Strategic Entrepreneurship & New Business Opportunities at ToolsMed [1]
- Case A -

Case Questions:

1) Which obstacles to strategic entrepreneurship and innovation & new business development can you identify at ToolsMed? Some are explicit, some are implicit and more in-between the lines.

2) How can you categorize those obstacles?

3) At the time, ToolsMed had made the decision not to invest in innovations and new business opportunities because of a heavy economic recession. In how far is that a good or a bad decision? Why?

Liselore Schuster was preparing for the upcoming strategy review with the company´s Executive Board. She wanted to do this well, because she firmly believed in the importance of innovation and new business development for the future of ToolsMed.

Schuster was heading ToolsMed Innovation & New Business Opportunities Group (INBO) for 4 years now. This department had been installed by early 2012 to focus on new innovations and new business opportunities that were in line with the company´s capabilities yet adjacent or distant from its core business. ToolsMed had made considerable progress since then in how it managed its innovation activities and emerging new business opportunities. With the energy and enthusiasm of Liselore Schuster, several new business opportunities had been identified, in close collaboration with the business units, and had received funding from the Board. These innovations had been mostly more incremental and could be characterized as 'low-hanging fruit' that extended the existing core business and improved ToolsMed market position with its existing customers.

In this way, the INBO group had enjoyed some first, occasional successes with the creation and development of these new innovations, and their successful market introduction. However, over the past two years it could not really show any new successes. In contrast to INBO's headstart in its first 2 years, the success rate of its incubated projects over the past 30 months - from May 2014 until December 2016 - was lower than the team had expected. Schuster and her team were puzzled about the underlying reasons.

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[1] *This case was prepared by Prof.dr.ir. Victor A. Gilsing for the sole purpose of aiding classroom instruction. The case is not intended to serve as endorsement of the company or as an illustration of effective or ineffective management. In order to protect the company and its real name, the name ToolsMed is used in the case.*

Were the innovation teams that they coached and supervised, mismanaged by the team-leaders? And was it in that respect also attributable to INBO's recruitment and selection of team leaders of these innovation teams? Or, instead, was it the advice and coaching that these teams received from INBO that was insufficient or inadequate? Or, were there perhaps reasons beyond the discretion of the INBO Group? As the core business of medical diagnostic tools exhibited increasing indications of maturity, the creation of major innovations and the pursuit of new business opportunities became more and more important. The question facing Schuster was what she and her INBO Group should do in order address this mounting strategic challenge.

Foundation & History

ToolsMed makes products & tools for medical purposes such as, among others, stethoscopes, ear checking devices, radiographic scanning machines and skin diagnostic instruments. See also appendix 1. The company was founded in 1925, and had grown to a 400 million Euro business by 2007 and employed around 2500 people. The company was located in Western Europe with its HQ and R&D facilities at the same location, and manufacturing at different locations throughout Europe, and with two sales offices in the US. Expansion to Asia was also envisaged.

In 2010, the company had gone through a major restructuring because its business had gone flat for already a number of years. The deep economic crisis from 2008 onwards, also known as the Great Recession, had further aggravated the situation but the decline had already set in before that, with the DotCom crisis in 2001. Around 2009, the situation started to worsen rapidly as revenues dropped by more than 15%, with not even the beginning of indications that signaled a future recovery. Two major reasons that could be identified were ToolsMed's high cost structure and its appalling innovation track record. Its high cost structure made that ToolsMed started losing business to competitors in its existing markets of doctors and hospitals, whereas its poor innovation track record made that this loss in existing markets could not be compensated for by growth in new markets. In addition, as was generally felt at ToolsMed, the Great Recession had made things even more difficult and had not provided the right timing to invest in innovation and new business opportunities.

To address this crisis, a new CEO was appointed, Walter Lisch, by May 2010. Lisch was a former McKinsey partner who possessed deep expertise in restructuring companies through implementing operational excellence programs. To address the crisis, he started with a major cost-cutting program in order to bring costs down and make these more in line with the rest of the industry. This entailed, among others, the layoff of 350 people over two years, which was about 15% of its total staff. In addition, he made the decision to sell off the business unit of stethoscopes to a private equity fund. This had become a commodity-like business with low margins and very few opportunities for innovation and new business opportunities. With the proceeds from this sale, € 115 million, he could strengthen the firm´s capital position that had detoriated over the past years as well as fund its future growth. This decision to sell off the stethoscope business unit resulted into a much more focused company that specialized in the most advanced medical tools and instruments. Strategically, it aimed at operational excellence in order to ensure that cost levels remained under control and its competitiveness in the marketplace was regained in order to get onto solid financial grounds again. These measures started to bear fruits after about 18 months, so that by the end of 2011 confidence slowly started to return, both with the company, its employees and its shareholders.

