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ENTREPRENEURSHIP

Meeting the Challenge of Corporate Entrepreneurship

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For large companies, creating new businesses is the challenge of the day. After years of downsizing and cost cutting, corporations have realized that they can't shrink their way to success. They've also found that they can't grow rapidly by tweaking existing offerings, taking over rivals, or moving into developing countries. Because of maturing technologies and aging product portfolios, a new imperative is clear: Companies must create, develop, and sustain innovative new businesses. They must become Janus-like, looking in two directions at once, with one face focused on the old and the other seeking out the new.

Corporate entrepreneurship is, however, a risky proposition. New ventures set up by existing companies face innumerable barriers, and research shows that most of them fail. Emerging businesses seldom mesh smoothly with well-established systems, processes, and cultures. Yet success requires a blend of old and new organizational traits, a subtle mix of characteristics achieved through what we call balancing acts. Unless companies keep those opposing forces in equilibrium, emerging businesses will flounder.

In this article, we first describe the management issues facing companies that pursue new-business creation, as well as the usual problematic responses. We then explore a number of the most critical balancing acts companies must perform, the choices they entail, and the risks corporations face when they fail to get the balance right. We conclude with a look at the hybrid systems that are often needed to support these balancing acts, focusing in particular on IBM's Emerging Business Opportunity management system because of its success in mastering several of them simultaneously.

The Two-Cultures Problem

It's no secret that corporations are designed to ensure the success of their established businesses. Existing operations, after all, account for the bulk of their revenues. Finely tuned organizational systems support current customers and technologies. The operating environments are predictable, and executives' goals are stability, efficiency, and making the most of incremental growth.

New businesses are quite different, with cultures all their own. Many are born on the periphery of companies' established divisions; at times, they exist in the spaces in between. Their financial and operating models are seldom the same as those of existing businesses. In fact, most new business models aren't fully defined in the beginning; they become clearer as executives try new strategies, develop new applications, and pursue new customers. Because of the high levels of uncertainty associated with new ventures, they need adaptive organizational environments to succeed.

The distinctive features of new businesses present three challenges. First, emerging businesses usually lack hard data. That's particularly true when they offer cutting-edge products or when their technologies aren't widely diffused in the marketplace. The difficulty, as one technology strategist told us, is that "it's hard to find marketplace insights for markets that don't exist." Financial forecasts are also undependable. Large errors are common, a fact that led one printing and publishing company to call its early-stage financial numbers SWAGs, short for "scientific wild-assed guesses."

Second, new businesses require innovation, innovation requires fresh ideas, and fresh ideas require mavericks. We've heard too many stories of leaders trapped by conventional thinking: Microsoft's wariness of open-source software, Polaroid's grudging move into digital cameras, GM's and Ford's reluctance to embrace hybrid cars, media companies' distaste for blogs, and so on. Some degree of unconventional thinking is essential for new businesses to take hold, but many radical ideas are foolish or unfounded. Most mavericks, sadly, can't tell the difference between good and bad ideas. They persist in defending pet themes, demand repeated hearings, and refuse to take no for an answer. The dilemma, says Home Depot CEO Robert Nardelli, is that "there's only a fine line between entrepreneurship and insubordination."

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The third challenge is the poor fit between new businesses and old systems. That's particularly true of systems for budgeting and for human resource management. Corporate budgeting systems favor established businesses because incremental dollars usually provide higher financial returns when invested in known markets rather than unknown ones. New businesses are therefore difficult to finance for long periods, and in times of austerity, they are the first to face funding cuts. In a similar spirit, companies design HR systems to develop executives whose operational skills match the needs of mature businesses—not the strategic, conceptual, and entrepreneurial skills that start-ups require. In both cases, the answer isn't to proceed haphazardly but, as we shall explain later in this article, to modify systems so they are less biased against new businesses.

Why Traditional Responses Fail

Faced with these challenges, corporations respond with one of two approaches. Some disperse the task of new-business creation, assigning it to existing divisions, while others centralize it, lodging it in special-purpose divisions or venture groups. Both approaches have delivered mixed results.

Diffused responsibility fizzles out.

In an organization where every executive shares responsibility for new-business creation, the CEO expects employees to be as committed to turning new ideas into new businesses as they are to expanding mature ones. Some companies impose aggressive targets to motivate managers—at 3M, the poster child for this approach, 30% of sales must come from products developed in the last four years—and they link the achievement of those targets to every employee's compensation.

