COLLECTIVE DISRUPTION

HOW CORPORATIONS & START-UPS CAN CO-CREATE **TRANSFORMATIVE** NEW BUSINESSES

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Excerpt: Introduction & Chapter 1

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INTRODUCTION

Years ago, when I joined Sunbeam Corporation as VP of product development, the company was in shock and in crisis. Reeling from the effects of its brutal ex-CEO (the infamous "Chainsaw Al" Dunlap) and mired in bankruptcy, Sunbeam needed to rebuild its ability to innovate. Quickly.

As part of the turnaround team, we set about restoring the process of collaboration internally. But, clearly, that would not be enough. For a company in bankruptcy, we had no choice but to learn how to leverage outside experts in areas such as product development. We didn't call it open innovation, but that's what it was. We partnered with suppliers, inventors, and outside companies like never before. We went from launching 10 new products in the first year to more than 150 by the end of the second. And you know what? Working with these creative partners actually made us more creative thinkers inside the company. Our management team navigated Sunbeam through Chapter 11 reorganization, rebuilt the business, returned it to profitability and a few years later the business was acquired by Jarden Corporation.

That was my introduction to the concept of open innovation. The experience took me in a new direction in my work and helped inform the business evolution I've championed in my ventures and with my clients. I've spent ten years leading a boutique consulting practice (Venture2) working with large companies and startups in open innovation—connecting, collaborating and commercializing innovations. I've also run venture-funded startups and worked for a venture capital firm investing in open innovation platforms during this period. I've experienced open innovation from many perspectives. Open innovation to support the core business is important, but it isn't enough.

The old definition of innovation is dead. The process that companies used to follow of innovating a new product or a new iteration on an existing brand is just what it takes to stay alive these days. In this highly connected world, new ideas are coming from everywhere, with emerging competitors disrupting established companies every day. Companies now need to focus on new business creation for step-change growth. This is scary because transformative innovation is not what most big companies are good at. This book addresses that soft spot in the big-company skill set. I'm teaching the art of collaboration for new business creation.

Companies must learn to play the disruption game and use it to continually reinvent themselves. The time has come to challenge the paradigm that the startups are always the ones that disrupt large, established companies. Through the collective disruption model, you can engage and leverage the entrepreneurial ecosystem to co-create new market-disrupting businesses.

Collective disruption combines the best of big brands and startup nation.

Let me confess upfront that the word "disruption" (which you'll see in these pages) is an overused one. In this book, I'll be referring to disruptive innovation in a slightly broader sense than Clayton Christensen's traditional definition: disrupting a market via a technology or solution that brings simplicity and affordability and typically serves an unattractive niche within the market before it eventually redefines the industry. So, I'll more frequently refer to transformative innovation. Whatever label we give it, I'm addressing the type of innovation that can redefine companies and industries and is about helping to transform companies by creating whole new businesses or growth platforms. Transformative innovation by my definition is therefore not sustaining or core business innovation aimed at maintaining today's enterprise.

If you're an executive in a large company, charged with growth through transformative innovation, this book is for you. You may be a GM or a leader in marketing, business development, R&D, or perhaps a dedicated group focused on new business creation. You're living the unique challenge of creating transformational and step-change growth in a company that rewards stability and optimization. While corporate innovation like this is difficult, there's no shortage of passion within the leaders and teams at companies I work with. The challenge is how to unleash it in ways that aren't stamped down by the cultures, reward systems, and policies of these companies. I've had the great experience of being in your shoes and working alongside visionary corporate leaders who are tackling these challenges.

I've also had the rewarding opportunity of being an entrepreneur, founding a venture-funded startup, and then becoming president of an early-stage venture capital firm. So if you're an entrepreneur or startup founder, I hope to provide insights for you as well. While I'll be speaking mostly to the corporate leader in this book, entrepreneurs can gain answers on how to partner with corporations in new ways and how they can leverage corporate partners to reverse engineer their businesses for faster scale-up and exit.

