McKinsey Digital

How to launch a new business: Three approaches that work

Analysis of more than 200 corporate business builds shows what success looks like.

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COVID-19 and its ongoing repercussions have forced business leaders to reevaluate their priorities and strategies. One area where businesses across all regions have accelerated their commitments is around building new businesses. Leading growth businesses in particular have made this strategy a top priority, according to recent McKinsey research.[1]

Yet despite the growing enthusiasm for business building, incumbents with good ideas, strong commitments, and big ambitions will frequently run headlong into a big question: How do we actually go about building a business? Getting the answer to this question right is crucial because it shapes the entire operating model of the business-building venture, with significant implications in terms of budget, organization, and strategic direction.

A leading industrial company learned this at a cost. When executives wanted to optimize operations in their factories, they believed setting up a fully independent start-up dedicated to developing new factory concepts was the only way to make it happen. Despite millions of dollars of investment, however, it didn't work. The start-up struggled to access data and insights, failed to fully grasp the challenges of the core business, and did not attain sufficient support in the parent organization to test and implement changes. This example supports our research, which shows that fewer than a quarter of businesses launched ten years ago are viable large-scale enterprises today.

Figuring out the right approach to business building is especially important now as new opportunities for innovation surface. Prompted by the pandemic, new business-building archetypes have emerged, such as remote service provision, digital retail, and collaboration platforms.

As is true for many complex undertakings, there is no single right approach for launching a new business successfully. In addition, certain strategies will be important no matter which approach a company takes. Joint ventures and alliances, for example, can help to reach scale and enter new markets, and working with partners in ecosystems that, in some cases, include erstwhile competitors can expand offerings, access capabilities, and accelerate scale.

After analyzing more than 200 corporate business builds that we have supported, we have identified three major approaches that have proven successful. While other approaches can certainly work, the three we explore in this article have an established track record and clear conditions for success. The characteristics of each are unique, and so, too, are the criteria and conditions for success (Exhibit 1).

1. Internal VC-like incubator

In this approach, incumbents develop a broad portfolio of ideas, with the goal of producing a few winners that can be successfully commercialized. Teams within the parent organization develop concepts for new businesses and pitch them to a dedicated venture-capital-style board comprising internal and external experts, who select the most promising ones. Successful teams receive milestone-based funding and resources to validate core assumptions and develop a minimum viable product (MVP)—a crucial governance necessity no matter what approach a business chooses (Exhibit 2).

The business has to be vigilant to ensure that the start-up culture "sticks" and that the legacy corporate culture doesn't slowly start to take over. One way to do that is to assign an experienced business-building coach to each team to build up and nurture an agile test-and-learn culture.

Establishing an incubation approach is particularly suitable for incumbents that have a clear overall sense of the future direction of their business and sector, as well as a strong pipeline of promising

[1] Shaun Collins, Ralf Dreischmeier, Ari Libarikian, and Upasana Unni, "Why business building is the new priority for growth," December 2020, McKinsey.com.