More attention for innovation

Still, the challenge that remained by early 2012 was that of ToolsMed future growth. Although with its current cash position, ToolsMed could ´buy´ growth through an acquisition, Lisch did not see immediately attractive candidates. In addition, he was well aware that the company was still not entirely on solid financial footing given its focus on recovery from its recent crisis and on the further implementation and finetuning of its operational excellence program. When mixing up this process of recovery with an acquisition and then followed by a complex, time-consuming and potentially risky post-merger integration process, all that had been gained over the past 18 months could be jeopardized again. Lisch did not find this an attractive option, or at least not on the short term. In addition, he found that it was important that ToolsMed would develop its own strategic entrepreneurship and innovation capabilities, and that innovation would become an unquestioned priority at the company. Something that had not been the case until now.

In the history of ToolsMed the priority for innovation had waxed and waned. Over the years it often occurred that only if a senior executive developed an interest in a new innovation, it could get a shot. In this way, senior executives served as a sponsor of certain innovation projects, and offered resources and could help to defend these innovation teams against ´political attacks´. However, what had happened already twice was that when a senior executive left the company or changed positions, the innovation projects were often immediately in jeopardy. The underlying problem of how ToolsMed was going to address its future growth had never been a fundamental strategic priority. This lack of strategic priority made that ToolsMed procrastinated on its innovation activities. In addition, an underlying infrastructure with organizational processes, capabilities and routines to support the creation and nurturing of innovations was also absent, resulting in that new initiatives and ideas were not gaining traction in the marketplace and often disappeared quickly from the company’s radar screen.

In an earlier attempt to boost growth in 2005, the former CEO Ruben Berger had created an fund of €20 million, in order to boost new innovations and future growth opportunities. Managers were invited to come up with new ideas for innovation in their business units by pitching their ideas in front of the Board. This quickly led to a situation where rather quickly developed business plans (some would say ´quick & dirty´) were presented that all showed projected upward future sales figures that followed the same, infamous ´hockey-stick´ pattern. However, with little formal systems and infrastructure in place supporting the execution of these innovation plans, most of it never materialized if it even started in the first place.

> As one manager reminds: '*The idea was if we put enough money into these projects, it will all be solved. But money is, albeit important, only one input that you need but certainly not enough. Unless the rest of the organization really believes why these innovations are needed, and accepts that the process of their creation, incubation and delivery is a slippery one, with high uncertainty, it is not gonna fly*.´
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> Another one recalls: '*I think, fundamentally, we have a cultural problem in that we consider the creation process that leads to new innovations as too messy and hence as too difficult to manage. Most of us are trained as medical professionals and as engineers, and we feel pretty uncomfortable with processes and stuff that are inherently unpredictable. I think our culture sort of unwarily considers innovations as weeds in the garden….something you rather avoid than embrace.'*

To address this fundamental problem of how to restore future growth in new markets, Lisch established in early 2012 a new department for Innovation & New Business Opportunities (INBO) with the aim of developing a systematic innovation capability and expertise in pursuing new business opportunities. To head this new department, Lisch appointed Liselore Schuster. Schuster was trained as an electrical engineer and was a seasoned manager who had worked with ToolsMed already for over 25 years, especially in manufacturing and also with experience in supply chain management. One reason for Lisch to appoint Schuster was that she, as a seasoned manager had enough credibility and political clout within ToolsMed. In addition, she had demonstrated to have excellent people skills. With her appointment, the signal that he intended to give to the company was *'Innovation is of critical importance to our future, and it is gonna stay. You better take it seriously'*.

Schuster started her task with forming a study team to develop an in-depth understanding why ToolsMed systematically failed to come up with new innovations and why it often missed new business opportunities. With the help of an external consultant, they started with what seemed somewhat of a paradoxical task, as ToolsMed was markedly improving in its current operations such as engineering, manufacturing, sales, planning, after-sales and marketing through its ongoing operational excellence program. However, it still failed miserably in its innovation activities.

With her study team, Schuster moved quickly in those first months in 2012, in order to get a solid understanding of the underlying reasons. In her report to the Board, she listed a number of obstacles that had inhibited ToolsMed from accomplishing significant innovation successes.

There was a strong focus on existing markets such as mostly on doctors in hospitals and on the delivery of ToolsMed's existing products. This focus was largely attributable to ToolsMed's strong marketing orientation in its business units that emphasized the very careful listening to existing customers. This strong focus on its existing customers made that new markets with unserved customers were generally not on the radar screen of ToolsMed's business units. For example, ToolsMed had produced ear scanning tools for human ears already for years, but had largely missed the adjacent market of ear scanning tools for animals such as dogs, cats or cattle.