This book introduces the concept of the innovation ecosystem, its presence, its power, and the ways in which companies of all sizes can become connected in order to meet the demands of the new innovation imperative. In the following chapters we'll address:

- Why big companies are being left behind in the new hyperfast innovation game
- How an innovation ecosystem can help companies create not just new products but also entirely new lines of business
- How the entrepreneurial skills of lean startups can (and can't) be applied in the corporate environment
- How a co-innovation strategy—with entrepreneurs and corporations—yields new business creation faster and at a lower risk
- New approaches to business incubation that leverage the best of entrepreneurial and corporate skills in prove-out and scale-up
- What skills are needed to manage this co-creation process for the profitability and success of all involved

In the first part of the book, I'll focus on how the innovation game is changing and how it's playing out across big and small companies. I'll look at the difficulties large companies are having generating and implementing big new ideas and how entrepreneurs may hold the solution. I'll discuss open innovation and its much-needed evolution from transactional approaches to more relationship-based networks. This isn't another book on open innovation, but that foundation is important for my premise: that large companies and startups can co-create transformative new businesses.

In the second part, I'll look ahead to the ways in which collaboration and co-creation can be harnessed for new business creation and transformative innovation. Adapting lessons from venture capital firms and the lean startup movement, I'll detail the ways in which large companies can embrace this ecosystem concept and move forward and make it a reality. I'll introduce a framework that takes you from discovery to scale-up and integration of these strategic growth initiatives.

Throughout this book, I'll share case studies and interviews with leaders in this collective disruption revolution from large companies, accelerators, and entrepreneurial firms. These executives speak candidly about the challenges and opportunities they've faced in bringing big ideas to life.

We've entered a new era of innovation, for entrepreneurs and big companies alike—the era of the collective disruption. I invite you to join in, understand the rules of this new game, and learn how to play to win.

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THE ERA OF DISRUPTION

Once upon a time, there was a company whose name was synonymous with innovation.

Eastman Kodak could lay claim to some of the most creative and enduring innovations of the twentieth century. Kodak led the development of film-based photography, and scarcely a consumer in the U. marketplace went untouched by the revolution. It was the company that gave us the Brownie, Kodachrome, the Instamatic. So entwined with photography did this company become that its very name became the phrase we used to describe a cultural touch point: “a Kodak moment.” By the 1970s, Kodak controlled a whopping 90% market share of photographic film sales in the United States and had the profits to match.

Yet, by 2012, the icon would be in bankruptcy.

What happened?

The digital revolution arrived, and Kodak failed to adapt. It wasn’t for lack of trying. Kodak was fully aware of its predicament even as it emerged, worsened, and then became a full-blown crisis. Many attempts were made internally to respond to the massive change that digital technology brought to the photography market. Kodak restructured, it pledged to meet the challenge of the digital age, and it exhorted its innovation teams to focus in this new direction.

But in the end, the business could not make the leap into the modern age. The beloved brand slid into financial ruin.

In many ways, the Kodak story is one that exemplifies the need for this book, A company was born, grew, and thrived on new inventions and then, once large, found itself unable to adapt that innovation process within its successful framework. Kodak didn’t turn its back on innovation; indeed, company officials continued to beat the drum for innovation throughout the decline. Still, it was a company that could not seem to recapture its innovative streak. Cut off from its creative wellspring, it eventually was starved out of the business it had once dominated—even, arguably, invented.

Many will blame management mistakes or the advent of new technology or changes in the consumer marketplace, but I’d argue that the Kodak story is one that is not unique. Big companies—once innovative companies—are experiencing it over and over again. Think about RIM and its rapid fall from grace as it missed the smartphone revolution and refused to reinvent itself in the exploding consumer market for these phones and the ecosystem of apps that it spawned. Think about the ongoing disruption of the publishing industry. The *New York Times* itself created a telling internal report (which was later made public) on the challenges of the digital revolution and a call to action to do more—faster—or die. Not long after the report was drafted in April 2014, the *Times* ousted its executive editor, and the incoming replacement, Dean Baquet, wrote in an internal e-mail to staffers: “The best companies constantly look for ways to get better. They embrace change, rather than simply telling themselves how good they are. As great as we are journalistically, there is much more to be done digitally.”