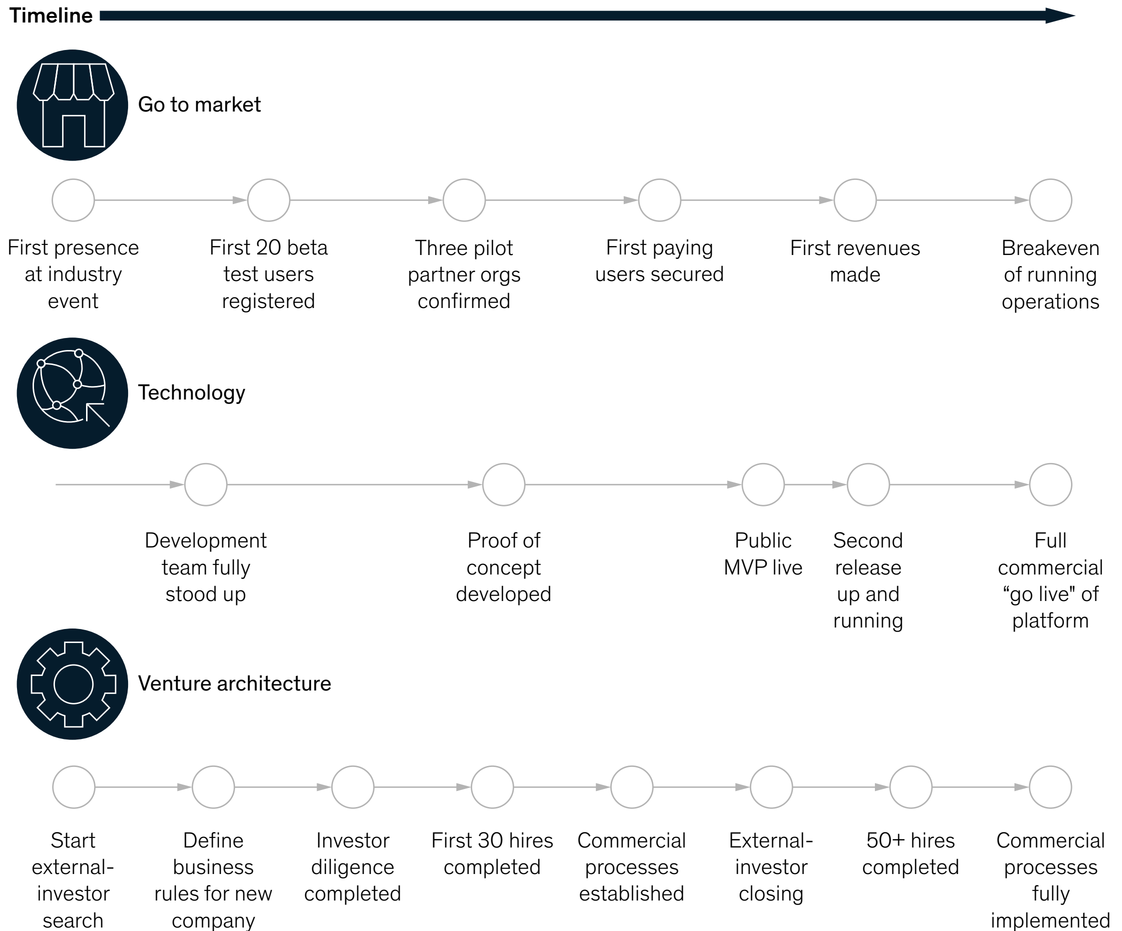
Exhibit 1

Each approach to business building has unique conditions and criteria for success.

	1. Internal VC-like incubator	2. Scale-up factory	3. Clean slate
Description	Internal employees develop ideas from the bottom up, pitch them to an internal venture-capital (VC) board, receive funding for initial-concept validation, and then build and scale the approved concepts	Parent company sets up a fully owned but separate subsidiary exclusively dedicated to business building. This factory takes concepts from the parent and scales them as independent businesses	Incumbents set up a new, fully independent start-up that leverages such advantages of the mother company as access to distribution channels, but is independent in its decision making
Strategic posture	Develop broad portfolio of businesses from well-developed pipeline of ideas; incubate multiple concepts	Commit fully to building multiple businesses at scale. Typical focus is a portfolio of five to eight new businesses at any given time	“Bet big” on a promising idea with significant investment and high speed to market
Maturity of ideas	Early stage: ideas validated and turned into minimum viable products (MVPs) prior to scaling	Mature: typically strong, validated concepts or MVPs generated by parent’s R&D organization	Medium: riskiest assumptions have been validated, but the business still needs to be built and scaled from scratch
Proximity to core business	Close: ideas are generated by internal employees in response to core-business needs, with the parent company remaining the new venture’s key customer	Arm’s length: factory ventures typically aim to support the core business as well as to acquire external customers	Independent: separate legal entity, often as 100% daughter company with focus well beyond the incumbent organization’s core focus
Ecosystem role	Business is buildable without strong collaboration with external partners, but partner solutions may be helpful to expand and scale the offering	Parent/core business remains most important relationship, but external customers and partners are required to scale	Attracting numerous external partners and customers often essential to building a viable business. Frequently important to be perceived as neutral in the market
Source of required capabilities	Primarily internal, with external advisors included on the VC board	Mix of internal and external, with the factory filling capability gaps (eg, digital skills) primarily through external hiring	Primarily external for both leadership teams and broader staff
Long-term target setup for new businesses	Flexible: scaled business can be integrated back into the parent or spun out	Independent, but closely aligned with the parent’s core activities	Independent, standalone business collaborating with the parent. Exits to third parties also viable