As a consequence, business unit managers did not spend a lot of time and energy on monitoring and understanding other markets or newly emerging areas. As a consequence, capabilities for collecting data on new markets and information on new trends were poorly developed. The emphasis in management control information for the core business was on quantifiable, hard data that were preferably as accurate as possible, such as on market size, % market growth rates, market shares, competitors' moves etc. etc.

Gathering insights into entirely new or newly emerging markets typically relies on qualitative information and an interpretation of 'weak signals' that require an exploratory attitude as well as a willingness to deal with the ambiguity that comes with the discovery of uncharted territory. Such an attitude with an appreciation for intuition rather than ratio was rare at ToolsMed. Most of its staff was formed by academically trained people, either with a medical background or with an engineering background in electronics or mechanics. Most of these professionals qualified decision-making based on 'gut-feel' or 'intuition' as 'soft, unscientific and unprofessional'.

> A former innovation champion reminds: *'My gut-feel tells me, time and again, that a big opportunity out there for ToolsMed is formed by the markets for security at airports and other public places. With the increasing threats of terrorism as well as growing numbers of travelers, this market could form a tremendous opportunity for ToolsMed. I believe that with ToolsMed's deep expertise in radiation technology and its strong reputation for precision in all that it does, it could be well positioned to enter that market. I am well aware that this is non-core business for ToolsMed at the moment, and would take it far out of its comfort zone but, hey, that's what entrepreneurship and innovation is all about. The only way to find out is just to try….and I always wanted to do that. But I felt ignored and ridiculed, time and again….and therefore decided to leave - which proved to be a very good decision in hindsight'.*

Organizational incentives & systems especially emphasized a strong focus on short term results and a precise meeting of targets, both revenue - & cost wise. In addition, the company had in its recruitment of talent mainly relied on hiring medical professionals and engineers that, if motivated and capable, could get promoted to business jobs such as in marketing & sales or to become a business unit manager. This also made that these departments were being deeply influenced by a medical and an engineering attitude, both of which shared an emphasis on precision and craftsmanship and rewarded flawless execution with a strong operational focus.

All in all, this led to behavior that was strongly geared to avoiding the making of mistakes and the reduction of risks, and in this way contributed to ToolsMed strong reputation and its past successes. However, it had been at the expense of creativity, thinking-out-of-the-box and experimentation. Basically, the company lacked any capabilities in strategic entrepreneurship and hence had no experience in creating, experimenting, funding, selecting, upscaling and/or terminating of new growth initiatives and innovation opportunities. Unless an innovation idea was a passion of a senior manager, who secured its funding and gave it attention, innovation projects and ventures tended to float within the organization as essentially no one really wanted to host them. Many new business initiatives were just pushed onto a business unit manager's responsibilities. This not only led to very limited interest and attention from their side to these ventures but also to attempts to get rid of these and try to relocate these with someone else.

> As one experienced business unit manager commented: *´You could see that lack of organizational support from the fact that people working on innovations and running new businesses had to defend their time on an ongoing basis in order to justify their legitimacy in the organization. That is not very motivating, to say the least´*

The few innovation projects or ventures that passed all these hurdles, and were being tolerated, often failed along the way. This was often because of inadequate skills in new business building and an inability of dealing with its many unknown unknowns, such as for Internet opportunities and consumers. Reducing this ambiguity required a lot of experimentation with its inevitable setbacks and failures, which asked not only for a lot patience and perseverance but also for an open mind in order to be able to learn from this process, and then try it again and again. To do this in an organizational culture of medical professionals and technically savvy engineers, who both cherished medical or technical precision and who were generally wary of taking risks, this was a mounting task. This resulted into a situation in which a systematic process that served as an organizational foundation for these innovation projects and ventures activities was lacking. As a consequence, in times of necessary budget cuts, these activities were the first to be killed, simply because it hurted no one.

To address these issues, Schuster realized that a more systematic approach to strategic entrepreneurship and innovation was needed. Lisch encouraged her to use a blank-sheet approach in that 'anything new' was allowed such as focusing on entirely new customers, relying on different channels to reach those customers, developing new business models etc etc. Everything that contributed to create new pathways to future growth was welcome. An important structural design choice formed that the INBO Group was separated from the core business. The idea was that this gave them more autonomy and provided them with more freedom to be creative and think-out-of-the box. Schuster reported to Mark Kelly, who was senior vice-president and responsible for Corporate Strategy. The team was located at its second manufacturing location, about 150kms from its corporate HQ. Furthermore, Lisch decided that he would monitor the progress of the INBO Group over time mainly on cashflow.

