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CUSTOMER DISCOVERY: Module 5, Episode 1 – The Innovator's Dilemma

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TITLE:

Why Corporates Can't Do What You Do

DESCRIPTION:

Understanding how corporate incentive structures create friction when innovating, and why this makes startups attractive partners

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[LEARN@LIFT Episode Intro]

Welcome back everyone. In the last module, we introduced the idea that large companies aren't always capable of doing what startups do, and in turn, why this creates the need to work with you in order to innovate. In this module, we're going to explore this idea in greater detail.

To start, let's talk about the concept of risk as corporates understand it. Because we all understand what risk is — a risky situation is one in which we're exposed to some type of danger. Whether or not we consciously realize it, we're constantly making decisions by evaluating risks, rewards, and the tradeoff between the two. If you needed to cross the street to get yourself a cup of coffee, your brain is deciding between the downside of crossing the street — perhaps the inconvenience of searching for the crosswalk, or the remote potential of being ticketed for J-walking — against the upside of enjoying a hot, delicious cup of coffee.

As an entrepreneur, you made a risk-reward decision when you decided to start your own business. No matter how great your startup is, there's never a guarantee that it will be successful. There's a chance you'll be the next unicorn, but there's also a chance you'll be slogging away for years and years, struggling to get traction. On the other hand, joining a large, established company as an employee is predictable. You'll start getting a paycheck

immediately. Of course, there are certain risks to being an employee, too. The company could hit hardship and enter into a period of mass layoffs. But corporates are generally a safer option.

However, as an entrepreneur, you've also made your decision based on the potential UPSIDE if you're successful. The rewards for building a successful startup greatly exceed the potential rewards of being an employee, plus there's also the non-monetary reward of seeing your vision come to life. To you, that's worth the potential risk of failure, so this set of incentives impacted your decision to become a founder.

Now, let's look at how risk works in the corporate environment. Bureaucracy is something that exists in any large organization, whether that's a government, a non-profit, or a corporate. Bureaucracy is a human construction used to defuse the risk and potential negative impact of a decision across lots of people. It's also used to avoid making decisions at all, in many cases.

And as we discussed in the previous episode, getting a deal done with a large company usually requires working with stakeholders across a variety of departments. One reason for this is the diffusion of responsibility that's created by internal bureaucracy. No one has the unilateral authority to say yes to you. This may seem grossly inefficient, and indeed it can be. But there's an advantage to this setup, too. If something goes wrong with the deal — if you fail to deliver or are just unable to perform as expected — the blame is now spread among several stakeholders, rather than one single individual. Let's be clear on this point, too. The diffused responsibility for decisions is a methodically designed feature, not a bug, in corporate structures.

Now, let's look at why that is and ultimately, how understanding this can help you move deals forward. In the same way that you weighed the potential risks and rewards of starting your company, your corporate counterparts are following a similar evaluation process when deciding whether or not to champion your startup internally.

Let's start with the potential rewards for your corporate counterparts. If they champion a deal and things go very well, first of all, they will look good internally. They'll be the person who found the hot new startup and made the deal happen. This is good, and it helps them improve their reputation within the company. However, in terms of actual monetary rewards, there usually isn't much. They may get a better performance review or end of year bonus. They may even be put on a fast track to promotion. But the rewards aren't nearly as clear or well-defined as they are for you as a startup founder. There's also a definite cap on the upside.

On the other hand, the downside risk is quite significant. If your corporate counterpart champions a deal and your startup can't perform, or worse, does something fraudulent (Walgreens and Theranos comes to mind here...), the blame falls on the corporate employee. Depending on the severity of the failure, that employee could lose their job, but more commonly is a stagnating career due to a missed promotion, negative performance review, or a smaller bonus. While these consequences aren't the end of the world, they're outcomes that no employee wants, and will actively try to avoid.

So the short version of this is that for corporate employees, championing a startup deal can lead to small rewards, and major risks. Those aren't exactly favorable conditions for seeking risk.

You may be wondering why large companies don't incentivize their employees with greater monetary rewards for successful projects. Honestly, this is a very hotly debated topic, but it ultimately hasn't changed much, despite the attention it's gained in recent years. Generally speaking, compensation within a large company isn't just about money — it's also about status. And it would be very strange in this type of environment for the CEO to not be the highest paid person in the organization. Hypothetically, it would make sense for large companies to incentivize their teams to create value and compensate them based on a percentage of the profits or equity created. But this would shake up the entire compensation structure, and it's very unlikely to happen.

Instead, working with external startups like yours is a way for companies to outsource the messy innovation work, without shaking up their existing incentive structure. Does it end up costing them more? Sure, but that's not really a problem to corporates with a flush balance sheet. Understanding the dichotomy between how risks and rewards are evaluated from the startup's and corporate perspective is crucial to understanding how to move deals forward.

Another critical point to understand here is the role that credit and blame plays in the deal-making process. When you have your first interactions with a large company, unless you are extremely lucky or well-timed, you'll inevitably have some initial conversations and then struggle to gain traction with concrete next steps. The key at this point is to build momentum.

So how do you do that? The goal is to show your corporate counterparts two things: First, that you are continuing to grow and gain traction, and second, that they are in danger of missing out — in other words, you need to trigger their FOMO. One way to show you are gaining traction is by sharing significant company milestones, like fundraising rounds, mainstream press or interviews, and new features, particularly if those are relevant to the corporate's use case. Triggering FOMO is a little simpler. Just show that you're gaining traction in their industry, ideally with companies they consider competitors. Nothing makes a large company move faster than feeling that their direct competitors are ahead of them on something. Why does this work so well? Simple: it's easy to assign blame. And blame is something that doesn't sit well at large companies, as we discussed earlier.

Knowing what you know now about risks and rewards as well as credit and blame within large companies, is it any wonder that external innovation is a huge asset for corporates — and opportunity for you?

This corporate incentive structure is precisely why large companies need you, the startup founder, to be a part of their innovation ecosystem. From one perspective, the dichotomy between startup and corporate incentives can be massively frustrating. Why can't we all just get on the same page? But viewed through a different lens, there's a perfectly symbiotic relationship here. External startups provide the experimentation and risk taking that a

corporate just can't create to the same degree in-house. And this creates a wonderful opportunity for you as a startup founder.

Now that you understand the dichotomy between risk and reward in startups and large companies, you have the foundation for the next stage of our discussion: why some startup opportunities are more interesting than others.

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