



CUSTOMER DISCOVERY: Module 5, Episode 3 – The Innovator's Dilemma

TITLE:

Detailing The Innovator's Dilemma

DESCRIPTION:

Market leaders often fail as new, disruptive technologies reshape entire industries, creating a case for corporate-startup innovation partnerships

[LEARN@LIFT Episode Intro]

Throughout this bootcamp module, we've been discussing the reasons why large companies can't always do what early-stage startups do — despite all their resources and scale. What we've started to outline — and we'll fully unpack in this episode — is a concept you might have heard before: The Innovator's Dilemma.

This phrase was coined by legendary Harvard Business School professor Clayton Christensen. The late Christensen was rightly known as an innovation guru, and he studied what causes great companies to fail. He published those findings in a book called *The Innovator's Dilemma: When New Technologies Cause Great Firms to Fail*, and in this book, Christensen examines two main reasons for this phenomenon: new technologies, and new business models.

One concept that Christensen popularized is the idea of the "S-Curve." I recommend going to the Resources page and looking at the S-Curve chart in the article titled "The Most Important Concept in Entrepreneurship," so that you fully grasp the idea I'm referring to here. The S-Curve is a technology adoption curve that applies to all innovations, whether that innovation comes from a startup, or a large company.

To start breaking this down, innovation is an iterative process. When a new technology is first released, the value is limited. For example, think about the first mobile phone. They were gigantic, not really portable, had terrible battery life, and they cost a fortune. The same is true for most technologies. I mean, have you ever seen the pictures of early cars? At this stage, if you use the new technology, you're considered a pioneer or an early adopter. Some of your friends might even think you're weird.

But over time, as companies iterate on new technologies, improvements are made. Mobile phones became smaller, more powerful, less expensive, and connected to the internet. All of a sudden, the innovation becomes incredibly useful to customers. This is when broader adoption of the technology really explodes. And it's when it becomes more weird to NOT use the technology than to use it. Think back to when companies first started giving their employees smartphones: that's the point of mainstream adoption.

But after a certain level of development, further iterations on the technology produce diminishing levels of return in terms of the technology's usefulness and value to the end customer. This is when things plateau. Think about recent iPhone models. Or way back to the last few iPods. New colors were introduced, storage capacity increased, processors operated a little faster, and the cameras became incrementally sharper. But the days of the iPhone being seen as rapidly-evolving, cutting-edge technology are behind us.

Now, let's tie viewing new technologies through the lens of the S-Curve back to what we discussed in the last episode: aligning your startup with the corporate's vision of the future. If a potential corporate partner views your technology as comprising the first part of the S-Curve in their industry — or a related industry they're looking to explore — you'll likely see a deep interest in partnering.

We used the Facebook-Oculus acquisition as an example of this. You can also look at that acquisition through the S-Curve. Facebook appears to believe that virtual reality technology is an important part of the future. While this technology isn't mainstream just yet, they viewed Oculus as best-in-class, and they wanted to ensure they control the technology behind it. Time will tell whether this acquisition pays off, but you can see where in the S-Curve Facebook

viewed virtual reality by their willingness to acquire an unproven technology: advancing toward an inflection point, but not yet into the mainstream. If they believed VR was further along the technology curve, and already moving into broader adoption, they'd likely focus their acquisition on a technology that already had distribution and customer acquisition in place.

If you're interested in reading more of the details behind this, check out the link to Clayton Christensen's famous Harvard Business School paper Exploring the Limits of the Technology S-Curve on the Resources Page.

A second and incredibly relevant concept that Clayton Christensen gifted the innovation world is the problem of "incumbent-sized" deals. What we mean by "incumbent" is a large company who has established dominance in a particular market. For example, Microsoft and Salesforce would be considered incumbents in the enterprise software market. Google is the incumbent in the internet search market. Facebook is a social media incumbent. You get the picture.

While incumbents have the advantage of a large customer base, this has its own set of problems. So how can having a lot of customers be a problem?

As a startup, let's say you're doing less than \$1 million in revenue per year. If an opportunity comes along to work with a customer, and they're willing to pay you an additional \$1 million dollars, it's a no-brainer. You'll find a way to work with them, assuming you're capable, the work is profitable, and the opportunity fits within your mission or focus. An opportunity to more than double revenue with one new customer is worth bearing most any challenges along the way.

On the other hand, if a customer asked a large company to help them do something that wasn't already one of the corporate's offerings, and they were willing to pay \$1 million dollars for it, it is NOT a no-brainer for large companies. The corporate will have to evaluate the opportunity cost of the resources and people involved in delivering on the project, and whether or not there are higher value opportunities that would be ignored, because they were

too busy with this \$1 million dollar opportunity. And most importantly, for a company doing double digit, or even triple digit, BILLIONS in annual revenue, an additional \$1 million dollar project is quite frankly not a big deal. This effect of the Law of Large Numbers is something we discussed in more detail in the last episode, so feel free to revisit that if you'd like.

There's also a concept called "Inattentional Blindness" that's worth briefly discussing here, too. First, if you have never seen the inattentional blindness experiment, pause this episode, and go over to the Resources page and watch the short video. Seriously. It's worth doing. What this experiment highlights is a facet of human attention that makes us blind to things around us when we're laser focused on a particular task. And, if not for that hyper-focus, we would be VERY interested in those other things. This makes logical sense, too. The world around us is infinitely complex, and our brains need filters to make sense of it all, and to accomplish the right things that are worthy of our time and energy.

If we apply this principle to the corporate world, this means that it's already easy for employees to miss potential opportunities — simply because they're focused on their jobs! These blind spots are what can lead to opportunities for new market entrants, like startups, and why incumbents focused on executing in their core business can be disrupted. They'll pass up a small project that can be the harbinger of a much bigger wave that rocks their industry.

So this the question we've come to: Is this \$1 million dollar project a simple, one-off gig? Or is it the first of thousands of potential projects?

The incumbent, as a result of its risk profile and a focus on its core business, will be more likely to pass up the new opportunity. And many times the \$1 million dollar project will just be a single opportunity without any future potential. But in the instances where the smaller project is a sign of things to come, the startup has a significant advantage over incumbents. It's in a better position to react to changing customer needs, which has nothing to do with being "smarter" than corporate employees — this is simply a virtue of each group reacting to the incentive structures and the opportunities in front of them.

Now, this also raises the question, “How do I show that my project is a sign of things to come?” While we’ll dig into this question in greater depth in Module 4, when we discuss facilitating your first meeting with a prospect, think back to what you learned in the last Module about corporate organizational roles — the difference between innovation teams and business units, namely — and what each is incentivized to focus on. The timing of those things to come is key here. Innovation teams are more likely to focus on the kinds of tectonic shifts that happen over the next 3 to 5 years. So naturally, the proof points they’ll be looking for to confirm that you’re heading in the right direction are nascent, and earlier-stage. In contrast, business units are more focused on delivering short-term results in the next quarter and fiscal year, so they need to see later-stage proof points — like a growing number of active users or revenue — that suggests they’re already falling behind the curve, and need to seek out a partner.

To summarize, corporates have become increasingly aware of how these two problems, the Law of Large Numbers and Inattentional Blindness, combine to create a serious dilemma for innovators. And it’s motivating the proliferation of corporate-startup engagements teams and corporate venture capitalists who are proactively looking for startups like yours to do business with.

[Insert Episode Closing]