The main drawback of this approach is that it's easy for traditional businesses to dominate new ones. Veteran employees often choose to ignore incentives and suppress new ideas, especially those that render existing skills obsolete or require new ways of working. RR Donnelley, the U.S. printing giant, failed in its first attempt to make digital printing popular, largely because of internal resistance. Its sales managers were accustomed to selling long-term contracts to customers' purchasing managers on the basis of personal relationships and the price per page. They were uncomfortable selling solutions to senior managers, which the digital business demanded, and wouldn't share expertise with the digital-printing division or send orders its way.

Since they were able to make their numbers the old-fashioned way, no one could point a finger at them. As one Donnelley executive observed, resistance to the new business often took the form of the "Donnelley nod"—an apparently supportive shaking of the head but, in truth, a signal of lack of commitment.

For related reasons, a new business that doesn't fit with the company's existing product lines or markets frequently has trouble finding an organizational home. Few general managers are willing to assume responsibility for projects they privately view as diversions. In some cases—as with Home Depot's Floor Store, which the retailer launched in July 2000 to sell flooring and carpeting products—the fledgling business is shunted from district manager to district manager and from division to division, which doesn't allow it to establish a foothold. The new venture fails to attract influential sponsors and so won't receive sufficient resources or attention to survive.

In other cases, the pressure to create new businesses becomes so dominating that it overwhelms the organization. A cowboy culture results; in its wake comes a loss of financial and operating discipline. The classic example of this problem was Enron in the late 1990s, which rewarded executives for their ability to launch new trading businesses in the mold of its successful natural gas business. The result: an outpouring of trading businesses—coal, water, pulp and paper, broadband, and (later) media services, freight services, data storage, and semiconductors—that made less and less strategic and financial sense. Very few of Enron's second- and third-generation businesses became profitable, which paved the way for the company's downfall.

Centralization isolates.

Concerned by their poor track records of new-business creation, many companies decided that the wisest course was to completely separate new ventures from existing divisions. In the 1970s and 1980s, these efforts took the form of internal corporate venture divisions, special-purpose groups that companies charged with launching and nurturing the lion's share of new businesses. In the 1990s, many businesses launched corporate venture capital groups that mimicked the operation of venture capitalists by providing new businesses with arm's-length funding, disciplined oversight, and advice. Boeing, DuPont, and Exxon were among those that established corporate venture divisions, while companies like Intel, Lucent, and Xerox set up corporate venture capital groups.

Both approaches focus on nurturing new businesses in their formative stages. However, the challenges come later, when it's necessary to integrate fledgling businesses with the mainstream. Because centralized new-venture groups magnify the clash between the old and the new cultures, suspicion and fractious relationships are common, as are power struggles between new-business managers and division leaders. Over time, integration becomes more problematic, and companies must either spin off the new businesses or shut them down. The result, as Norman D. Fast wrote in *The Rise and Fall of Corporate New Venture Divisions,* is that centralized groups typically have "a long-term mission but a short-term life span." In fact, corporate venture groups in the United States last, on average, only between four and five years, according to Paul Gompers and Josh Lerner in *The Venture Capital Cycle*.

Balancing Acts

Companies should avoid either-or approaches to corporate entrepreneurship because they place the old and new cultures in conflict with each other. A new approach is called for, one that melds those cultures while avoiding extreme behavior. Lean too much in one direction, and the process drifts out of equilibrium; get the balance right, and corporate entrepreneurship will flourish. With apologies to F. Scott Fitzgerald, the test of a first-rate company may well be its ability to hold two opposing ideas at the same time and still function.

Entrepreneurial Equilibrium

Corporations can grow new businesses by performing three kinds of balancing acts:

Balance trial-and-error strategy formulation with rigor and discipline.

- Narrow the range of choices before diving deep.
- Closely observe small groups of consumers to identify their needs.
- Use prototypes to test assumptions about products, services, and business models.
- Use nonfinancial milestones to measure progress.
- Know when—and on what basis—to pull the plug on infant businesses.

Corporations must perform balancing acts in three areas: strategy, operations, and organization.

Develop strategy by trial and error.

