiments well improves your chances of converting ideas into new revenue streams by 75%.

Traditional methods for validating new business ideas, such as Market Research and State Gate Product Development are good approaches for winning in mature, stable markets; they just do not help when seeking to play in unknown emerging ones.

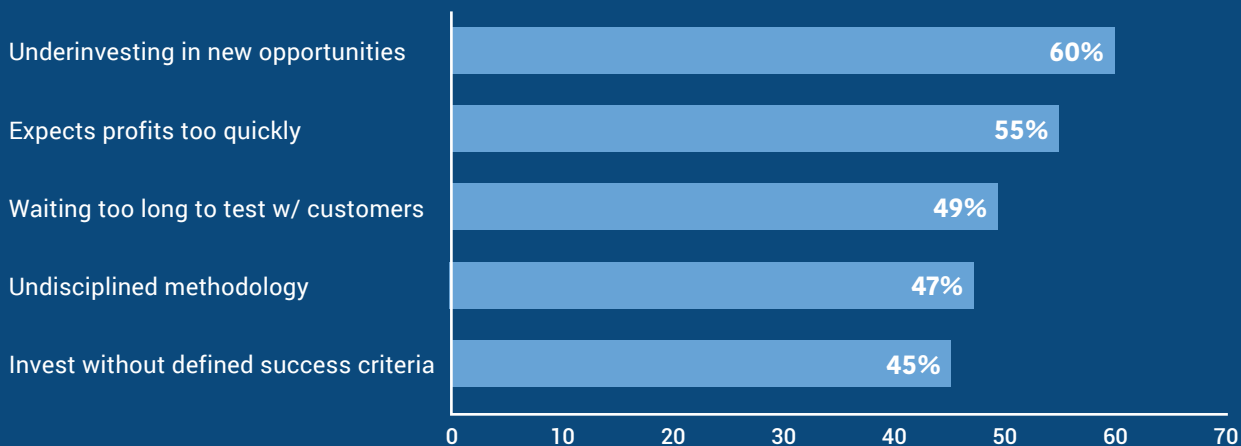
Effective Experimentation Improves Chances of Success



Just like a science experiment, a business experiment is about failing and learning. The Lean Startup movement has done a lot to teach us how to do this systematically. However, Lean Startup is designed for new, venture-backed firms, not teams working in corporations.

Independent of the Lean Startup method, our survey identified the top five barriers that firms need to overcome:

Top 5 Barriers for Corporates



Key Success Factors for Experimentation

1. *Have a clear set of assumptions or hypotheses to test*

Too many firms start an experiment with an open question, not a testable statement.

2. *Develop a minimally viable solution*

The single biggest predictor of success is that you have a simple version of your offering to test.

3. *Test quickly with customers*

The other key predictor is getting in front of customers early with focus groups or interviews; live feedback is essential.

4. *Use a disciplined approach to experimentation*

Being disciplined will not guarantee success, but it certainly increases the odds. Our survey found that the unsuccessful firms are 2.5X more likely to be using an undisciplined approach to incubation.

Mastering these 4 practices can set you up to successfully scale a new disruptive venture.

Case Study: Never Invest Ahead of Learning

In 2010, GE's digital transformation vision was bold. It saw the possibility for the 'Industrial Internet of Things'. They anticipated sensors gathering data about every aspect of a manufacturing plant's operation being fed back and analyzed in the Cloud in real-time. These 'smart machines' would radically improve effectiveness and efficiency for thousands of companies world-wide. They forecast a market worth \$500 billion by 2020 and committed to create a first-mover advantage. GE tripled its R&D budget, built a 1,000-person software division, and launched its own big data platform--Predix.

Five years later its failure was one of the reasons the CEO was forced to resign and for GE crashing out of the Dow Jones for the first time in 100 years. GE invested ahead of learning. They built the unit without running experiments to confirm the customer problem, ensuring that they had a viable solution, and the customer's willingness to pay for it.

New businesses that have autonomy are 2x more successful at scaling

Give New Units Autonomy to Scale

Successful Incubation is exciting. It confirms you have a good idea and know the ingredients for success. However, the real victory comes from scaling the experiment into a sustainable business.

The most significant enabler is giving a new unit the autonomy to make the choices about how to scale, without needing to conform to the requirements of the traditional core business.

Firms where new businesses have a high degree of autonomy are **twice** as successful at scaling and generating disruptive new revenue streams.

But what does it mean to give a new venture autonomy? We know from many years of research that new unity's need to be able to operate as a separate unit, with a reporting line that gives it freedom from day-to-day business pressures.

We also know that these units need their own people, resources, culture, and flexibility from corporate rules. What we learned is that while these are all important, there are a few practices that may explain the difference between success and failure.