This story will continue to be told about those who fail to adapt and embrace the new definition of innovation and its now-necessary connection to new business creation. The old definition of innovation is dead. Just ask Kodak and the many, many other big brands that find themselves caught in this transition. According to research by Richard Foster (author of *Creative Destruction*), the average tenure of companies in the S&P 500 has shrunk from 61 years back in 1958 to just 18 years as of 2012. At this rate, 75% of the current S&P 500 will be replaced by 2027.

This crisis is personal to me. I have been on both sides of the conference table as it has unfolded. In my work inside and outside of big brands, I have come to know, respect, and work alongside the managers who have to make innovation work for both the company and the customer. Theirs is a serious challenge. I know because it has been and continues to be mine as well.

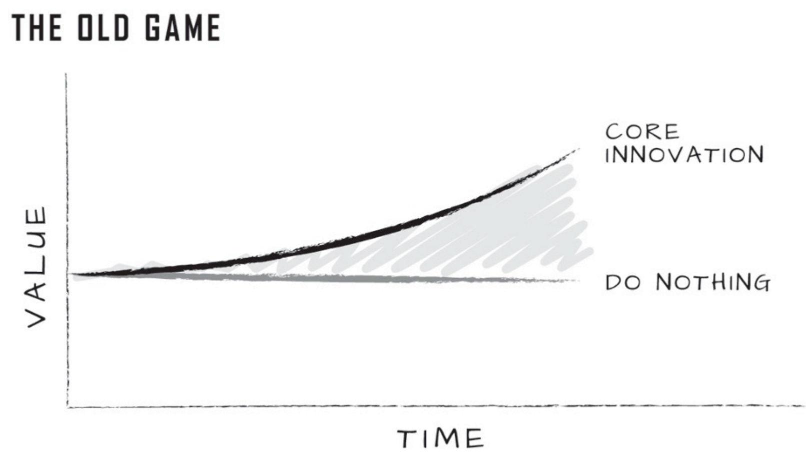
Over the course of this book, I’ll explore how to resolve this challenge on a large company scale by embracing more transformative approaches to growth. I’ll go into great detail about the kind of new partnerships and new business creation orientation big companies need to adopt in order to regain the necessary innovation engine—the driving force that unless restarted will simply let a company sputter into bankruptcy and has-been status.

But for this chapter, I’ll focus on the why, because it’s a reasonable and important question to address at this stage in our conversation. Why can’t big companies seem to innovate and create new sources of growth? They should be able to do anything. They’ve got all the resources and connections and the deep bench of talent that tiny firms can only dream about. Amazing things should be possible. So when that doesn’t happen—and it doesn’t happen for lots and lots of big companies—it makes sense to step back and try to understand the forces that trip the mighty.

The Game Has Changed

One of the most important points to make at this juncture is this: it’s not the company’s fault. Which company? Any. I could list for you a dozen firms currently on the hot seat for having lost their innovative edge. It’s a commonly told tale. As any company (RIM? General Motors? Sears?) struggles to come up with innovative new ideas, critics will often point to individual errors made by company management. Some of this criticism may be perfectly valid, but it misses a larger point. In our global economy today, we are experiencing a generalized trend of large companies struggling to harness innovation to drive new sources of growth. Something has happened that will not be fixed by company-specific finger pointing.

In many ways, the problem that companies are experiencing starts at the very core of the innovation discussion—what we mean by “innovation.” We use the word “innovation” to describe things that are new to the marketplace. Over many decades, we have learned to use the word “new” rather liberally. A change in packaging could qualify as new, as well as an update in formula, an additional flavor, even a move from family- to single-serving size. At one time, each of those things would qualify as innovation for many a successful company. “New and improved!” was the industry standard, and companies clearing this relatively low bar could count on retailers and consumers to respond positively and with wallets open.