New businesses operate in highly ambiguous environments. Ambiguity isn't the same as uncertainty, as executives are realizing (see, for instance, Nitin Nohria and Thomas A. Stewart, "Risk, Uncertainty, and Doubt," HBR February 2006). In uncertain environments, the options are reasonably clear, and the likelihood of different outcomes can be assessed. In ambiguous environments, the full range of alternatives and outcomes isn't known, leading to many possible directions and evolutionary paths. The high levels of ambiguity in new businesses imply that corporate entrepreneurs won't get it right the first time. Because hard

Balance operational experience with invention.

- Appoint "mature turks" as leaders of emerging businesses.
- Win veterans over by asking them to serve on new businesses' oversight bodies.
- Consider acquiring select capabilities instead of developing everything from scratch.
- Force old and new businesses to share operational responsibilities.

Balance new businesses' identity with integration.

- Assign both corporate executives and managers from divisions as sponsors of new ventures.
- Stipulate criteria for handing new businesses over to existing businesses.
- Mix formal oversight with informal support by creatively combining dotted- and solid-line reporting relationships.

numbers are difficult to come by and strategic options are difficult to identify, past practices, too, offer little guidance. Experimentation is essential. Managers must begin with hypotheses about what will work and what won't; then, they should search for ways of validating or invalidating their preconceptions, knowing that first-cut strategies will change over time.

When taken to extremes, however, this approach can be counterproductive. Countless studies have shown that technologies in search of a market rarely succeed. In fact, many new businesses struggle for years because top management, hoping that one more trial will lead to success, is unwilling to close them down.

Overcoming these problems requires a balancing act that combines open-minded opportunism ("Let's try it and see how customers react; we'll make changes based on what we hear and keep at it until we get it right") with disciplined planning ("Let's think systematically about the market and the proposed technology, formulate a hypothesis about customer needs, design experiments to test our hypothesis, and repeat the process until we're sure we've got the right product, technology, and business model"). Here are five ways in which executives can couple trial and error with rigor and discipline.

Narrow the playing field.

Unguided searching is an inefficient way of finding new ideas. Companies need some criteria to narrow the range of potential choices and to judge whether a technology or market presents a desirable opportunity. The goal isn't to be definitive but to scope out certain areas of promise. Smart companies identify sectors that may be worth pursuing, first by applying screens based on the attractiveness of markets and technologies, and later by combining them with executives' best judgments about promising industry trends. GE evaluates new business ideas with an eye toward increasing the scope of its operations: All new businesses must take the company into new territory—a new line of business, region or country, or customer base—and also have the potential to generate at least $100 million in incremental sales in three years' time.

The most effective companies combine brainstorming, usually at the divisional level, with corporate criteria for reducing the list of ideas. In the early 2000s, Henkel, the German consumer and commercial products company, asked employees what consumer needs they had identified when using its laundry and home care products and if those needs suggested any new business ideas. Within 48 hours, top management received more than 1,000 proposals by e-mail. It then set up a ten-person "invent team," which rated each idea on a ten-point scale based on assessments of market size, whether Henkel had the necessary technical knowledge in-house, whether the proposal fit the brand, and whether a launch was feasible within a year. Over one weekend, the team managed to shrink the list to just 50 high-potential ideas.

Learn from small samples, closely observed.

In ambiguous environments, the deepest learning comes from interaction with a small number of customers, not from surveys of many potential users. The latter have great statistical power but seldom provide the formative insights that executives gain from ethnographic approaches. That's the tack that P&G has taken under CEO A.G. Lafley, who insists that managers stop worrying about focus groups and spend time in consumers' homes, watching them cook and clean, before launching new products. In 2000, the typical P&G marketer spent less than four hours a month with consumers; by 2004, that number had tripled. Intuit, which makes tax-preparation software, relies on a process it calls "Follow Me Home." The company sends employees to watch customers carry out accounting and tax-preparation tasks in their homes and offices, which helps uncover pain points that can lead to new opportunities. Starbucks periodically takes product development teams on "inspiration" trips to meet customers on their home turf. For example, in early 2006, one team visited many Starbucks outlets and other restaurants in Paris, London, and Düsseldorf, Germany, to get a better sense of local cultures, behaviors, and trends. Nokia used the same approach in China, India, and Nepal, to study how people with low incomes would use cellular telephones. Based on the research, the company's developers created an icon-based menu—consisting of pictures rather than letters and numbers—that allows semiliterate villagers to use cell phones.