What Schuster decided, quickly after she started, was to pursue two different, complementary routes. A first one was to identify the ‘easy innovation opportunities’ that were largely in line with the existing business. Most of these opportunities had not gone unnoticed and were on the shelf for months or in some cases for even years already. But with the strong focus on operational excellence over the past two years, these had not received due attention. In close collaboration with the business units, these opportunities were identified, prioritized and implemented. Mostly, this was done by the business units themselves but the INBO group had supported this process by implementing some new important measures as a stage-gate process, staged funding, monitoring through milestones and training of people in the core business on issues such as how to develop, test and upscale these incremental innovations. An important test case was formed by ear scanning devices for animals that was quickly picked up by the business unit ‘Scanning devices’ and which turned to become successful quickly, within as short as 18 months. See also appendix 2.

An important motive for Schuster to start with these incremental innovations was that, in this way, she could showcase some early successes that would help her to secure the legitimacy of the INBO Group when heading off for more adjacent and/or radical innovations. The latter formed the second route she aimed to follow.

To put this second route also into motion, she and her team came up with a ToolsMed 2.0 proposal, which she presented to the Board in the summer of 2013. The strategic thrust underlying the proposal was to exploit and use the underleveraged assets at ToolsMed that were stored and embodied in its people, processes and technologies. In order to accomplish this aim, the approach was to combine the strengths of how venture capitalists (VCs) operate with the strengths of a corporate venturing approach that was used at other companies. See also appendix 3. By combining these two approaches, the idea was to combine the best of both worlds, and to provide ToolsMed with a more systematic and formalized process that would help it to build a capability for repeatedly developing and commercializing new innovations, and not only hoping for ‘one-hit-wonders’.

In consultation with Mark Kelly, Schuster designed the new set-up for INBO Group and made a distinction between the core business which was labeled as ‘C-business’ and new business that was labeled as ‘N-business’. Within this latter category N-business, she further distinguished between ‘Big N’ and ‘Little N’ business. The qualification of ‘Big or Little’ for ‘N-business’ was based on the distance between such newly emerging opportunities and ToolsMed core business in the following way: Big equals close-to-core opportunities, such as the market of private clinics that had showed rapid growth for already a number of consecutive years, whereas Little equals far-from-core opportunities such as Internet and business-to-consumer opportunities. Whereas INBO was responsible for both types of innovations, Schuster realized that these formed entirely different ballgames, with the ‘Little N’ opportunities being far more ambiguous and risky, relative to ‘Medium or Big’ opportunities. Therefore, Schuster created a smaller extra unit within INBO, called ‘Radical Innovations’, that were entirely focused on ‘Little N’ opportunities.

This subgroup was headed by Stephan Raes, a 32-year old upcoming manager within ToolsMed, with a passion for innovation and a strong, future-oriented attitude. In close consultation with Liselore Schuster, he decided to use a different set of processes from the rest of ToolsMed, with a staff of 5 full-time Little N explorers. Their Moonshot ambitions showed up by seeking to produce results over a 5 to 10 year horizon. Whereas its initial budget was € 5 million to experiment and incubate with new initiatives, its budget could grow to 15 - 20 million over time. Instead of relying on existing technologies, to serve existing or new markets, Raes aimed at new technologies and new markets, through a multichannel strategy of reaching its new customers. In keeping in line with VC best practices, a sequence of increasing funding was envisaged in line with how much the ventures progressed. Monitoring would take place based on milestones. By aiming ‘for the moon’, high attrition rates were anticipated, with failure the default and success the exception. In addition, little N ventures were managed on cash flow, instead of expenses that formed the standard within the rest of ToolsMed.

APPENDIX 1

Source: ToolsMed company presentation

APPENDIX 2

Source: ToolsMed company presentation

APPENDIX 3

Venture Capital vs. Corporate Ventures

Venture Capitalist	Successful Corporate Ventures
Small investments in any one venture	Generally, same in early stages: • "make a little, sell a little" • Also some medium investments
Invest in many ventures	Same
Funding is stable between rounds	Same in early stage, off-budget and milestone based
Maximum freedom of action to succeed	Some limitations, but "champions" rewarded for succeeding in spit of the environment
Independent of other entities' interest	New ventures perceived as essential to general manager's interests
Investments are opportunistic	Search for synergy
Don't give up easily-average start-up takes > 8 years before IPO	Can be 5-10 years
External metrics of succes-market based	Initial/external
Incentives tied to the external metrics of succes • Long-term and highly variable	Varied methods • Short-term and less variable • Incentives may be based on goasl each year
Fully engaged lead investor on board of directors	Senior sponsoring manager is rewarded for venturing

Source: ToolsMed Company Presentation