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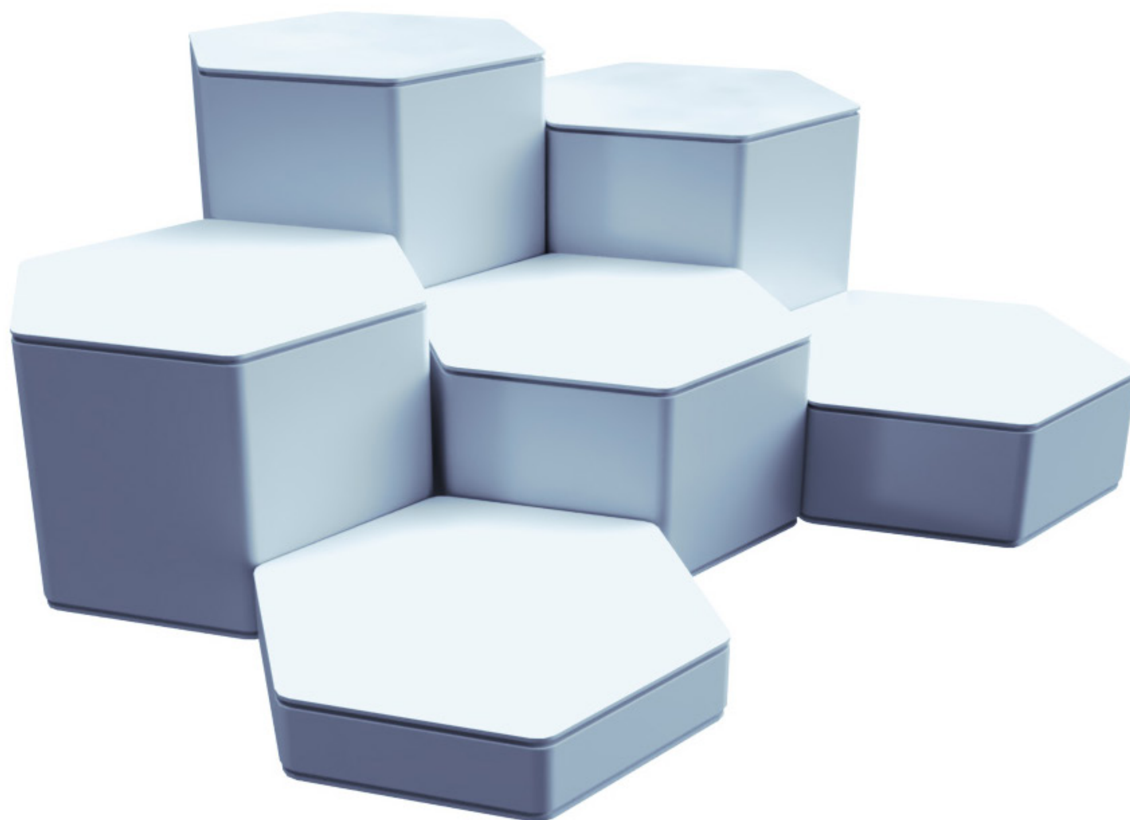
Scale or fail: How incumbents can industrialize new-business building

Repeatable, successful innovation requires a dedicated 'growth engine' that can build promising ventures into growing businesses.

by Philipp Hillenbrand, Dieter Kiewell, Ivan Ostojic, and Gisa Springer



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Across industries, digital attackers and an accelerating pace of change have increased the pressure on incumbents to innovate quickly and create new avenues for growth. Repeatable, scalable innovation—in the form of new-business launches—has become an imperative,[1] and its importance has increased more than 70 percent since COVID-19.[2] As the stakes rise, an increasing number of established corporations are taking a page out of the start-up ecosystem's playbook. For example, 41 of the world's 50 largest public companies[3] now have an accelerator, incubator, or corporate venture-capital fund (or all three). Investment has also seen a dramatic rise: corporate venture capital participated in a quarter of all venture-capital-backed fundraising in 2019.[4]

Despite this urgency and concentration of resources, success stories are rare. Even companies such as Y Combinator, one of the most successful at selecting and building early-stage ventures, see more than 50 percent of their funded ventures die.[5] Mature companies typically aren't set up for this kind of rapidly scalable innovation. Instead, they are built to protect their incumbent positions and have tens of thousands of employees and a complex network of stakeholders. While advantageous for steering large organizations on a path of incremental growth and risk management, this setting is wholly unsuitable for creating fast-moving, high-growth ventures.

