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The next generation of corporate incubators

New incubator models to deliver breakthrough growth

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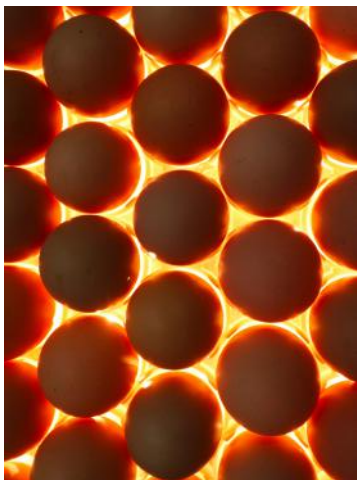
While large organizations have enthusiastically embraced the creation of in-house corporate incubators to identify and support breakthrough growth opportunities with start-ups, the results have been disappointing for many. This article argues that to overcome these challenges and successfully scale up new opportunities, corporates have to embrace next-generation models.

Until recently, start-up incubators were all the rage across large corporates looking for non-core growth through new business creation. Similarly, start-ups saw huge opportunities for access to markets and the potential to scale up.



However, outside digital-native sectors, few corporates have managed to generate the sort of large-scale growth from start-ups that they were hoping for. So, what's the future for corporate incubators? In this article we explore the next generation of incubators, which some companies are already using to drive non-core growth in more systematic and reliable ways.

The trouble with corporate incubators

Over the last five to 10 years, corporates have fully bought in to the idea that growth is driven by newcomers, and this has led to a huge increase in transactions with start-ups. For example, in the US food and beverage industry, the multiple for deals valued at more than $1 billion jumped from 13 to 20 times EBITDA from 2016 to 2017. A recent Arthur D. Little/MatchMaker Ventures (ADL/MMV) survey[1] into corporate/start-up collaboration, which involved more than 300 companies across different industry sectors, found that 98 percent of corporates worked with start-ups in some form.

1. Source: "The age of collaboration II": Joint ADL/MMV survey of corporate/start-up collaboration suggests 98 percent of corporates collaborate with start-ups (to be published in full in June/July 2019)

Many corporates have set up in-house incubators and accelerators as their primary means of start-up collaboration – vehicles to help develop start-ups during their early months or years. These provide facilities, advice, training, funding, and sometimes market access, to help them scale. There was a steep increase in corporate-funded start-up incubators and accelerators up to 2016, with some 70 active programs listed in the corporate-accelerators.net database, although it is likely that the actual number of programs was well in excess of this.

However, of those 70 programs listed in 2016, by 2019 nearly half have closed down, either completely or to be replaced with a different type of vehicle[2]. While some of this is due to an oversupply of incubators and accelerators relative to the number of start-ups, a major factor is dissatisfaction with progress. The ADL/MMV survey found that only 31 percent of corporates considered their collaboration activities successful[3]. Many companies, such as Qantas, Intel, Qualcomm and Citrix, to name a few, have abandoned or downsized their accelerator programs, or else shifted to third-party managed accelerators[4].

So what are the main causes of failure? The most-often-quoted reasons are:

- **Lack of major impact on growth:** While incubators do generate new proofs of concept, often these don't make it past scale-up. And for those that do, the scale of the new business is often one or two orders of magnitude smaller than the core business, especially for established global corporates. For example, a new $100 million business in a peripheral market hardly even registers on the scale for a $20 billion revenue company, however innovative it may be.

- **Misaligned or unclear objectives:** Some corporates launch start-up vehicles without any clear strategic rationale because they see their competitors doing it. Sometimes there is lack of full top management endorsement. Start-ups, too, usually have very specific ambitions and motivations, and are highly invested into specific ideas and concepts. If their aims are unclear or misaligned, or if top management is not supportive, it's unlikely the collaboration will deliver success.

2. Source: Arthur D. Little research
3. "The age of collaboration II": Joint ADL/MMV survey of corporate/start-up collaboration, to be published in full in June/July 2019
4. Nesta/Mind the Bridge, 2018. The status of open innovation in Europe: Corporate start-up collaboration. Report to start-up Europe, pp18

- **Long times required to scale up:** Start-ups often need four or five years to achieve scale, which is typically too long for corporate management teams backed by impatient shareholders – many corporates cancel their programs prematurely, after, say, two years.

