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INNOVATE

Conventional wisdom holds that when companies become larger, they inevitably lose the capacity for innovation, creativity, and growth. I believe this is wrong. As startups grow, entrepreneurs can build organizations that learn how to balance the needs of existing customers with the challenges of finding new customers to serve, managing existing lines of business, and exploring new business models—all at the same time. And, if they are willing to change their management philosophy, I believe even large, established companies can make this shift to what I call portfolio thinking.

HOW TO NURTURE DISRUPTIVE INNOVATION

Successful innovation teams must be structured correctly in order to succeed. Venture-backed and bootstrapped startups naturally have some of these structural attributes as a consequence of being small, independent companies. Internal startup teams require support from senior management to create these structures. Internal or external, in my experience startup teams require three structural attributes: scarce but secure resources, independent authority to develop their business, and a personal stake in the outcome. Each of these requirements is different from those of established company divisions. Keep in mind that structure is merely a prerequisite—it does not guarantee success. But getting the structure wrong can lead to almost certain failure.

Scarce but Secure Resources

Division leaders in large, established organizations are adept at using politics to enlarge their budgets but know that those budgets are somewhat loose. They often acquire as large a budget as possible and prepare to defend it against incursions from other departments. Politics means that they sometimes win and sometimes lose: if a crisis emerges elsewhere in the organization, their budget might suddenly be reduced by 10 percent. This is not a catastrophe; teams will have to work harder and do more with less. Most likely, the budget has some padding in anticipation of this kind of eventuality.

Startups are different: too much budget is as harmful as too little

—as countless dot-com failures can attest—and startups are extremely sensitive to midcourse budgetary changes. It is extremely rare for a stand-alone startup company to lose 10 percent of its cash on hand suddenly. In a large number of cases, this would be a fatal blow, as independent startups are run with little margin for error. Thus, startups are both easier and more demanding to run than traditional divisions: they require much less capital overall, but that capital must be absolutely secure from tampering.

Independent Development Authority

Startup teams need complete autonomy to develop and market new products within their limited mandate. They have to be able to conceive and execute experiments without having to gain an excessive number of approvals.
I strongly recommend that startup teams be completely crossfunctional, that is, have full-time representation from every functional department in the company that will be involved in the creation or launch of their early products. They have to be able to build and ship actual functioning products and services, not just prototypes. Handoffs and approvals slow down the Build-Measureprototypes.
Handoffs and approvals slow down the Build-Measure-Learn feedback loop and inhibit both learning and accountability. Startups require that they be kept to an absolute minimum.
Of course, this level of development autonomy is liable to raise fears in a parent organization. Alleviating those fears is a major goal of the method recommended below.

A Personal Stake in the Outcome

Third, entrepreneurs need a personal stake in the outcome of their creations. In stand-alone new ventures, this usually is achieved through stock options or other forms of equity ownership. Where a bonus system must be used instead, the best incentives are tied to the long-term performance of the new innovation.
However, I do not believe that a personal stake has to be financial. This is especially important in organizations, such as nonprofits and government, in which the innovation is not tied to financial objectives. In these cases, it is still possible for teams to have a personal stake. The parent organization has to make it clear who the innovator is and make sure the innovator receives credit for having brought the new product to life—if it is successful. As

one entrepreneur who ran her own division at a major media company told me, “Financial incentives aside, I always felt that because my name was on the door, I had more to lose and more to prove than someone else. That sense of ownership is not insignificant.”

This formula is effective in for-pro t companies as well. At Toyota, the manager in charge of developing a new vehicle from start to finish is called the shusa, or chief engineer:

Shusa are often called heavy-weight project managers in the U.S. literature, but this name understates their real roles as design leaders. Toyota employees translate the term as chief engineer, and they refer to the vehicle under development as the shusa’s car. They assured us that the shusa has final, absolute authority over every aspect of vehicle

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development.[1]

On the flip side, I know an extremely high-pro le technology company that has a reputation for having an innovative culture, yet its track record of producing new products is disappointing. The company boasts an internal reward system that is based on large financial and status awards to teams that do something extraordinary, but those awards are handed out by senior management on the basis of—no one knows what. There are no objective criteria by which a team can gauge whether it will win this coveted lottery. Teams have little confidence that they will receive any long-term ownership of their innovations. Thus, teams rarely are motivated to take real risks, instead focusing their energies on projects that are expected to win the approval of senior management.