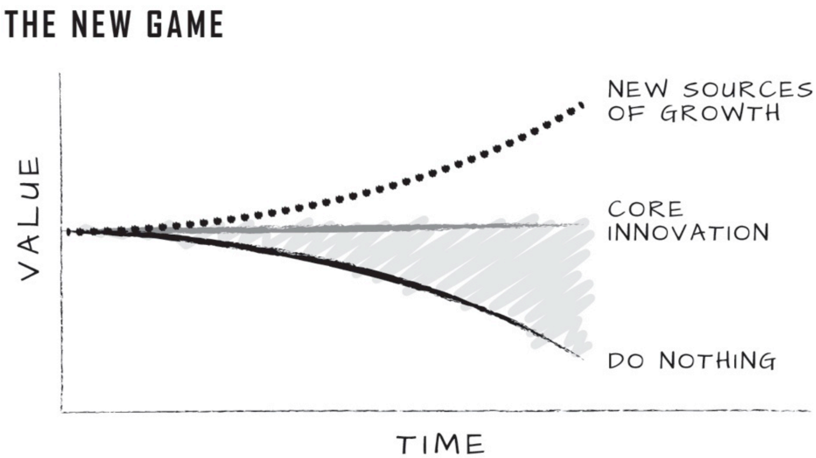


Then came the digital revolution. Everything—including the definition of the word “innovation”—changed.

Technology underwent an expansion that rewired every industry. With the advent of the Internet, communications exploded in reach and in speed. A world that once relied on mail carriers and telephony was now hyper-connected. People and companies could share ideas and collaborate on work at a higher and faster level than ever before.

With this technology boom came a blast of technology products onto the marketplace. In hardware, the parade of computers, desktops, laptops, cell phones, smartphones, and tablets was steady. The hardware came with a companion wave of software that erased barriers of time and distance. New services sprang up to serve this newly decked-out consumer with speed and precision. The technology changed the lives of millions.

It also changed our definition of what it meant to be innovative.



Enthused by the groundbreaking, life-changing newness of the tech boom, end users at every level began to demand that rate of change on a regular basis. Consumers wanted to buy the new, exciting stuff. Retailers wanted to stock it. Stock analysts wanted to see this level of innovation in the pipeline of the companies they followed. Investors large and small scoured business plans not for slow, steady growth but for a breakout new product. Now, having something with a new color or new package wasn't enough; it had to be a new experience, a new idea, a breakthrough game changer. If not, it was ordinary. It paled by comparison to the exciting new tech stuff coming out of the startup communities all over the world. Now imagine as this level of expectation flows down to the folks that design cough syrup and toasters.

Every year, the unencumbered genius of the startup community produced some amazing new thing: maybe an even smaller way to house technology, an even faster way to communicate, an even richer entertainment experience. Standing next to the exciting newness of entrepreneurial experimentation, the innovation of many big consumer products companies started to look a bit stale. Think of it from the consumer perspective: if you had some cash to spend, what would catch your eye? The slightly new iteration on an old product you've known and loved forever or the fascinating, mind-blowing newness of the latest gadget or software?

It's too easy to think of this shift as being one driven by technology—it was not just a question of new, faster machinery at work. What was happening in Silicon Valley and other centers of innovation, both real and virtual, was a new emergence of connectedness. Technology connected us in ways that were faster and more meaningful than ever before. Innovation wasn't what it used to be. The game had changed. Big companies were rapidly being left behind.

The shift was not lost on corporations. They may not have been first to spot it, but as it spread as a trend, they caught on. They knew the world had changed around them. In boardrooms up and down the Fortune 500, presentations were passionately made: *We need to be more innovative!* Many agreed this was necessary. No one argued against the need for better innovation. Yet few companies seemed to be able to actually do it.

How did this happen? The answer is complex; both external and internal forces drove the trend.

External Forces

The consumer marketplace has become a faster and more demanding game. Consumer products have to be better. Now that customers can shop across time zones, lesser products cannot run and they cannot hide. Everyone—across all industries—is held to the highest standard. If in the old days customers might be satisfied with a mediocre product because that's all they knew to be available, today that veil is lifted. Today, they know immediately, with a click of the mouse, what is available to them and what the "best" in any given category might be. They're free to leave you for the better product at any time. And they will, too. This raises the bar for every company in a category. Consumer expectations have risen and show no signs of coming back down. This puts the pressure on companies to deliver products that meet the new higher standard.

Alongside the higher customer expectations comes a new demand for speed. If customers were once satisfied with an innovation every year or two, today that product cycle is vastly reduced. Companies find that their innovations are quickly copied and even overshadowed by competitors. The innovation game becomes one in which the innovators are constantly at a run, with little downtime between new product generations. Even as a new product or service debuts, already its challenger is entering the ring.