Exhibit 2

In a VC-based funding approach, budgets are automatically released based on milestone achievements.



early-stage ideas. They may, however, lack initial certainty on what the “winning concepts” will be and how they should be set up for the long term—as an internal division or an external spinout, for example. In our experience, the internal incubation approach works best when the new business is expected to focus on the parent’s core business.

A leading consumer food company achieved great success with this internal incubation approach. After a successful restructuring program, the company’s CEO and board first set a clear vision and ambition that new ventures should primarily benefit the core business and enable significant improvements in the top and bottom lines. Management then invited employees to form small teams that included a team lead and a management sponsor, such as the division head.

Over the course of six weeks, these teams then independently developed more than 100 ideas for new businesses aligned with the overall strategy.

All teams scoped out MVPs and pitched their concepts to a newly created internal venture-capital (VC) board that included senior managers, external venture capitalists and technologists, sector experts, and strategic customers.

The VC board then provided initial funding to ten concepts that covered a wide range of applications, including IoT devices, process automation, data platforms, and resourcing marketplaces. Key decision criteria were resources required, path to scale, time to impact, expected overall P&L impact, and unique advantages of the parent company that could be leveraged to build the new businesses. Each initiative was assigned a delivery lead, an experienced business-building coach who helped employees to identify and de-risk the core assumptions first.

Over the course of the next six to ten weeks, these teams built out their MVPs to test core assumptions, such as market demand, required investment, and potential to scale. Those that were successful then approached the VC board and business-unit leadership for additional resources to scale the MVP. Within 16 months, the program to incubate the new businesses became self-funding.

Key success factors:

— *Adopt a true VC mindset, and kill ideas without clear potential early on* in order to cut losses and strengthen the organization's focus and resources on concepts with high potential.

— *Include external experts on your VC board* to increase objectivity and add important new perspectives.

— *Match venture teams with experienced delivery leads* to provide crucial coaching and skill building to test and adapt quickly.

2. Scale-up factory

Frequently, an incumbent organization already has a strong pipeline of new-product and -business concepts that have been validated with first customers and partners. But because it lacks the specialized resources, talent, and expertise required to quickly and successfully scale an entirely new business, promising ideas wither.

A scale-up-factory approach can help address these issues. In this model, the parent sets up a fully owned "factory" that is exclusively dedicated to rapidly scaling promising concepts from the parent's R&D pipeline into independent businesses. Typically, with this approach, the parent is the first and largest customer of the new businesses. In return, the factory's new businesses can leverage the parent's brand, reputation, and customer network. Importantly, providing employees with equity gives them "skin in the game" and helps attract and retain the best digital talent from start-ups and tech firms.

Despite a strong R&D pipeline, new ideas at a leading global energy player frequently did not reach sufficient scale to generate meaningful new revenue streams. To change this, the company used the scale-up-factory approach to address a key business goal: build and scale disruptive technologies and business models from the internal R&D into rapidly growing and revenue-generating businesses.

The new scale-up factory is located in a separate office and staffed with a dedicated team, most of whom were hired to meet the need for specialized skills and a "start-up mindset." The new company is governed by its own leadership and a dedicated, internal board of directors, rather than by business-unit leaders. While senior group leaders dedicate significant time to strategic decision making and steering toward targets and milestones, they do not get involved in the scale-up factory's day-to-day decision making.

