

Learn to Leap! #1

How traditional companies can overcome legacy obstacles to business building

Supporting start-ups in a legacy business requires changes in both skill sets and mind-sets.



Efforts to foster innovation at an established company often run into challenges from the existing technology, processes, culture, and mind-sets. Avid Larizadeh Duggan, entrepreneur and investor, draws on her venture-capital expertise to explain to McKinsey's Philipp Hillenbrand how corporations can successfully transform themselves, establish their own venture-capital arms, and support start-ups.

Key insight #1

Radical innovation requires radical changes in processes, skill sets, technology, culture, and mind-sets.

Philipp Hillenbrand: Why do you think established corporations often shy away from radical innovation and instead try to gradually transform themselves and adopt emerging technologies?

Avid Larizadeh Duggan: I think complacency of the leadership team is often a factor. When you have been a leader in your category for a number of years, it's easy to believe that you're too big to fail. Disruption doesn't happen from one day to the next; it's often a gradual process over a number of years, where the disruptors slowly gain market share while the incumbents fail to see them as threats.

That may be because the disruptors are focused on a small niche or on a set of customers in which the incumbents have no interest. It could also be the complexity of the incumbent's legacy technology or processes, or the fact that they overestimate their own ability to innovate quickly because they underestimate the speed at which customer behavior is changing.

In addition, radical innovation requires radical changes in processes, skill sets, technology, culture, and mind-sets—all of which can be daunting and require time, significant investment, and focused commitment. Unless the leadership team really believes it's a matter of survival and recognizes the reality of the threat to its dominant position, it won't be willing to put the organization through the upheaval and stress of change. It may also view the loss of short-term profits as too great an opportunity cost.

Taking a company through radical change is a difficult task and requires a specific skill set that may not be obvious to those who have known only continuous growth and success. A CEO who either doesn't have that skill set or isn't able to recognize the need for it will miss transformational opportunities for her company. Also, CEOs in times of growth and innovation are different from CEOs focused on profits and stability.

Sidebar

Avid Larizadeh Duggan biography

Avid Larizadeh Duggan is a nonexecutive director on the board of Barclays UK. She was formerly chief operating officer at Kobalt, following stints at Skype, eBay, Accel Partners, and Google Ventures. She also cofounded Boticca, which was acquired by Wolf & Badger. She was named one of the World Economic Forum's "Young Global Leaders" and was on Inspiring Fifty's list of the 50 most inspiring female influencers, entrepreneurs, business leaders, academics, and policy makers from across Europe three years in a row, from 2015 to 2017. Avid has also been named as "one of the most influential European female VCs" by Tech.eu and was awarded the honor of being an Officer of the Most Excellent Order of the British Empire (OBE) for her work and services to its economy, business, and education.

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Key insight #2

Unless a company is led by people who embrace innovation and change, it will remain in a legacy state.

Philipp Hillenbrand: In your experience, which legacy element is the most underestimated obstacle for a company to overcome in order to pursue a fresh new approach: legacy mind-sets, legacy IT, or legacy processes?

Avid Larizadeh Duggan: Oftentimes, it can be all three because they reinforce one another. It all starts with mind-set and culture. People fix technology and processes; they can't fix themselves. And unless a company is led by people who embrace innovation and change, it will remain stuck in a legacy state.

In order to effect change in an organization, the first requirement is for individuals and teams to trust each other as well as their leaders. If this trust doesn't already exist, it will take time, commitment, and a potential leadership change to establish it.

Individuals and teams must believe they are working toward a purpose that is bigger than themselves or the company. This will motivate them in hard times to continue reaching for that North Star and help attract the best talent. When faced with the choice to work for a company that is trying

to help solve an impactful challenge versus one focused solely on profits, the answer is clear.

Giving individuals and teams autonomy is also key, which often requires a cultural shift among incumbents. Today, the best talent wants to be empowered to make change, and most innovation comes from those in the trenches, not from the executives or the board.

Talent empowerment can't be dictated—it needs to be enabled through culture, tools, and processes. Individuals and teams need to feel comfortable disagreeing with their peers and leaders. They should be enabled by easy access to data to experiment, measure, and iterate quickly. Failure from experimentation and quick decision making should be part of the norm.

Therefore, the best way to remove roadblocks is to change mind-sets first. The tone must be set from the very top through the CEO, her executive team, and the board. There can be no hesitation, and a clear vision and unified agenda are vital to deploying the necessary resources to promote cultural change throughout the organization.

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Key insight #3

A company must plan its start-up strategy and make sure it has the ability to execute on that strategy.

Philipp Hillenbrand: If a corporation decides to launch its own corporate venture-capital (CVC) fund or even a business-building capability to launch its own start-ups, what advice would you give them?

Avid Larizadeh Duggan: I've come across a number of CVCs where it was unclear whether they were strategic to their parent company or what exactly their investment criteria were, because the messaging was too complicated and not straightforward. This not only confuses other funds that may be a source of deals, but, more importantly, it confuses the target companies. It also makes it more difficult for the people running the fund to focus on finding the right companies that will add value if the strategy isn't clear.