Fueling both of these trends—shorter product cycles and consumer expectations—is the broader trend of connectivity, not just in business but also in the human experience. We are all connected today in ways that were unimaginable a few years ago. We can know about retail trends in faraway lands. We can hear about breakthroughs around the world the day they happen. We can share our opinions and our experiences with clicks at light speed. Connectedness is not just a consumer phenomenon but also a phenomenon that has changed the company/consumer relationship. Years ago, consumers might wish a product had a certain feature. Today, they'll fire up their mobile device and shoot the CEO an e-mail describing their demands—and they'll expect an answer. Connectedness is both a blessing and a curse for corporate entities. It allows companies to better understand what consumers want, and it is also an open channel for consumers to talk back. That's not something Eastman Kodak had to worry about back in the Brownie days. Times have changed. Today, ideas come from everywhere.

Internal Forces

While those external forces were taking shape, companies were developing internal approaches that would ultimately stymie innovation efforts.

In fairness, big companies are not built to support breakthrough or transformative innovation. They are built to support optimization. The bigger any company grows, the more players extol its efficiencies, its economies of scale, its ability to replicate and execute on a wider stage. These are all processes that call for standards, best practices, rules, and regulations. They build companies that reward managers who can work within a system, not throw it into a tizzy with a light bulb idea. Big companies prize the smooth, efficient running of their bigness, and the bigger they get, the harder it is to hold onto the disruptive energy of an innovative process. Big companies reward risk avoidance.

Here's a good example of that mind-set at work. Years ago, the CEO of GE Capital wanted to jump-start the innovative energy of his company. So he offered two-dozen of his managers an interesting opportunity: he pledged $1 million in funding to any of the managers who could take an idea and turn it into a new business. However, almost no one took the bait. Only one or two of the managers stepped forward to try. The rest were well wedded to the big-company mind-set. Working on their own, they saw that known spaces seemed to offer more upside than taking a risk on a new approach—even with a $1-million incentive.

The GE Capital story is a classic rendition of the risk-averse mind-set that pervades big companies. Sticking to what you know is better than risk something new, even if the payoff might be huge. With 22 out of 24 managers thinking this way, how could GE Capital hope to recapture its entrepreneurial mind-set? Clearly, behaving in venture mode was far from attractive to the team leaders. But it's not an issue with individual employees. Rather, the culture and management behaviors that make these companies great at optimization stand in the way of disruptive thinking. When they try these "one-off" attempts such as that at GE Capital, few believe that it's real or that it's a long-term commitment.

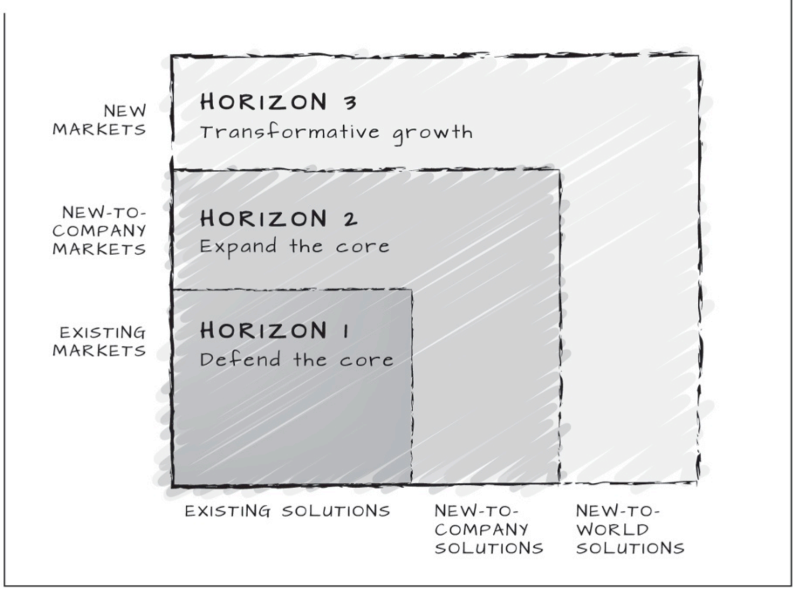
Many of them are naturally passionate and creative. Udaiyan Jatar (U.J.), an experienced corporate innovator who now leads Blue Earth Network and its work in transformative innovation, told me: "I think we have a prejudice that big-company executives or employees are not creative. We also have this prejudice that they're not passionate, and these are wrong perceptions. They are very creative and very passionate. Just not passionate about incremental thinking—cost cutting and somehow trying to eke out a 0.2% growth in the quarter even when there may be disruptive, world-changing ideas that exist within those employees that are never tapped. The barriers to unleashing creativity are often self-inflicted and systemic, but they can be overcome and frequently are."