It is possible to greatly improve the odds, however, by developing the muscle to build multiple businesses and to build each one better. To explore the most effective growth models, we drew on our experience helping clients build more than 200 new businesses, best practices observed in venture-capital-backed start-ups, and proprietary research. These insights suggest companies can achieve sustainable success by forming a "growth engine"—a dedicated team established to manage the building of multiple businesses from launch to scaling to maturity. This growth engine facilitates the free flow of new ideas and focuses support along each stage of a venture's growth, helping to accelerate the journey from promising idea to mature company.

Meeting heightened interest from investors

We recently conducted a survey of 50 equity analysts to gain a better understanding of the value at stake for incumbents that launch start-ups. The results show that in an increasingly crowded innovation marketplace, the bar for success is high, and despite significant investments in business building, many companies are falling short of their goals. One respondent commented, "Most corporate accelerators exist just for secondary benefits like PR agenda, while the major purpose of innovation (value creation) gets lost."[6] Beyond the baseline conditions for new-business success (see sidebar "Two conditions for successful growth"), equity analysts expect corporations to raise their innovation game significantly across three dimensions (Exhibit 1):[7]

1. *Demonstrate that their new businesses are not simply "backyard success stories."* Validation must come from outside the parent company: these start-ups must be able to secure funding independently from investors in the market. Just 48 percent of respondents believed that internal-only valuations were sufficient proof of a start-up's value.

2. *Prove value growth using concrete, transparent metrics.* Too many companies point to strategic benefits, which are both vague and unprovable. Value creation must be assessed using tangible metrics such as top-line revenue, which was cited by 80 percent of respondents.

[1] Philipp Hillenbrand, Dieter Kiewell, Rory Miller-Cheevers, Ivan Ostojic, and Gisa Springer, "Traditional company, new business: The pairing that can ensure an incumbent's survival," June 2019, McKinsey.com.
[2] Shaun Collins, Ralf Dreischmeier, Ari Libarikian, and Upasana Unni, "Why business building is the new priority for growth," December 2020, McKinsey.com.
[3] Based on the largest 50 companies in the world by market capitalization as of June 2020.
[4] *2019 global CVC report*, CB Insights, March 2020, cbinsights.com.
[5] Analysis of all Y Combinator companies that are ten years old or older, ycdb.co.
[6] Survey of 50 leading equity analysts from the United States and the United Kingdom with cross-industry profiles, balanced between portfolio focus on dividend/buyback versus share valuation and buy side versus sell side.
[7] Ibid.

Two conditions for successful growth

To generate value from venture building, the parent company must create conditions that enable rapid growth. Two ingredients are essential:

— The original idea must be disruptive. Ben Horowitz, cofounder of Andreessen Horowitz, summarizes the need to play against conventional wisdom to capture outsized returns: "By definition, a breakthrough idea looks like a stupid idea. If everybody recognized the idea as a breakthrough idea, it wouldn't be a breakthrough at all."[1]

— The new venture must maximize its learning speed, informed by data-driven insights from structured tests with real customers.

[1] Paul Sloan, "Ben Horowitz: Every breakthrough idea looks stupid," CNET, October 12, 2012, cnet.com.

Exhibit 1

Keys to new-venture value include market validation, hard metrics, and independence from the parent company.