- **Inadequate resourcing:** Working with start-ups requires focused management effort and funding, not just to scout, screen and validate potential start-ups, but also to engage and integrate them, as well as to nurture the relationship throughout its life cycle. This is particularly key at the scale-up and commercialization stages, when start-ups themselves often lack the right capabilities and experience. In this respect, corporates are much less able to provide the sort of support that a venture capitalist could offer. A recent Nesta survey found that 33 percent of corporates in Europe identified lack of internal resources as a major barrier.

- **Lack of a systematic approach:** Often companies set up internal organizations for growing new businesses, and call them "new business groups", "special projects groups" or similar. However, frequently these organizations are run as collections of unconnected emerging new-business projects, with little or no systematic approaches to ensure early de-risking and fast-enough "speed to scale".

- **Cultural mismatch:** There are many dimensions in which culture mismatches are possible: for example, start-ups are relatively high-risk investments which are prone to failure, while corporates are naturally more process-oriented and risk-averse. Corporate innovation staff may see start-ups as a threat to their existence, while start-ups may see corporates as a threat to their autonomy, diluting their equity. In the Nesta survey, 53 percent of respondents cited cultures of risk aversion as barriers[5].

5. Nesta/Mind the Bridge, 2019. Open Innovation Outlook 2019: Macro-trends in 2019 for corporate-start-up engagement

- **Lack of a home:** One of the biggest barriers of all is the lack of a home for the new business once it's created, in particular, a pathway for results to be scaled up, implemented and absorbed into the business. Existing brands can be all powerful and dilute or reject new products if they do not fit, or if they are perceived as risks that could cannibalize existing business.

Bring on the next generation

So with all these challenges, is there still a future for the corporate incubator model? The answer is emphatically yes – provided that companies are willing to consider some new approaches to designing and operating the incubator to overcome the challenges. It is also essential that the incubator itself is one part of a broader innovation effort with a diverse and balanced innovation portfolio.

The starting point is to design the incubation vehicle specifically with the intention of delivering major new, scaled-up, de-risked, transformational growth. This is in contrast to the old model, in which the incubator concept relied on running a number of experiments in peripheral business areas, in the hope that one or more proofs of concept might lead ultimately to a viable business.

We have seen companies succeed in this new approach using five steps, as illustrated in Figure 1.