Use prototypes to test business models.

Without some tangible basis for discussion, most people find it difficult to evaluate new ideas. Prototypes are invaluable: They give life to emerging products and provide a basis for informed responses from potential users. They should be detailed enough for users to evaluate form, content, and desirability, and companies should couple them with forums for consumer debriefings, discussions, and reviews. Prototypes are particularly useful for testing assumptions about customer needs. UPS experimented with a grocery delivery business partly to determine whether it could tie that in with residential delivery of other goods such as consumer electronics products. Because the prototype locations showed that even loyal users ordered groceries only once every ten to 14 days—a frequency that didn't justify a larger residential delivery infrastructure—UPS quickly dropped the idea.

Track progress through nonfinancial measures.

Trial-and-error strategy formulation shouldn't be entirely unguided—that would make it little more than guesswork. Concrete goals are essential, but in ambiguous environments, goals must take the form of project-based milestones, such as "We will conduct five customer trials in these two industries in the next three months." At times, companies can assess new businesses' progress by using leading indicators such as publicity or incorporation of product specifications into industry standards. The targets must be measurable: "We will receive three positive mentions in trade journals and three favorable comments from industry analysts in the next two months."

Suspend judgment, but not indefinitely.

The biggest risk when companies develop strategies through trial and error is that the process will continue for too long. Failures are common in new-business creation, and corporations need to be clear on when—and how—they will decide to pull the plug. New venture teams and top management must agree about the standards that will be applied to a project, the length of time it will be allowed to continue, and who decides whether to shut it down. There are many criteria for making the call—time elapsed, dollars spent, pace of technological progress, customer enthusiasm, confirmed orders, financial performance, competitors' success, and so on—but most critical is senior managers' willingness to make timely go or no-go decisions. Kodak's corporate entrepreneurship program failed in the 1990s largely because of senior managers' unwillingness to close several poorly performing new ventures, such as a copier services business, a floppy disks business, and a bioscience and pharmaceuticals business. That wasted resources and destroyed the program's credibility.

Operate with something old, something new.

Existing companies will enjoy an advantage in new-business creation only if they build on their strengths; otherwise, they will be no better off than start-ups that must begin with a clean slate. Novelty for novelty's sake is seldom a source of competitive advantage. At the same time, if new businesses make operating choices only by drawing on their parents' strengths, reusability and efficiency become the driving values, and time-tested but inappropriate people, processes, and systems will be the result. How do executives avoid these unhealthy extremes?

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In most cases, the best combination of the old and the new entails a blend of experience and invention. Selling to preexisting customers, staffing with seasoned personnel, drawing on established distribution channels, and working with proven processes will improve the odds of creating profitable and sustainable operations. Differentiation, however, requires fresh thinking and innovative approaches to operations. To get the best of both worlds, companies should do the following:

Staff new ventures with "mature turks."

Companies often put young, hard-charging mavericks in command of start-up ventures. Frequently, those executives are new to the company or haven't grown up in the business. Such people, runs the argument, are less constrained by companies' current ways of working. Unfortunately, they're also less likely to know which corporate resources are available or have the credibility to draw upon them. A better strategy, common at GE and 3M, is to put "mature turks"—managers who are already successful at running larger businesses but are also known for their willingness to challenge convention—in charge of new businesses. An observer described one such executive as "a 60-year-old with beads and a ponytail—a maverick but a through-and-through Xerox person with the credibility to get new businesses off the ground."

At times, top management must handpick leaders from a list of high-potential executives; at other times, it can find candidates by looking at annual personnel evaluations and identifying managers with high scores on entrepreneurship, innovativeness, and risk taking. In 1999, when

L.L. Bean launched Freeport Studio, a brand of women's clothing, it selected employees for the new business from within the organization partly on the basis of how they answered one question: "How did you feel when you took a risk?"

Change veterans' thinking.

Employees will seldom embrace a new business unless companies presell them the idea. Smart companies place division chiefs and group heads on the oversight committees or boards of promising start-up efforts. They expect familiarity to lead to understanding, and understanding to breed acceptance. Companies can also foster shared understanding by getting executives to envisage the future through exercises such as scenario planning. For years, Bill Gates took Microsoft's senior team on weeklong retreats, where discussion revolved around emerging technological trends and competitive threats. To reinforce the message, companies may sometimes need to alter incentives and promotion criteria, particularly when existing values are deeply rooted in organizations.