After two years, the businesses developed by the scale-up factory have scaled to more than 100 employees and have already become a significant revenue-growth motor for the parent company.

Key success factors:

— *A strong pipeline of "potential blockbuster" ideas within the parent company* that have been validated and deemed commercially viable

- *Clear funding and governance* to establish accountability for each project that has business-unit and factory representation, remove any ambiguity in approvals and funding (such as joint signatures between factory and business unit), and align up front on milestones for the release of further funding

- *Strong learning and pattern-recognition processes*—the more scale-ups the factory executes, and the better team members become at collecting and codifying learnings, the more efficient the factory's processes will become (a key insight from our latest research)

3. 'Clean slate' business building

In some cases, executives have identified a big, promising idea for a new business well beyond their organization's core focus, such as leveraging a disruptive new technology or entering a new industry. In this case, a clean-slate approach works best, with the new business typically fully owned by the incumbent (or jointly owned with external investors) and all talent hired externally.

Similar to the scale-up factory, the new start-up enjoys organizational independence but has greater entrepreneurial latitude. Speed is more important than process perfection in areas such as HR, IT, and procurement. The new business develops its own tech stack, for example, and explores different business models, even working with traditional competitors. It has different compensation and hiring models than the parent company, as well as its own R&D and insights capability to aggressively test completely new markets. Incumbents that have been successful in driving growth via clean-slate business building often start to shift to adapting principles of the scale-up-factory approach described in the previous section.

"Acqui-hiring" talent (that is, hiring an entire team or acquiring a company to access its talent) can be used to turbocharge business builds in any of the three approaches outlined in this article, but it is particularly suitable for accelerating clean-slate builds when internal capabilities are limited. Acqui-hires provide incumbents with immediate access to a well-integrated team with relevant capabilities who can hit the ground running.

Acqui-hiring can work only if the new venture has a strong culture that can quickly and successfully integrate the acqui-hired team. Clear leadership communication and strong alignment of incentives—such as equity awards distributed to all members of the business-building team—are critical to bringing the new team on board and avoiding potential resentment from members from the incumbent organization.

Using a clean-slate approach enabled one of the world's leading engineering companies to quickly build a highly innovative IoT platform to sell software through an app store. Initial testing had validated the concept, which also had strong support from top management. Given the need to move quickly and lacking the right talent internally, the company set up a new start-up with strong financial backing, a separate office several hundred miles away from parent-company headquarters, and a leadership team hired from leading technology players.

Senior executives from the parent organization narrowed down the catalog of more than 1,000 rules, regulations, and governance processes that new divisions were typically required to implement to only about 50 that were essential. To establish the new business's neutrality, the company set up a new industry alliance and collaborated with external partners—some of them direct competitors of the parent company—from day one.

To further accelerate this process, the company decided against gradually hiring developers or retraining staff. Instead, it acqui-hired a full development team of more than 30 people from a major software producer. This approach enabled the building of a highly complex digital solution and a thriving ecosystem with dozens of partners at record speed: first sales were generated less than 15 months after the acqui-hire had been completed.

Key success factors:

- *Strong focus on culture* through strong investment in regular team-building activities

that are crucial to integrate teams and unite them behind a common goal

— *Foundations for an ecosystem of partners built early on* by engaging with external partners—even competitors—as soon as the new business is set up, so that the market perceives it as a neutral player; then build out a large-scale ecosystem over time

— *A start-up CEO fully committed to the new venture,* through incentives (equity, bonus structure, and so on) that are fully tied to the start-up's fortunes and do not include a "safety net" in the form of guaranteed continued employment with the parent

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Business building is increasingly a core strategic pillar for companies operating in a digital world. Selecting the approach that is right for any given business, based on an understanding of the necessary trade-offs, conditions, and criteria for success, is one of the most important decisions incumbents need to make, as it can unlock the opportunity for rapid growth.

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