New-venture value creation is more credible when validated by the external market

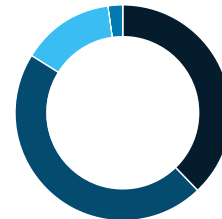
92%
Analysts who agree new-venture value creation is validated by **third-party investors**

vs

48%
Analysts who regard internal-only valuations as proof of value creation

Isolation from the company's core business is beneficial for the innovation engine's value creation

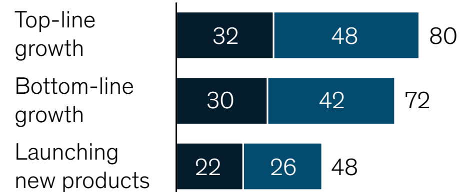
84%
Analysts who agree that clearly ring-fenced innovation engines will lead to greater value growth and delivery for the organization



Analysts assign value based on "hard" financial metrics over "soft" performance indicators

When asked which indicators could lead to parent-company value growth, financial indicators were clear winners

% of analysts who think hard metrics make new-venture value credible



3. *Commit to seeing the journey through.* To ensure the growth venture has the necessary capital and opportunity, it must have a dedicated unit and ring-fenced funding to protect it from short-term earnings pressures on the parent company. In total, 84 percent of respondents believed this structure will improve value growth.

Introducing a new growth model

To flourish, new businesses require a tailored, light-touch governance and operating model tied closely to the very top of the organization.[8] This structure calls for support from a dedicated unit with specific business-building/entrepreneurial talent (sales, growth hacking), tech talent (software engineers, DevSecOps engineers, data engineers, and data scientists), and product talent (product owners, designers) to achieve the sole purpose of maximizing the odds of success by balancing risk with execution speed.

A number of leading companies have achieved this balance by developing a growth engine that incorporates the necessary flexibility and scalability to propel innovation, from conception to a multibillion-dollar business, for multiple ventures simultaneously (see sidebar "bp Launchpad"). The growth engine is a separate entity from the parent company and focuses support along three phases of growth (Exhibit 2).

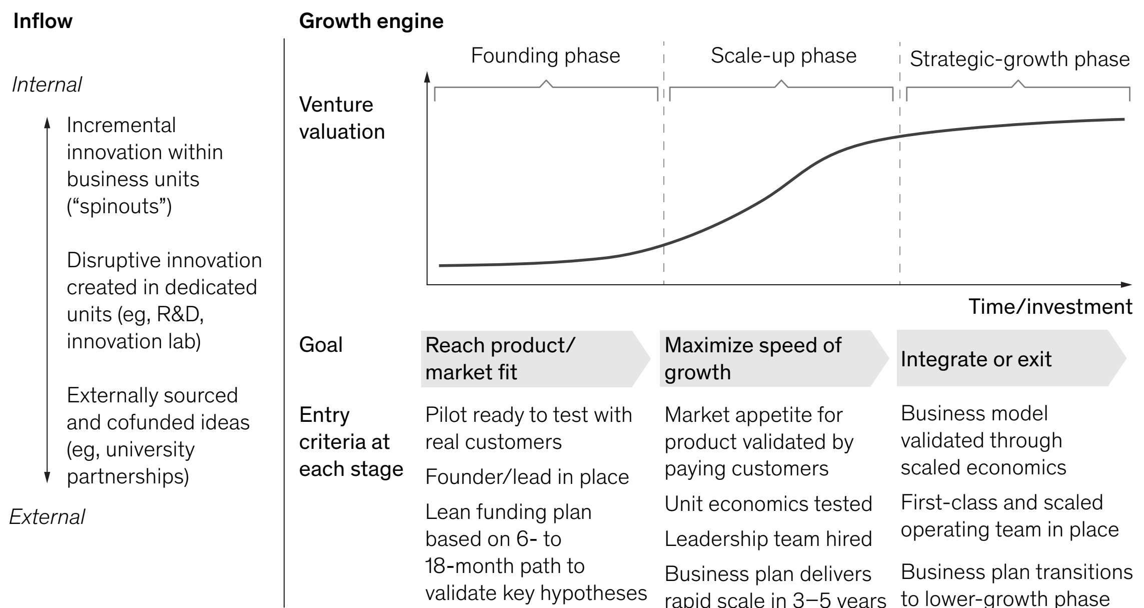
Phase one: Foundation

For an early-stage product or business looking for a market, the growth engine takes on a dual role. First, it implements in new ventures best practices that lay the necessary foundation for growth. Second, it establishes strong financial discipline: project

[8] Sonia Barquin, Ralf Dreischmeier, Sascha Hertli, Jerome Königsfeld, and Andrew Roth, "The big boost: How incumbents successfully scale their new businesses," August 2020, McKinsey.com.