Assuming the majority of CVCs are strategic, it's imperative that the company plans its start-up

strategy before setting up a CVC. For example, does it want to acquire start-ups, does it want to partner with them, or does it want to learn from them?

Further, the company should ask itself whether it has the ability—culture, processes, and skills—to execute on its start-up strategy. If the answer is no, then resources must be secured to address these challenges. Otherwise, all the time and money spent running the fund will result in very little return on investment.

For example, I often see established corporations struggling to take advantage of the innovations brought by start-ups, because they move too slowly and have complicated processes or legacy technology that hold them back.

Key insight #4

Companies must identify what start-ups need and which needs they can fulfill with minimal friction to the legacy business.

Philipp Hillenbrand: How can corporations find the right mix to support start-ups while protecting their autonomy and entrepreneurial spirit?

Avid Larizadeh Duggan: Companies need to first identify what the start-ups need and which needs they can fulfill with minimal friction to the legacy business. One common example is distribution, which start-ups often lack access to. They may have technology and a product, but they struggle with acquiring customers. Corporations, on the other hand, have significant distribution channels and customers. The key is to make these easily accessible to start-ups.

There should be an existing, repeatable process within corporations to deal with start-up partnerships. This process should not require lengthy nondisclosure agreements or integrations. Corporations need to create a user-friendly

sandbox type of environment where selective start-ups can access a defined set of customers for testing. Once the testing is successful, they can then be given access to a greater number of customers.

In addition, if the corporation is committed to working with start-ups and scale-ups in the long term, it should invest in transplanting their DNA to help bridge the culture and communications gap. Start-ups and corporations typically don't understand each other's processes and methods of communication, so it's critically important to have someone who can straddle both worlds and enable the right approach. It's also crucial to find someone at a senior level who is empowered by the CEO to make changes, train others, and hire more talent who share that same DNA.

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Key insight #5

How to handle start-ups once they grow up depends on whether the corporation tends more toward a centralized model or a platform model.

Philipp Hillenbrand: What's the proper long-term goal for corporate start-up investors who want to play more than a financial role? Should they plan on integrating their start-ups back into the corporation?

Avid Larizadeh Duggan: There is no universal answer to this question, which depends on whether the corporation tends more toward a centralized model or a platform model.

With a platform model, a corporation has a number of independent business units that have their own strategy, revenue model, and leadership team who drive decision making. These units report back to a group executive team, often a much smaller entity in charge primarily of capital allocation—such as investing in existing operations, acquiring other businesses, issuing dividends, paying down debt, or repurchasing stock—and of hiring the best executives to fill out the leadership roles across the organization.

Think of the way Alphabet works, for example. The more a company leans toward this model, the easier it is for it to integrate new companies through acquisitions. These companies can continue to operate somewhat autonomously, and their success rate is much higher, such as with Amazon and Zappos.

With a centralized model, however, integration becomes more complex, as the acquired company needs to be fully assimilated, its processes often fundamentally changed, and its culture vastly diluted. As a result, the rate of success is much lower and the cost far higher.

If a corporation comes to the realization that its survival depends on significant innovation rather than incremental change, and it lacks the ability to execute on that innovation with its existing resources, it can choose to follow one of two routes: it can either acquire innovation or hire people to effect the change.

The second route takes time and a commitment to changing the culture of the company and to training not only the senior executives but the middle management as well. It requires hard choices, patience, and perseverance.

The first route, if the corporation follows the platform model, may be quicker and achievable. However, in a centralized model, if the corporation wants to acquire and integrate innovative companies, it will need to adjust its culture as in the second route. It will have to update its processes, technology, and skills to ease the integration and make it successful. So unless there is a true commitment to cultural change, the chances of survival are slim.

Key insight #6

You can always improve and grow, but you need to be willing to take risks, fail, learn from failures, try again, and persevere.

Philipp Hillenbrand: Despite your incredible success as a business builder and start-up investor, there must have been some failures and bad decisions along the way. Can you share a favorite and tell us what you learned?

Avid Larizadeh Duggan: I always tell younger people that no one's career is linear. Most people experience step changes with periods of plateau. It's all about keeping a growth mind-set. You can always improve and grow, but you need to be willing to take risks, fail, learn from failures, try again, and persevere.

I don't have a favorite failure, mostly because I don't like to fail, but also because every time I do, I find the positives, which helps me carry on and not get bogged down. There is always something to learn from and to use to grow into a better person.

One failure I learned a lot from was splitting up with my cofounder at Boticca. We had been

working together for four years, and then, in what felt like one day to the next, I didn't recognize him anymore. We suddenly seemed to have different views for our company as well as different values.

This taught me about the importance of nurturing relationships at work. I was so focused on execution that I had forgotten about the soft side of my role. I was taking care of the teams that reported to me, but I wasn't giving the same attention to my cofounder.

This failure made me a better investor and taught me to ask the right questions to differentiate great founding teams from struggling ones faster. And I am now able to advise founding teams on how to avoid what had happened to me. It has also made me a better operator with a much stronger focus on culture and communications, which makes for even better execution.

Philipp Hillenbrand is an associate partner in McKinsey's Berlin office.

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