

ORGANIZING FOR INNOVATION

Michael Lurie and Erin Lima

Established corporations introducing new products, technologies or lines of business need to think carefully about how best to organize to succeed.

Extensive practical experience as well as a rapidly growing body of research indicates that the established organization is ill-equipped to support the successful development and launch of new products and businesses.

Executives at established companies must recognize that the new venture will require the careful creation and development of a discrete organizational structure with its own resources, processes and values in order to incubate, cultivate, and harvest the business opportunities of the budding innovative enterprise.

In this article, we will review some of the leading research into organizing for innovation, and then summarize key guidelines for executives.

The Design of New Organizational Forms **by Jennifer Herber, Jitendra V Singh and Michael Useem**

In their excellent chapter “The Design of New Organizational Forms” in *Wharton On Managing Emerging Technologies*, Jennifer Herber, Jitendra V Singh and Michael Useem explain: “Dominant players often fail to adapt because it means dismantling the very organizations that have led to their success. Past adaptations become inertial constraints, leading to a kind of “competency trap”. The organizational architectures that companies have built to propel their success can become as outmoded as feudal kingdoms in an age of democracy”.

Herber, Singh and Useem discuss six emerging organizational forms. These include virtual organizations, network firms, spinouts, ambidextrous firms, front-back designs and sense-and-respond firms. These are all examples of dynamic, adaptable organizations well suited to innovation.

10 Rules for Strategic Innovators **by Vijay Govindarajan and Chris Trimble**

In *10 Rules for Strategic Innovators*, Vijay Govindarajan and Chris Trimble describe the fundamental difference between the organizational DNA of the established company (which they refer to as CoreCo), and the new innovative business unit (NewCo). CoreCo is all about planning, leveraging core assets, meeting customer needs, efficient processes and clear growth and ROI metrics. NewCo is about creativity, experimentation, learning, adaptation, flexibility and rapid response. They describe a powerful framework for how NewCo can survive and thrive in this environment.

Govindarajan and Trimble explain: "(NewCo) must address the three unique challenges that arise from the unnatural coexistence of a new and mature business within the same corporation: a forgetting challenge, a borrowing challenge, and a learning challenge. NewCo must *forget* some of what made CoreCo successful. It must *borrow* some of CoreCo's assets – the greatest advantage that NewCo has over independent start-ups. And it must be prepared to *learn* how to succeed in an emerging and uncertain market.

Govindarajan and Trimble present the four elements of organizational DNA as staff, structure, systems and culture. They explain that each of these elements need to be carefully considered to decide which of them should "forgotten" by NewCo and which should be "borrowed", in order to maximize NewCo's ability to "learn".

Govindarajan and Trimble conclude that *NewCo should have a distinct approach in most respects, and leverage CoreCo's strengths and assets in one or two key areas.* "The NewCo organization must be built from scratch, with new choices in staffing, structure, systems and culture. This is the only way to defeat the powerful forces of institutional memory."

The Innovator's Dilemma **by Clayton Christensen**

In *The Innovator's Dilemma*, Clayton Christensen explains why established companies are ill-suited to innovation, particularly disruptive innovation that undermines the core business. Christensen describes three categories of institutional capabilities: resources (people, assets, customer and supplier relationships, etc.), processes (how inputs are transformed into outputs) and values (what is important to the organization).

He explains that these capabilities are typically developed in that order over time. First, the company has some good resources, then it evolves efficient processes, and then it develops its core values. When a new business starts up within an established company, it needs to go through the same sequence, but it is now battling the established company's values and processes.

Christensen explains that established companies have three broad options to build innovative business units with the right resources, processes and values. These are:

- Acquire a new company and keep it as a standalone entity with its own processes and values.
- Create new capabilities internally, which he demonstrates is difficult to do because these violate the fundamental purpose and success formula of the established business.
- Create capabilities through a spin-out. The question then becomes how separate versus integrated does the spin-out need to be? Christensen offers a useful framework to determine the nature of the spin-out based on its fit with established company values and processes.

To succeed in the long term, focus on the middle term
by Geoffrey A. Moore

In a recent article in Harvard Business Review, Geoffrey Moore builds on the work of McKinsey in defining three time horizons for a corporation's portfolio of products or businesses. Horizon 1 refers to the current year, Horizon 2 to developing the next generation of high growth opportunities, and Horizon 3 to researching future business opportunities.