Exhibit 2

Driving innovations from concept to maturity requires a dedicated 'growth engine,' focused across three broad maturity phases.



bp Launchpad

Bp has built a track record of investing in new energy and technology start-ups. However, it had limited experience and capability in scaling these ideas into stand-alone businesses in adjacencies to its core.

The goal for bp was to establish an in-house capability to identify and quickly scale high-potential, data-led, disruptive technologies and business models. With that in mind, the company formed a dedicated business-building capability in 2019 that it dubbed "Launchpad" as a new legal entity, implementing a new, fully agile way of working and securing C-level approval for budget and buy-in for autonomy.

Fast-forward to 2021. Launchpad now includes a team of around 40 experienced business builders and technologists whose sole focus is to build and scale new ventures. Launchpad's goal is to create $5 billion of new enterprise value for bp in stand-alone digital businesses by 2025, accelerating bp's journey to a net-zero carbon portfolio.

The first business it launched is emblematic of the latent potential that Launchpad is hoping to unlock. Leaders identified a promising bp technology for real-time fiber-optic industrial analytics that had existed within the organization for more than three years but was stuck in a permanent pilot project without a path to commercialization. In just six months, Launchpad turned the R&D effort into a fully stand-alone business that serves bp's core operations as well as external customers. The venture has revolutionized real-time asset optimization and generated several hundred million dollars in value in bp-operated assets since founding.

The capability developed to successfully build new businesses helped bp launch another venture. After investing five years in developing and testing a high-fidelity, subsurface imaging product, bp Launchpad decided to build a business around it. It hired a team of 20 people with a range of skills (including data analysis, product development, and marketing), built a modular software stack that could be easily deployed for customers, implemented at-scale production of the hardware, and executed the external go-to-market program. With this build-out, bp Launchpad grew this land-surveying solution from a pilot to a fully independent company with a growing base of external customers in less than 12 months.

leads must validate a business's potential under a constrained-funding scenario, which focuses leaders on the items that are most critical for their project's success.

To achieve these objectives, parent companies must vet new entrants and take them on only if they meet criteria for being "ready." That means the product must be ready for testing and have a leader capable of steering the project through its first six to 18 months, similar to the standard for seed-level venture investing.

Once promising ideas have been screened, the growth engine acts as an incubator. It supports the project by offering guidance on best practices and hands-on delivery muscle (for example, rapid design-driven prototyping) to begin testing the product in the market. As well-defined success milestones (adoption, customer-acquisition costs) are passed one by one, funding is gradually increased until the business has validated its potential for hyperscaling.

Phase two: Scale-up

The challenge now shifts from establishing first signs of traction (the "zero to one" stage) to rapidly scaling the business (the "one to ten" stage). As the venture enters this scale-up phase, the capital requirements grow exponentially. Consequently,

the growth engine should confirm several elements before beginning rapid acceleration:

— The market's appetite and the venture's scaling potential must be validated based on customer-oriented key performance indicators (KPIs) such as revenue, number of users, or value created.

— The unit economics and business model must either already be profitable or demonstrate a clear pathway to profitability.

— Last, and most important, a leadership team capable of steering the team through rapid growth must be in place.

Once a venture is judged to be scale-ready, the growth engine shifts its support to operate as a "scale-up factory." It deploys relevant experts who have experience in achieving scale, such as developing targeted marketing programs or managing scale-up operations. The growth engine also works with the venture to take advantage of its parent company's advantages, such as providing leverage in negotiations with key vendors, building distribution networks, or accessing the senior levels of potential B2B customers.

Phase three: Strategic growth

In this phase, the relatively mature venture no longer needs hands-on support. The growth engine shifts to a strategic role both on the venture's board and as a lead player in either helping the business reintegrate into the parent company or maximizing returns through exit.