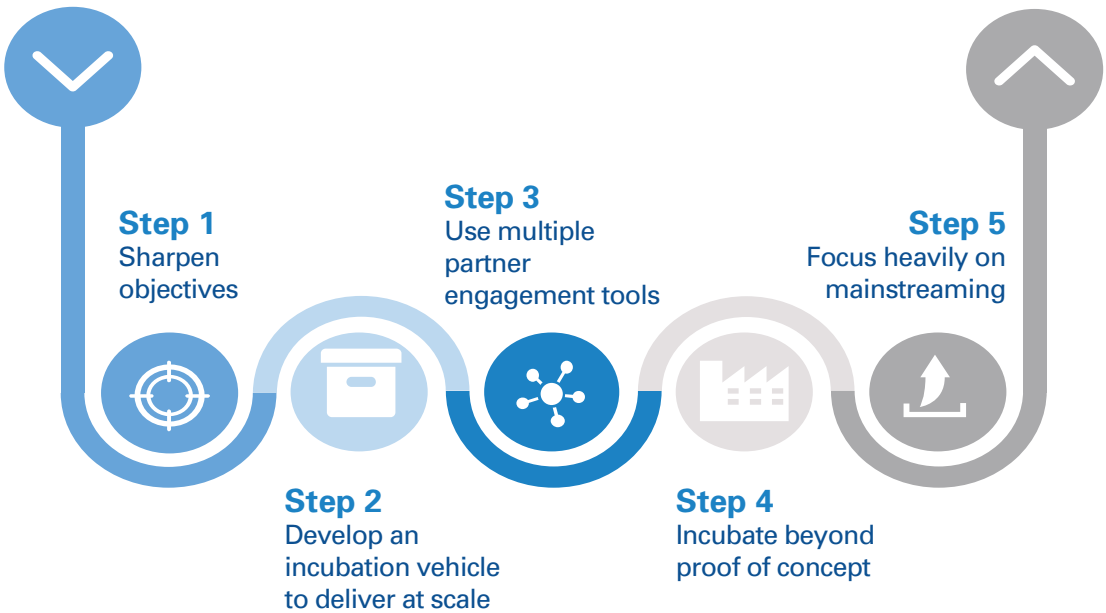


Figure 1: The next-generation corporate incubator: Five steps to success
Source: Arthur D. Little

1. Sharpen objectives: Often, companies looking at non-core or longer-term growth only go as far as defining some broad technology/application domains or themes to guide their innovation efforts. An example could be "artificial intelligence in the supply chain", or perhaps "mobility-as-a-service". Such broad domains are often of little help in prioritizing investment or selecting the right external innovation partners. Companies that are more successful in delivering significant new growth spend much more effort on defining inspiring visions supported by razor-sharp objectives: what are the future unmet customer needs, what challenges need to be overcome to meet them, and precisely how could these be articulated in terms of practical innovation programs?

These discussions are the vital first step in laying the groundwork for mainstreaming of a future new business. Importantly, these objectives should be precise in terms of scope and challenges, but not limiting in terms of possible technological solutions or numbers of experiments that could be undertaken. Once agreed, the objectives should be supported by top management, and championed by those within the organization who will be responsible for implementing the results. They should be managed via an appropriate governance mechanism, which should be cross-functional, rather than just within R&D. Metrics should be tailored to reflect progress with respect to objectives (e.g., number of challenges overcome), not just revenue and profit, which may not be achieved until further down the line.

2. Adopt an incubation vehicle designed to deliver at scale: Some companies are now setting up purpose-built vehicles to incubate and deliver new, scaled-up and de-risked businesses in non-core areas, instead of (or in addition to) conventional start-up incubators. These may be either run from within the corporation or wholly externalized, but whichever route is adopted, these vehicles need to be given strong independence and autonomy from the mainstream corporation. They need to fully leverage the external partner ecosystem, including specialist service providers and established businesses, as well as start-ups (Figure 2).