Develop some capabilities, but acquire others.

Leaders of new businesses often feel that they must build every capability from the ground up. Not all skills are best developed from scratch, though; some can be purchased. The make-or-buy decision hinges on the availability of skills in the open market, the time needed for internal development, and the ease with which outside capabilities can be integrated into the organization. UPS preferred to make acquisitions when it needed specialized skills, as it did in 2000 with its purchase of Livingston, a Canadian logistics firm specializing in the unique documentation and technology systems required for the delivery of health care products, and its sister company Livingston Healthcare Services, in the United States. It also acquired companies when they had built relationships that would take UPS years to cultivate; that's why, in 2004, UPS bought Menlo, a freight forwarder that had 20-year ties with both customers and representatives of multimodal transportation services. In contrast, internal development was UPS's approach to developing mission-critical, customer-facing capabilities such as tracking and shipping systems, especially when the skills touched many parts of the business, involved legacy systems, and presented integration challenges.

Share responsibility for operating decisions.

New businesses prefer complete control over their destinies. However, it's easy to lose perspective. Stanford's Robert Burgelman, in *Strategy Is Destiny,* quotes the head of one of Intel's start-up businesses as saying: "We created a very entrepreneurial culture that prided itself on being different from the rest of Intel. Some of this was justified. We have a different business model….However, when we really looked at it, we found that we were being different for difference's sake."

When corporations force new and old businesses to share responsibility for critical choices, the former become more accepting of established practices and more successful at leveraging existing strengths. For many years, Expo Design Center operated independently of parent Home Depot, although the two businesses sold related products and could realize synergies in merchandising and procurement. Their buyers were brought together to improve efficiency when Robert Nardelli became CEO; they now sit on the same floor of an office building, at adjacent desks, and jointly make decisions on common purchases. That has led to large savings from the 25% of vendors that Home Depot and Expo Design share.

Integrate with autonomy.

A new business needs help from the parent company as it strives to develop an independent identity. That assistance usually takes the form of protection, sponsorship, and other types of support from the corporation's senior-most executives. Organizationally, the company gives the new business a direct reporting line to a respected leader, who becomes responsible for providing oversight, allocating resources, offering strategic guidance, and ensuring that its managers aren't hog-tied by the parent's rules. The leader treats the new business as an exception, free from the usual controls, performance standards, and review processes demanded of the company's mature businesses.

This approach works well—until it becomes necessary to hand the new business, which has outgrown the leader's ability to manage it as an exception, over to an existing business group. That's when resistance sets in and battles break out. Some conflict is predictable—there may be a knee-jerk "not nurtured here" response from existing businesses. Yet it does reflect some legitimate concerns. New businesses are rarely designed in ways that ensure a comfortable transition to the established organization, and the division managers who inherit them are not schooled in the requirements for successful handoffs. Those managers have good reason to worry that the infant businesses will fail and that top management will hold them responsible.

Too much independence leads to a related problem: a lack of organizational learning. At times, new businesses develop strategic and operational innovations that, should they succeed, are expected to be passed on to other parts of the company. That's why these businesses need considerable independence and protection in their youth. But if they are held too far apart from the mainstream or are regarded as threats to the existing order, the new ideas they embody will never take hold in the company. GM launched Saturn in 1990 to be a "different kind of car company," with innovative advertising, labor practices, operational processes, and sales strategies that were meant to serve as models for the rest of the organization. However, by 2004, GM had reannexed Saturn, tightly linking the business to its established factories, marketing programs, and labor contracts, partly because the company's other divisions had no desire to be "Saturn-ized."

For these reasons, we find, integration works best when it begins early in the life of a new business. Managers are more amenable to inheriting organizations that they have had a hand in shaping from infancy. The challenge is to get the balance right between identity and integration, and to make the shift at the proper time. Too much integration in the early days or a rushed handoff, and the new business will never differentiate itself. Too much early independence or corporate dominance, and established divisions will resist the integration of the new business. Companies can achieve the proper balance if they follow a few simple principles.

Assign corporate and operating sponsors.