We need new ways to both unleash internal creativity and tap into external creativity sources for growth.

Rebalancing the Portfolio

Companies need growth. They need to find ways to create new business platforms while still managing and optimizing their current business. That's been the challenge of management for decades, if not centuries. The three-horizons framework originally presented in the book *The Alchemy of Growth* is a simple and proven framework for thinking about building a balanced portfolio of opportunities for today and for the future. What's changing is the pace at which companies need to replace these core products and businesses. That means more emphasis on creating options for future businesses.

GROWTH HORIZONS



Horizon 1: Defending and refreshing the core is where most companies spend their time and where most of today's revenues and profits come from. Ignore the core at your peril, I agree. However, what used to be core business innovation is now what it takes just to stay in the game.

Horizon 2: Expanding the core and adding adjacencies are becoming much more important parts of the portfolio mix in today's hypercompetitive markets. The speed at which you need to identify and introduce these innovations and growth opportunities is accelerating. In many ways, rapidly introducing these opportunities is the new core strategy.

Horizon 3: Creating viable future options sometimes means monitoring and engaging in transformative innovation, which can involve market-disrupting opportunities. The payoffs are seldom in the short term, but the importance of this horizon to the future of the enterprise can't be understated, especially now that disruption is happening all around us on an almost daily basis. While still a smaller part of the portfolio mix, H3 work is more important now than ever, and yet many companies continue to focus on H1 and H2 almost exclusively. Why? Because H3 entails much more risk and is often much more about business model innovation than new products or services alone—precisely what large companies aren't historically good at and where they need the most help.

Companies need a balanced portfolio of initiatives across all three horizons. What's that ideal balance? It depends on your industry and your company's situation. But it's an important topic that the senior leadership team needs to address to understand the company's current focus and to set targets for the future. One study of a large cross section of companies (across industrial, technology, and consumer goods) conducted by Monitor (Deloitte) found that the high performers allocated their efforts/resources as follows: roughly 70% core, 20% adjacent, and 10% transformational. Google uses that same ratio as well. What's really interesting is that this same study showed that among high-performing companies, their distribution of returns was the reverse. Almost 70% of their total returns over time from innovation came from transformational innovation. So while protecting the core remains job number 1, investing in transformational (H3) activities is the only way to survive for the long term.

Susan Harman, VP & Product Champion, LexisNexis (formerly Intuit)

Harman understands the importance and the challenge of pursuing new strategic opportunities in big companies. When we talked, she described the importance of breakthrough and long-term thinking, along with the need to explore opportunities quickly using entrepreneurial approaches.

Companies need to have a balanced portfolio. They need to grow and to grow strategically by entering either new markets or adjacent markets.

The problem I have observed in big companies over the years is keeping the momentum going. The challenge is that large companies have to balance revenue being generated by their H1 portfolio offerings and the investment required to investigate potential H3 offerings, because the moment the company has any type of revenue or profit challenge, the resources get pulled from the H3s over the years.

A challenge faced by H3 intrapreneurs is that large companies have operational systems and processes in place to support their H1 businesses, and, typically, those processes don't work for an H3. The H3 intrapreneurs are constantly faced with boulders in their path, and they have to figure out how to navigate around them, underneath them, over them—or blow them up.

So if a company does want to invest in an H3 portfolio; how does it get started? It should invest in a very small team—probably a seasoned product management leader paired with a marketing leader—and look for opportunities that are strategic, large market size, in a space that makes sense for the company to be in. The basic research is done pretty quickly just to decide, "Should we be exploring this space?"