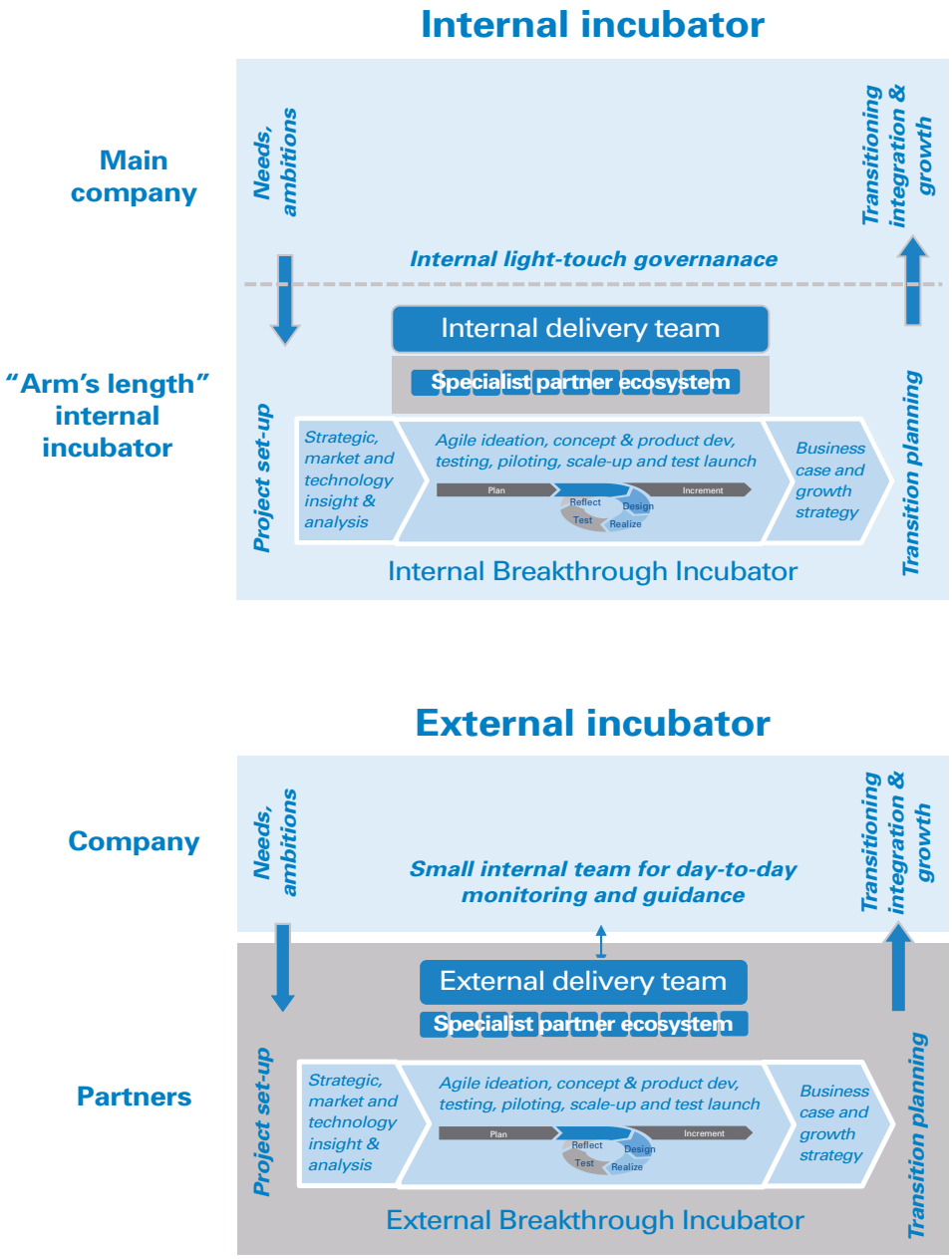


Figure 2: Next-generation corporate incubation vehicles – Internal and external models

These vehicles are distinct from conventional incubators in several key ways:

- They are designed to run a full, end-to-end process from ambition though to launch and scale-up of a new product/service line or complete business.

- They use a single lead delivery team to take full responsibility for achieving the goals, managing the process with a dedicated team, and leveraging input from multiple external partners, which include not only start-ups, but also established firms.

- They adopt an agile approach to new product/service development, integrating technical, commercial, operational and strategic inputs simultaneously, testing early and using more than one solution route. This enables much faster speed to launch, typically one to two years rather than the three to four years needed for a start-up.

They can be run either internally or externally:

- The **internal** model, in which the incubator is managed by an in-house corporate team, means the company maintains close control. However, if the incubator is not fully isolated from normal corporate influences and pressures, constraints and obstacles may slow the process down and stifle true breakthroughs.

- The **external** model[6], which we at Arthur D. Little refer to as the "Breakthrough Incubator", is similar in its end-to-end approach, except that incubator management is fully externalized to an independent lead delivery partner. This model offers great advantages, including maintaining arm's length operations from existing brands to avoid distortion and premature death, maintaining anonymity in the marketplace for first-mover advantage, and improved speed and agility. However, in this model, additional effort is needed to effectively transition the new business back into the company and capture all the learnings. (See step 5, below.) This model was used recently by a large food & beverage company to create major new platforms and product lines in a new market whitespace. (See case study 1.)