Corporate sponsors, who can be either line or staff executives, bring credibility and clout to new ventures, while operating sponsors, who are drawn from particular businesses, divisions, or groups, contribute organizational savvy and foster acceptance. Together, they are likely to give the right mix of freedom and discipline to new businesses, and to balance identity with integration. In 2006, Staples launched ten prototype rural stores. Each store reported simultaneously to the local district manager and to the company's vice president for strategic markets, who was responsible for the initiative. Such dual sponsorship helps overcome the problem of long and uncertain gestation periods. Few employees will sign up for a new business if they believe that resources will disappear when it becomes an independent business or if they sense that senior leaders are displaying on-again, off-again enthusiasm. With dual sponsorship, companies signal that the new business is a long-term commitment and that they have already given thought to its transition to maturity.

Establish criteria for handoffs.

Unless there are preestablished standards for handoffs from corporate oversight to divisional ownership, companies will make those shifts very slowly. Most new businesses prefer to stay under the protective corporate umbrella, where they enjoy privileged treatment and special status, controls are frequently looser, and resources are easier to obtain. The criteria for handoffs can be quantitative (revenue or size thresholds, number of customers, market share targets) or qualitative (clarity of strategy, stability and experience of the leadership team, competitive superiority), but everyone in the company must know and agree to them in advance.

Employ hybrid organizational forms.

Companies must also balance identity and integration by using innovative organizational structures. Such structures often consist of creative combinations of dotted-line and solid-line reporting relationships that mix formal authority with informal oversight. Councils and oversight committees are particularly useful. To support its shift from the commodity chemical business to specialty chemicals, Ashland Chemical created its Strategic Expansion Project Board, consisting of the CEO and all the group vice presidents. The board identified and funded projects that had significant commercial potential but cut across traditional business boundaries. The composition of the board ensured that representatives from multiple functions, businesses, and staff and line groups sat down together, combined perspectives, and worked out differences. Once projects became operational, they moved to the Commercial Development Group, whose head reported directly to the CEO.

How IBM Strikes a Balance

One company that has applied these principles is IBM. The starting point was September 12, 1999, when then-CEO Lou Gerstner learned that division managers had killed a promising project that focused on the explosive growth in biotechnology and life sciences computing. He fired off a scathing memo to his senior team, demanding to know why IBM kept missing the emergence of new industries. Executives quickly formed a task force to gather information by interviewing members of several struggling or unsuccessful start-ups within IBM, reviewing the academic literature on innovation and business creation, and benchmarking IBM's new-business development efforts against those of Cisco, Intel, Microsoft, and other large companies, as well as those of venture capitalists and entrepreneurs.

The team concluded that IBM's difficulties in starting new businesses could be traced to six root causes: a management system that rewarded execution and short-term results rather than strategic business building; a preoccupation with IBM's current markets and existing offerings; a business model that emphasized sustained profits and improvement in earnings per share rather than actions to drive higher price-earnings ratios; a financial, data driven approach to gathering and using market insights that was inadequate for embryonic markets; an absence of processes suitable for selecting, developing, funding, and terminating new growth businesses; and a lack of entrepreneurial skills. In essence, the team discovered that IBM, like many other companies, suffered from the two-cultures problem that we described earlier.

To overcome these obstacles, the task force recommended that IBM's senior executives devote more time and attention to developing emerging businesses; that the company identify and support promising opportunities; and that every business group and division develop its own sets of new businesses. Most important, executives recommended that IBM build a distinct Emerging Business Opportunity (EBO) management system to complement its existing systems.[1]

After several months, Gerstner remained concerned about the extent of the organization's acceptance of the task force's recommendations; the ability of IBM's existing processes to catch problems as new businesses grew; and the possibility that division managers might game the system. As one senior executive recalled, that led Gerstner to observe at one of the team meetings devoted to the topic: "Somebody around this table has to shepherd these efforts forward, someone who knows the culture well enough to kick the system. It can't be just some staff guy. It has to be someone with really big shoes." On July 24, 2000, Gerstner announced that he was promoting John Thompson, leader of the software group, to vice chairman and putting him in charge of the new-business effort. Thompson, a 34-year IBM veteran, had managed several product groups and had also led many cross-business initiatives, such as the pervasive-computing and life sciences programs. The appointment had an immediate impact. As one task force member put it: "When Gerstner made Thompson, the most respected group executive, vice chairman, the program got huge credibility. We knew then that Gerstner was serious."