Moore points out that while the established organization is set up to support the Horizon 1 businesses, and Horizon 3 businesses are the domain of market research and R&D, Horizon 2 businesses often fall into a kind of "no-man's-land". Moore states, "Horizon 2 projects fail to be embraced because they cannot deliver Horizon 1-level returns but are nevertheless held to the same yardstick.... Thus the advantages of in-house innovation at asset-rich corporations turn out for the most part to be illusory. Innovations are better off in bootstrapped start-ups, because at least there they can get access to the market and suppliers, and their investors will use fairer standards of measurement."

Based on the successful experience of Cisco, Moore offers a number of key lessons to grow innovative products and businesses within established companies. These borrow heavily from his extensive experience with the strategies and organizational approaches of independent, venture-backed start-ups.

- *Isolate and insulate Horizon 2 from Horizon 1*, with different structures, processes and reward systems.
- *Use acquisitions in the short term* to help fill the Horizon 2 gap.
- *For the long term, incubate businesses not products* – create separate business units with a focus on a single-high value segment.
- *Adapt "crossing the chasm" thinking to the dynamics of operating inside a major enterprise.*
 Moore writes, "For some time the venture community has known that the fastest way to grow a disruptive innovation into something really profitable is to focus on dominating a niche market where the new technology solves a mission critical problem.

Established enterprises, however, cannot afford to be so precise on their focus. The challenge of achieving growth atop an already huge revenue base requires them to operate on a grander scale, and all their processes, metrics and targets reflect this fact.

But these norms are toxic to Horizon 2 ventures, so it is critical to negotiate exceptions to all of them for the duration of the Horizon 2 timeline. Of course, all these exceptions would be standard operating procedure for crossing the chasm in a start-up. It's just that managing Horizon 2 ventures in an established company is more like trying to cross the chasm inside the belly of a whale".

- *Focus on leaders, not funding* – the scarcest resource in growing innovative businesses is effective, entrepreneurial leaders, not funding. The organization and

role must be structured to make this a challenging and rewarding career opportunity for the organization's best executives, otherwise they will go elsewhere.

- *Block resource migrations across horizon boundaries* – i.e. make sure the Horizon 1 business doesn't cannibalize the Horizon 2 businesses by attempting to develop and launch Horizon 2 products within the Horizon 1 structure.

Conclusions and guidelines

Combining the broad ranging research of thought leaders like these and Blue Mine Group's extensive experience with innovation, we offer the following conclusions and guidelines to executives of established companies:

- **Recognize new businesses are different.** Recognize that the business challenges of a new innovative product or line of business are very different from the business challenges of the mainstream established business.
- **Keep the new business largely separate.** Explore a range of organizational options to keep the new business largely separate from the established business, with the freedom to have different strategies, organizational structures, types and levels of employees, compensation and reward systems, performance metrics, information systems and even culture and values.
- **Provide the new business selected support.** At the same time as keeping the new business largely separate, understand how the established business can provide a limited set of carefully selected resources and support to the new business to give it a real advantage over standalone start-ups.
- **Carefully select the right leader for the new business** – someone with a rare combination of entrepreneurial drive and creativity, together with the maturity and experience to navigate the established corporation's power structure.
- **Provide the right rewards and incentives** to the new business leadership team, so that their careers are enhanced, not delayed.
- **Think like a venture capitalist with regard to the new business** – focus on long-term value creation and short-term metrics like learning, milestones achieved and market traction, not quarterly earnings.

Once the new business grows to the point where it is strong and established (often in the range of \$50 - \$100 million in annual revenue), it is ready to "exit" – either to be transitioned into the mainstream organization, or to be sold to another corporation where it is a better long-term strategic fit.

Resources

1. "The Design of New Organizational Forms" in *Wharton On Managing Emerging Technologies*, Jennifer Herber, Jitendra V Singh and Michael Useem (New York: John Wiley & Sons, Inc., 2000)
2. *10 Rules for Strategic Innovators* by Vijay Govindarajan and Chris Trimble (Boston, MA: Harvard Business School Press, 2005)
3. *The Innovator's Dilemma* by Clayton Christensen (Boston, MA: Harvard Business School Press, 1997)
4. *To succeed in the long term, focus on the middle term* by Geoffrey A. Moore (Harvard Business Review July-August 2007)

About the authors

Michael Lurie is Founder and CEO, and Erin Lima is a Director of Blue Mine Group in San Diego, CA. Blue Mine Group is an innovation strategy firm specializing in market traction for new products, technologies and lines of business.