CUSTOMER DISCOVERY: Module 4, Episode 3 – Creating Context

TITLE:

Understanding Corporate Innovation

DESCRIPTION:

Breaking down the roles, goals, and structures behind the groups who keep large corporates on the forefront of their industry

[LEARN@LIFT Episode Intro]

In this episode, we're going to introduce what we mean when we refer to "corporate innovation". Once you understand corporate innovation, why companies engage in it, and where you fit into that process, you'll be ready to dive into some more nuanced discussions about how to best work with large companies.

To start, let's define corporate innovation. At this point, corporate innovation has become a buzzword that can be a reference to things as varied as truly disruptive, never-before technologies or just stale, legacy products with new design and marketing behind them. In general, though, corporate innovation exists to help companies identify and execute in areas of opportunity outside of — but adjacent to — the company's core business, AND to get ahead of potential, existential threats to their existing business models.

Let's break this down with some examples.

You're probably familiar with the company Redbox. You know, those little red vending machines that you can rent movies from. What most people are not familiar with is that this project was created by the McDonald's innovation team in 2002. Yes, I'm talking about the same company that makes Big Macs. The group originally developed the idea with the goal of bringing more guests into McDonald's restaurants. So ultimately, growing their core business was the goal. And the vending machines they envisioned had many more items than just DVDs in them. They sold detergent, shaving cream, bandages, even milk. The project was originally deemed a failure because the vending machines didn't gain traction with consumers, with the exception being DVD rentals. After initially shutting down the project, McDonald's decided to bring back the idea exclusively for DVD rentals in 2004. That's when things started to take off. By late 2005, Coinstar bought a 47% stake in Redbox for $32 million. After several more years of successful operations, Coinstar paid McDonald's around $175 million for the remainder of the company. Which means McDonald's earned over $200 million from the sale of a corporate innovation experiment, in addition to any profits and synergies from their core business that were generated by the product. Not a bad outcome, right?

Now let's take a step back and look at the logic and process that McDonald's used with Redbox. The company's core business (thousands of fast food restaurants) had a goal of driving more customer traffic. There's also the school of thought that McDonald's core business is real estate. They sell hamburgers to pay for all the land and physical assets they control and can monetize in different ways. Finally, because restaurants differentiate themselves through speed and efficiency, any innovation opportunities couldn't require time and effort from McDonald's existing employees, so they needed a specific group of people thinking beyond just selling hamburgers.

The combination of these factors led to Redbox's creation. And while Redbox is an example of an internal innovation from a large company that was sold off to become a standalone company, almost every company will evaluate your technology through the lens of how it fits into their existing business. For example, if you have a technology that works best in a retail environment, but the brand you are pitching to sells mostly online, or through channel partners, they probably won't be too excited, no matter how great your technology is.

You can read more about Redbox, including how McDonald's originally pulled the plug on the experiment before restarting it exclusively for DVDs, in the articles on the Resources page.

Sometimes, the most monumental innovations can be created as the accidental side effect of solving a corporate's internal problems. The most clear example of this is the story of how Amazon founded AWS, Amazon Web Services. The origins of AWS go back as far as 2000, when Amazon was experiencing problems scaling. As a result, they upgraded their hardware and software in a way that allowed them to rent their upgraded IT infrastructure to their 3rd party vendors, so those vendors could sell their products on Amazon. Moving to this structure allowed Amazon customers and partners to outsource their computing needs — whether that was servers, storage, or networking — and pay for it on a per-usage basis.

Today, of course, AWS is a massive and wildly profitable business. For context, during the 2020 fiscal year, AWS did $45.3 billion in revenue and $13.5 billion in profit, and that accounted for 63% of Amazon's overall profit. Yes, 63%!

While AWS wasn't created by a formal innovation group, the company was able to create a new business as a byproduct of solving an internal problem. Sometimes these new businesses are modest gains, like in the Redbox example, but in rare instances, they end up reshaping the company, like AWS has done for Amazon.

Next, let's talk about the structure of corporate innovation groups. There are many flavors of innovation. There are some common responsibilities across them, like creating landscapes of emerging trends or focus areas, scouting for new technologies and startups, intrapreneurship, finding investment opportunities for the corporate venture capital group, or CVC for short, and even acquisitions. Let's break down some common terminology that corporate innovation groups use to describe themselves.

First, you may have heard the term open innovation before. While every company defines it differently, generally, open innovation refers to companies making their innovation needs publicly known, and opening themselves up to collaboration opportunities for others to approach them with. These outside collaborators could be startups, individual inventors, academic institutions, and even other large companies. There are different flavors of open innovation but most commonly, the company will have a website where they post their current needs and have a form for potential collaborators to apply. The best known example of this is Procter & Gamble's Connect and Develop program. Their website has needs listed across oral care, personal care, beauty, grooming, home care, packaging, digital, and much more. They even have a section where applicants can request to license P&G brands for categories that P&G doesn't currently operate in. If you haven't looked at their Connect and Develop website before, it's well worth your time, as it's basically the gold standard for open innovation. You can find a link on the Resources Page.