Thompson moved immediately on several fronts. Initially, he told us, he saw his role as that of an evangelist, selling the company's commitment to emerging businesses "by preaching the story and occasionally making an example by putting someone in the doghouse." At the same time, he consolidated responsibility, bringing in the corporate strategy and technology groups for staff support. He insisted, as one of the conditions for taking the job, that he control a pool of funds to support EBOs, and IBM set aside $100 million for the purpose. Most important, Thompson started creating the development, oversight, and review processes that would form the core of IBM's Emerging Business Opportunity management system. In the process, Thompson and his successor, Bruce Harreld, artfully managed a series of balancing acts.

Leadership.

Because many EBOs were in danger of falling between the cracks of established businesses, success hinged on their leaders' ability to navigate IBM's complex matrix organization to secure cooperation and support. The typical EBO leader had only four or five direct reports and otherwise relied on part-time assistance from other parts of the company, so each had to find ways to manage the activities of dozens or, occasionally, hundreds of IBM employees in different countries and business groups. Thompson therefore decided to choose EBO leaders for their experience and skill in working the system, as well as for their entrepreneurial, business-building, and creative talents.

Not surprisingly, many experienced managers had doubts about becoming EBO leaders. They perceived the move to be a step down; it was like, one of them said, "being asked to join a minor-league team after being a player in the major leagues." For this reason, and because the competencies they needed were difficult to find, IBM's senior-most executives handpicked the first EBO leaders. The top brass was involved in the process, Thompson pointed out, partly because "the line really didn't want to give those people up."

EBO leaders reported to the relevant business group heads, who also assumed primary responsibility for their performance reviews. However, IBM's mature turks also had a strong dotted-line relationship with Thompson and Harreld, who took over as IBM's EBO czar after Thompson retired in September 2002.

Strategy development.

Thompson charged EBO leaders with arriving at "strategic clarity"—which, at IBM, means having a deep understanding of the new business's marketplace, set of customers to be pursued, value proposition, existing and needed capabilities, and steps to be taken next. Unlike IBM's traditional planning processes, the EBOs' development process was exploratory, with frequent changes in direction. According to Thompson: "Sometimes it would take a year to a year and a half to get to a strategy we were happy with. You just kept iterating and iterating and iterating."

To resolve strategy issues, IBM encouraged EBO teams to engage with the marketplace. In the earliest days of a new business, when product designs and industry standards were still in flux, that often required selling a point of view to the outside world. Public relations and media communications were essential tasks, and EBO teams often worked directly with analysts, thought leaders, and technical columnists to gain positive coverage in the press. Eventually, however, mind share had to translate into market share. To that end, IBM expected teams to work with customers on in-market experiments, where they executed some elements of their business plans. The first step was to test the proposed product as a pilot or to persuade a few customers to allow IBM to incorporate the product or service into a new design (called a design-in). The EBO teams had to set targets that they hoped to achieve through the experiments, partly to acknowledge to themselves that failure was a distinct possibility.

As the results of the experiments came in, EBOs had to revise their strategies and business designs. Much of that work took place in monthly review meetings that included the EBO leader, the overseeing IBM business group or division head, representatives from finance and research, and the EBOs' czar (Thompson, then Harreld). At these meetings, Thompson and Harreld took care to establish ownership of the business development process: They set the agenda, asked the tough questions, and even held these meetings in their own offices. The reviews were rigorous and lasted several hours; one participant described them to us as "root canals." They were fundamentally different from IBM's traditional business reviews, which focused on financial performance versus plan targets. EBO reviews were much more developmental; they were designed to refine business plans rather than review the numbers.

Many EBO teams needed help defining their strategic intent; they found it difficult to set boundaries around what they wanted to accomplish. Assumptions about market needs and the business's ability to deliver were often wildly optimistic. Many teams had trouble identifying opportunities, sources of value, target customers, and the bases of sustainable competitive advantage. They had little experience with poorly defined marketplaces and had to learn the rudiments of strategic analysis. Because collaborative brainstorming and joint problem solving were the primary goals of these meetings, the process was contentious by design. A crisp presentation didn't matter. In fact, Harreld pointed out, most EBO leaders had to learn a new set of behaviors. "They were trained to answer every question and to have everything under control. I told them, 'Put it aside. The worse you look, the better this meeting is going to go.'"