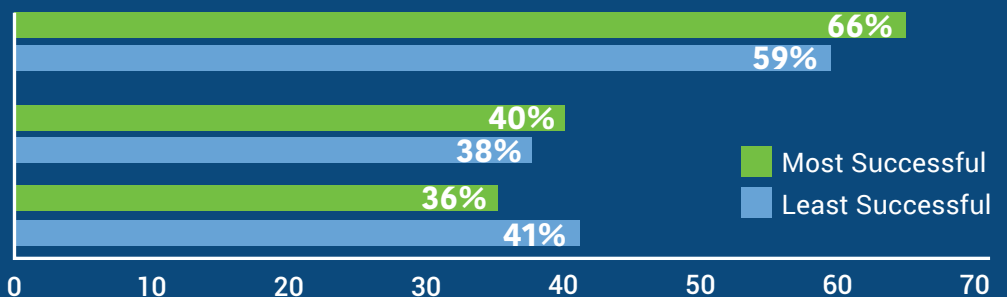
It turns out, firms that are successful or unsuccessful at Scaling new ventures all recruit new skills, sometimes hire from outside, and design different compensation plans. Unsuccessful firms actually rely more on financial incentives than the most successful.

Everyone Gives HR Policy Freedom

Hire different skillsets

Leaders recruited from outside

Different comp & incentive plans

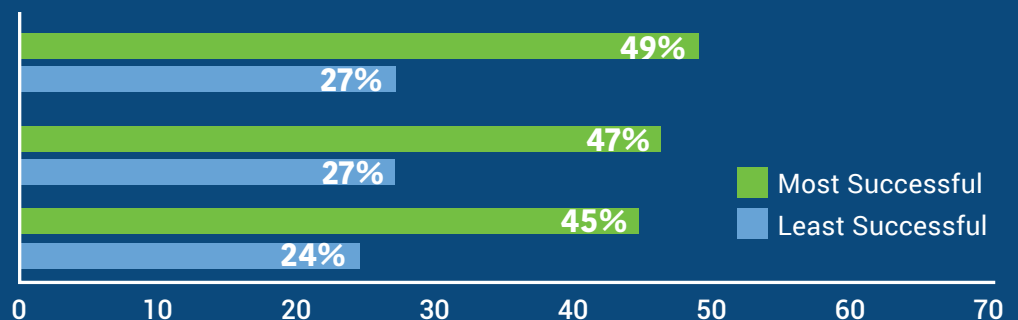


Corporate Disruptors Give Business Autonomy

Evaluated against different metrics

Resources protected from quarterly cuts

Corporate policies can be modified



Key Success Factors for Scaling a New Venture

1. *Report outside hierarchy*

Give them a reporting line outside the usual hierarchy, so that they are free to operate without being inspected as if they were the same as a mature operating business—and have recourse to senior management when conflicts emerge.

2. *Ring fence resources*

Ring fencing the new ventures resources so that they can Scale to the Ambition and not settle for incremental results

3. *Use proper metrics*

Hold them accountable using the right metrics, such as rate of customer acquisition or revenue growth, but almost certainly not margins or profit

4. *Create freedom from bureaucracy*

Enable freedom from corporate bureaucracy and rules, such as separate hiring practices, bespoke IT systems, or traditional go-to-market approaches. Things that are heresy in the core business may be essential in the Explore.

Case Study: Emerging Businesses at IBM

Although IBM has struggled in recent years, in the early 2000s it ran one of the most successful programs for Scaling new ventures. From 2000 to 2005, the IBM Emerging Business Opportunities program (EBO) developed a set of businesses that generated more than \$5 billion of profitable revenue growth. These nascent units were separated from the core business so that they had the freedom to operate with minimal constraints. They had their own development, marketing, and sales teams, staffed with people from outside the IBM mainstream. However, they also had business owners in the traditional core business. These 'home units' enabled privileged access to the resources the new units needed to be successful. By 2010, the CEO claimed these EBOs accounted for almost half of IBM's profits. Unfortunately for IBM, it discontinued this program with the change of management that followed.

So What? Now What?

We wanted to learn which innovation popular practices are making a difference to corporates seeking to beat the odds of disruption.

We found evidence that Design Thinking and Lean Startup-style practices are having an impact. We also found that there is more to success in the corporate garage than the startup.

We do not think we have found the whole answer, but there are some important clues that make us optimistic that the research can help guide corporate disruptors of the future.

So What?

The 5 Key Lessons for us are:

1. It pays to have a **clear ambition** that guides and drives your innovation efforts, you can only scale to the summit of your aspirations
2. **Beware of the Innovation Zoo** because although it feels good to run a 'Dragon's Den' for employees, it creates problems down the road when you try to turn those ideas into real businesses.
3. Use Outside-In methods that **genuinely challenge assumptions** from the Core business. Unless it makes you uncomfortable, you are probably not learning
4. **Master all three disciplines** of innovation – Ideation, Incubation, and Scaling – otherwise you will not convert your effort into revenue
5. Learn the **skills of business experimentation**, they can be counter cultural for corporations

Now What?

There is lots of data and fresh input in this white paper, but where to start? We suggest three key next steps.

1. Write down your end to end **approach to Ideate, Incubate, Scale**
2. **Assess your strengths** against on these practices.
See www.changelogic.com/3disciplines for more information.
3. **Frame an ambition**, do you know what you want to be famous for?



Change Logic works as facilitators, provocateurs and enablers, applying a proven method to guide clients through innovation and change.

Our clients are CEOs, senior teams, business unit heads, and heads of strategy leading growth and transformation.

Change Logic combines deep research from our founders (Professors Mike Tushman from HBS and Charles O'Reilly from Stanford) with successful application in technology, media, financial services and pharmaceutical companies.

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