That small team has to really dig into the target audience in order to really understand the customer problem to be solved and then follow the lean startup" process that starts with identifying the most important hypothesis to prove true/false. It's about moving very quickly through the process. This should not be millions of dollars in investment and a year of R&D to determine whether this is a viable potential business. Instead, they are starting out very small by testing concepts with users to really determine whether there's a there, there. And then developing *minimal viable functionality in order to solve for the love metrics and net promoter scores and not simply revenue and large user base.*

It's basically minimal investment following lean principles to really just determine whether there is something there that the company should consider pursuing. The challenge is that, typically, they will find only one potential in 10 exploratory attempts. And that one potential might not generate revenue for two years, and that is why companies often lose interest. One way to fast track this is to partner with entrepreneurial companies that are in the space, but that too has its challenges with establishing the appropriate rules of engagement and expectations.

The reward is there if companies are patient. Intuit and LexisNexis recognize that it is a portfolio play, that it is a strategic and long-term focus, and that there might be only one home run out of many attempts.

Susan Harman is currently VP and product champion, LexisNexis. Prior to that, she was an innovation leader with Intuit. Harman is passionate about leading consumer-driven innovation, with a particular focus on whitespace opportunities.

Are You Stuck?

The world has no shortage of great ideas. What's often lacking is the ability or the will to act on them. Does your firm really have a problem following through on transformative innovation and new business opportunities? Note these key signs:

1. You're not growing. You may be turning out the same number of new products every year, but that method of innovation is just keeping you at base level. It's preventing a backward slide, but it's not growing your margins, and it's not growing your top line. There's no point blaming the slow economy or some other outside force for this stasis you're in. Lack of growth is often a sign you are stuck in incremental mode.
2. You're identifying needs to support today's business but are missing the major shifts with your customers and new segments of customers that you could have captured.
3. You've been surprised too often by disruptive solutions, sometimes introduced by your major competitors but increasingly by new players you've never even heard of.
4. Funding is over-allocated to incremental ideas at the expense of breakout ideas. Others may argue that you have some truly breakthrough projects on the drawing boards. Look, for a moment, at which projects in your innovation portfolio really get the support to come to fruition. Do you find that incremental ideas get a lot of support quickly while the breakthrough ideas stall, stay in a zombie state with no real financial support, or get killed off outright?

5. Management talks about innovation but doesn't really want it to happen. This can be a problem as high up as the C-suite. If company leaders are talking about transformative innovation but making no change in process or policy to support the new behavior, then it's just talk.

If this sounds like your company, don't panic. While the situation is challenging, the answer is out there. Big companies are terrible at risk taking and disruptive innovation. They need more than instruction on how to innovate in this new world. They need partners—partners who run toward risk with arms open wide, partners who haven't been around long enough to develop a cannon of behavior that favors optimization over innovation. Big business needs to partner with entrepreneurs in new ways.

Traditionally, innovation has been an internal process. The creative minds of a company may have sequestered themselves deep in the corporate labs, away from the daily bustle of marketing or sales, cooking up new ideas that no one really understands until the team emerges to make the presentation to the rest of the firm.

But the days of the cloistered innovation team are long gone. Today, leaders in the corporate environment must redefine how they grow and be willing to partner for new ideas and new business creation.

Procter & Gamble is learning how to compete in this new arena by continuing to innovate the core while exploring whole new business models that leverage their brands into new areas. In the old days, innovation meant "new and improved" Tide laundry detergent, perhaps with a new ingredient that enabled a claim of better whitening. More recently, P&G introduced Tide Pods, a breakthrough form factor and enabling technology that reinvigorated the category. But even that isn't fueling significant growth for the brand. So now it is incubating whole new business models, including Tide-branded dry cleaners and Mr. Clean–branded car washes, in partnership with franchising experts as a way to leverage the brand into services far outside of its existing core. Time will tell whether this is a winning strategy. But P&G understands that it needs to try.

It's difficult to overcome these challenges to develop new products and services within your core, and it's nearly impossible to innovate entire new businesses and ventures where risks and unknowns are so much higher—unless you're willing to partner with those outside your company who specialize in just that way of thinking. This is not a prescription for an individual company with an individual problem; it is a mandate for industries ranging from consumer products to health care and industrial goods. The game has changed, so the players must change with it.