Monitoring.

Along with IBM's finance and corporate strategy staffs, Thompson and Harreld periodically evaluated each EBO using three parameters: project-based milestones, financials, and assessments of business maturity. Together, those metrics satisfied IBM's numbers-oriented executives even as they encouraged the EBOs to innovate and grow.

The project-based milestones were the primary basis on which EBOs were evaluated. IBM used many kinds of milestones: marketplace acceptance (for instance, number of customer pilots, customer references, and design-ins), external perception (IBM's public image versus the competition's, mentions by key technology columnists, presentations at industry conferences), ecosystem development (number of software vendor partnerships and technology alliances), internal execution (significant product development checkpoints and announcements), and resource building (additions of solution and brand specialists to the staff, creation of an advisory committee, outreach to other parts of the organization). As one participant observed, IBM's executives expected milestones to indicate progress toward a goal: "They had to be more than just [any] nonfinancial measures that were easy to count."

The EBOs were not, however, completely free from financial scrutiny. Once a new business was up and running, IBM's finance group calculated its revenues and direct expenses. The reports provided the basis for monthly reviews that the finance group conducted with each EBO's executives. Meetings were often brief, but they served a dual purpose. They prepared emerging businesses for the financial reviews that would be required of them as they matured. In addition, they provided a check: If the expenses of an EBO were below budget but it wasn't meeting its milestones, that often meant that the IBM division funding the new venture was cutting back on investments. "That's a foul," an IBM corporate finance executive told us. "And you can only find it by looking at expenses and milestones in the same meeting."

Finally, to track how well all the EBOs were progressing, IBM's corporate strategy department developed a color-coded scoring system. It rated each EBO in three areas: developing a clear strategy, defining an executable model, and winning in the marketplace. Red identified concerns or problems, yellow signaled limited progress and unresolved issues, and green indicated sustained success. The strategy team summarized the results of these assessments in monthly and quarterly reports to senior management. These ratings also helped executives determine when the new businesses were ready to be transferred out of the EBO management system.

The true measure of any system is its results. Of the 25 business bets that IBM has made in the past five years, three have failed, and the remainder are a mix of evolving and successful businesses. In 2002, these businesses contributed more than $6 billion in additional revenues; in 2003, more than $10 billion; and in 2004, $15 billion.

Most of the new businesses are now in the hands of IBM's business groups. That transition occurred quite suddenly. Gerstner's successor, Sam Palmisano, triggered the shift when he suggested to Harreld in August 2003 that "maybe we're hugging the EBOs too closely." Harreld responded by deciding, almost overnight, to move 14 EBOs out of the corporate system and into

IBM's business groups. In each case, he based his decision on two simple tests of sustainability: Did the business have clear leadership? And did it have a clear strategy? Any operational issues, he felt, were better addressed by the business group leaders than by the corporate strategy department.

The handoffs were accompanied by tightened monitoring and reporting. IBM made the business groups' quarterly reviews more rigorous, with corporate strategy executives attending to monitor the progress of the EBOs. Each group's monthly letter to the chairman had to describe the status of its EBOs. In addition, Harreld met twice a year with every business group head to review the EBOs' progress and to ensure that IBM's traditional culture wasn't choking their performance.• • •

For companies that wish to succeed with corporate entrepreneurship, the lesson is simple: Success is not an either-or proposition. New businesses should be nurtured through a series of balancing acts that combine entrepreneurship and disciplined management, short- and long-term thinking, and established and new processes. As IBM's EBO management system shows, when companies must choose between black and white, the best response is often gray.

1. For more details, see David A. Garvin and Lynne C. Levesque, "Emerging Business Opportunities at IBM" (A, B, and C), Harvard Business School case nos. 9-304-075, 9-304-076, and 9-304-077.

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Comments

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2 COMMENTS

safwan saidalavi 3 months ago

Good article. Having experienced similar situation, I have two points to share
1. It is easier to integrate if the new venture compliment your existing product/or is a new application of your existing product or service . If it is a direct substitute for your existing product(Newer evolving technology), getting the ground level support requires careful planning (Eg: which market to test first so as to keep self cannibalization to minimum, motivating your sales teams etc)
2. For MNC s , a platform to share new venture progress and success stories across geography helps in the knowledge sharing and for scaling up the operations at a faster pace

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