The other flavor of open innovation is the innovation challenge. The basic idea here is that companies put up prize money towards new solutions for a longstanding problem they're having trouble solving internally. There's usually a challenge website where the company describes the problem, shares the timeline, details the prizes, and outlines the judging criteria. Sometimes the prizes go beyond simple cash and can include potential pilot projects, legal assistance, technical resources, and other useful items. Others, like Comcast NBCUniversal's LIFToff Challenges, don't typically offer a monetary reward a. Instead, they provide opportunities to pitch business leaders and decision makers, and for select companies to pilot their solutions alongside a leadership team inside the company. This exposure and the connections founders make can position their startups for potential partnerships or deals, or get them corporate customers; all outcomes that could have a monumental impact on their future success. Finding innovation challenges can be a challenge in and of itself, but there are different newsletters you can subscribe to that share this. One to check out is OpenInnovationLeads.com.

External innovation is another common term you might hear companies use when describing how they work with partners. Typically, when companies use the term external innovation instead of open innovation, they are sourcing solutions for needs they don't want to disclose publicly, or at least not on a website like the P&G Connect & Develop example.

Companies that engage in external innovation often use a network of tech scouts to source solutions. These tech scouts could be in-house employees or external consultants. Typically, these scouts have been made aware of the internal needs of the company, and are tasked with finding potential partners who can help fulfill those needs. If you're ever contacted by a tech scout or someone who works in external innovation, it can be difficult to figure out their exact interest and end goal. Are they interested in a partnership, investing, being a customer, or something else? More often than not, someone working in external innovation will be interested in becoming a customer or creating a partnership.

Specifically, external innovation contacts will be looking to arrange a pilot project to gauge the potential for working together long-term. We'll be discussing pilot projects in more detail later, but for now, just remember that the main goal of a pilot project is to (a) figure out if there's a good fit between the company's need and your solution and (b) get to know you and your company. Sometimes, external innovation groups can be a feeder for investments. In other words, they are looking to see if your company might be worth investing in.

On that note, let's spend a couple minutes discussing corporate venture capital, CVCs.

CVC is increasingly important as part of the overall venture capital world. In 2020, corporate venture capital groups participated in roughly a quarter of all US venture capital deals, which was an all-time high. CVCs are usually given the mandate to focus on strategic investments, financial investments, or both.

Strategic investments are those that are connected to the parent company's strategy in a core way — for example, an eco-friendly packaging technology that is strategically important to a CPG company. Usually, when a company makes a strategic investment, they view it as an opportunity to help accelerate the company in some way beyond cash, by helping with distribution for example, OR as a way to accelerate their own corporate vision, perhaps with an eye towards acquiring the company in the future.

On the other hand, CVCs with a financial mandate are simply looking to invest in startups for future financial returns, like any other VC. These investments can be in fields completely outside of the company's core business. Sometimes, CVCs are given a dual mandate that's to generate financial returns while also contributing to the core strategy.

Increasingly, this line between strategic and venture investment is being blurred. For example, strategic investments used to require deal terms like first refusal rights for potential acquisitions. But listen to this quote from Doug Russell, head of MassMutual Ventures, who was interviewed by Pitchbook for an in-depth article on corporate venture capital: "CVCs are demonstrating that we're not looking for special terms. We're not looking for rights of first refusal. We're not looking for exclusivity in a business relationship". And from the same interview: "The approach doesn't necessarily diminish the strategic opportunities presented by a venture investment. Around half of MassMutual Ventures' portfolio companies have a business relationship with MassMutual, but those are developed independently of the initial investment."

You can find the rest of this really in-depth interview and CVC article on the Resources page.

[Insert section about Comcast Ventures]

One thing you might be confused about after all this talk of different innovation structures, external innovation vs open innovation, corporate venture capital, etc. etc. is what causes companies to use these mechanisms, instead of their own internal research and development capabilities? After all, isn't R&D supposed to be inventing and developing future products for these companies?

While the line between innovation and R&D isn't as clear as you might expect it to be, typically, the difference lies in whether or not something is tied to the existing business model of the company. For example, if a cosmetics company that only sells creams and serums were considering creating a device, it's likely that the device would be developed through the innovation group. The reason for this is the staff within the R&D department are likely experts in biology, chemistry, and formulation, but not in building hardware and physical devices. So the innovation group, which is equipped to collaborate externally, will take the lead in finding the right partners who can help develop that device. On the other hand, if the cosmetics company were developing a next-generation anti-aging cream, that would happen inside the R&D group. It might still involve external partnerships, which the innovation group could assist with, but R&D will take the lead.

Last but not least, let's discuss the term, business units.

This is a term you'll hear every time you engage with innovation groups. When someone refers to a business unit in this context, they are usually referring to a specific department within their company. For example, if your company sells a marketing automation software and you're discussing it with an innovation group, who keeps referring back to the "business unit", they're probably referring to the marketing department. Typically, innovation groups have limited implementation power and they'll rely on their business units for pilots and scaling up, which we have dedicated modules for in this bootcamp. Even in the instances where an innovation group has a budget to fund pilots, they usually need to work with business units to execute the pilot. This makes business units incredibly important, and they should absolutely be brought into active conversations sooner rather than later. They are essential stakeholders.

And there you have it. You now have all the context you need on the opportunity that corporate partnerships can create for your startup, how to lead with empathy, and how to understand the structures, roles, and goals of corporate innovation groups.

In the next section, we're going to dig into the Innovator's Dilemma, and how this creates the case for partnering with you, so you can speak to the true value you can create for your future partner.

[Insert Episode Closing]