As new ventures move from hypergrowth to relative maturity, executives can verify a venture's readiness for reintegration or exit along two fronts. First, it has graduated from the growth phase of typically triple digits annually to the high double digits. Second, the new business is or will be a material contributor to bottom-line earnings. For integration into the parent company, ventures must consider two dimensions:

— *Strategic alignment with the parent company.* In some cases, integrating a growth business into the parent requires a willing disruption or replacement of legacy business. For example, a financial-services institution that launches a fast-growing digital-banking venture might gain an advantage by folding the incumbent into the digital venture's brand.

— *Impact on future revenue.* Moving too quickly on this front, though tempting, carries the risk that increased governance and short-term pressure to deliver profits will cost the parent company a larger contribution from future potential returns.

Defining the parent company's role

Although the growth engine should function as a separate entity, executives at the parent company have an important role to play. It is critical for parent companies to first define success for each venture and then use these criteria to tailor the growth engine's support across all three launch phases. To determine which ventures graduate from one stage to the next, C-level leadership must co-develop with the growth engine's leaders a vision, investment strategy, and financial targets. This exercise should create a simple framework for ongoing assessment of each venture's potential growth and strategic fit.

Governance is then usually delegated to the overarching venture-building layer, supported by regular performance check-ins with each business's board (or proxy for earlier-stage start-ups). Trigger points for further approval on major decisions should be standardized by the parent company. This way, the governance is oriented around each venture's major decisions while supporting the necessary incentives and ownership structure for the founder team.

Avoiding common pitfalls

As executives embark on their business-building journeys, they should be aware of five common pitfalls:

1. *No North Star.* An organization with ambitious goals but an unclear vision and incoherent strategy often makes poor choices when it comes to choosing and prioritizing

opportunities. After all, how can you tell which bets to make or how big they should be without a clear strategy for achieving your vision? As one survey respondent explained, “If the strategy is poorly crafted or articulated to the markets, then the expected return along with future investment levels will decline.”

2. *Soft measures for defining success.* The organization may be able to articulate its goals, but its metrics for measuring the success or progress of a new venture do not reflect how that business is valued. In our survey, 44 percent of respondents stated that they don’t assign value to companies that cannot show hard evidence points, even if they demonstrate product innovation.[9]

3. *Ambitions of a start-up, culture of an incumbent.* The single biggest challenge in scaling new ventures is getting talent and culture right.[10] Too often, corporations expect unicorn-level success but are unwilling to implement the do-or-die incentives that encourage private founders to take the necessary risks. Similarly, without these incentives, the best and most proven talent is not attracted into the new business.

4. *Stakeholders first, customers second.* The world’s 50 largest companies have close to 200,000 employees, on average.[11] A workforce of this size creates an extensive network of stakeholders who can exert a significant gravitational pull on business-building efforts and slowly suffocate initiatives. For the most successful start-ups, the most important validation comes from the customer. High performers rely on the vision of founders while listening closely to customers.

5. *A focus on planning, not execution.* Planning is important in any business build, but companies often obsess over creating a perfect plan. The path to building a business is never clear at the beginning. The only practical way to move ahead quickly and effectively is to have a broad plan that provides some basic structure for the team and leadership, and then execute through rapid iterations and adaptations based on what is learned from customers.

For large corporations, building value from new ventures cannot be a paper exercise; real value must be demonstrated, and quickly, if the market is to believe a company’s venture-building activity will amount to more than increased costs and distraction from core goals. However, with the right structure, leadership support, and capabilities in place, companies can reinvigorate themselves through new growth.

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[9]Survey of 50 leading equity analysts from the United States and the United Kingdom with cross-industry profiles, balanced between portfolio focus on dividend/buyback versus share valuation and buy side versus sell side.
[10]Survey at more than 70 companies of C-level and VP/EVP executives with direct control over venture-building activities within their corporation, n = 93.
[11]Based on the largest 50 companies in the world by market capitalization as of June 2020.