6. Refer to Prism S1 2018 "The Breakthrough Incubator – How to create and rapidly launch new step-out businesses"

3. Use multiple partner engagement tools in an integrated way: Many companies already use a variety of innovation tools and vehicles, including start-up incubators and accelerators, corporate venturing, intrapreneur programs and internal R&D teams. However, often these are managed as separate vehicles focusing on different projects and challenges. Companies that are most successful in creating new businesses of scale tend to apply multiple tools and vehicles to address the same challenge in an interconnected way, orchestrating a collaboration culture throughout the organization. For example, a major European utility has found that interconnecting different tools is critical to success for breakthrough innovation: its corporate venturing team identified start-ups in advanced mobility, which were then passed on to the company's equivalent of a Breakthrough Incubator, which also took ideas from the internal R&D teams for the partnership to work on. This helps to ensure that results from a venturing program ultimately give rise to a new business area and ensures engagement with some internal intrapreneurs as part of the process.

4. Go beyond proof of concept (PoC) before integrating into the business: Many great opportunities die at the PoC stage. It is at this "downstream" end of the innovation cycle that most of the barriers lie. Because the new vehicle takes new business opportunities beyond PoC through into testing and scale-up before integrating them into the mainstream business, there is a much higher chance of success. For example, when Orange Spain wanted to create a new disruptive, cloud-only enterprise telecoms operator (called X by Orange, see case study 2), it used an external Breakthrough Incubator model not just to design a prototype for the new business, but also to operationalize and de-risk it before ultimately mainstreaming it – essentially a "build/operate/transfer" approach.

5. Focus heavily on the mainstreaming phase: Regardless of whether an internal or external incubator approach is followed, there is always a point at which the new business has to be either integrated into mainstream operations or killed off. As mentioned above, this phase is one of the most difficult, and because of this, many companies still fail to manage it effectively. A common approach is simply to make one of the existing business units responsible for the new

business, which can often lead to problems of "dilution": watering down the products/services of the new business so they fit more easily into existing operations and/or brands. This can be hugely value-destructive for a new venture.

A much better approach is to spend time to *structure and implement a comprehensive transitioning* or *mainstreaming process*, in order to ensure that the right structure and governance are in place for the new business, and that all the key interfacing functions (such as supply, operations, marketing, commercial and finance) are engaged to support it. It is also key to ensure that valuable lessons in terms of approach and culture are captured and transferred. In the example in case study 1, a food and beverage company spent over six months with some 50 separate touchpoint events to mainstream and transition a newly incubated and de-risked business with a multi-category range of new products, which had been developed and test-launched externally by its incubator function.

Importantly, this needs to be a two-way process, in which the business learns about the new venture and the incubated business adjusts to fit corporate requirements, though it is essential to ensure that the incubator function is sufficiently empowered so the results of incubation are not ignored or diluted. In addition, the handover process can be a valuable way to learn how to adjust the incubation approach in the future, as corporate incubators themselves are experiments to be refined and built on. Mainstreaming is important irrespective of whether the incubator is internally or externally managed.

Case study 1: Breakthrough – end-to-end product innovation for a global food and drink company

A leading food and beverage company set out to target new segments of the consumer population by developing innovative products tailored to their specific needs. It wanted the initiative to be consumer-needs led, scientifically and quantitatively driven, and independent of its existing portfolio of businesses and brands. While the initiative aimed at developing and launching new products and platforms, it was also focused on learning and bringing the organization up to speed on the targeted segments, as they were deemed important future growth drivers.

With the help of Arthur D. Little, the company created an external Breakthrough Incubator outside of its organization with the charter to ideate, create, develop, test, and launch new products that fulfilled the strategic objectives. As the project orchestrator, ADL created and implemented an agile approach using an ecosystem of collaborators that met the needs of every step of the project. ADL also coordinated with the client team on a regular basis to ensure input and buy-in to critical decisions and milestones. In just over two years the incubator delivered three new brands, developed 21 concepts and prototypes quantitatively tested with 4,000 consumers, launched six new product lines, and created 12 strategic platforms and an innovation pipeline with 170 concepts. Collectively, the outputs have multi-billion-dollar sales potential.

A key aspect was transitioning the new business back into the parent business, which took place as part of a comprehensive programme over six months, with more than 50 separate touchpoint events. The insight and learnings about the segments' emotional and functional needs will also form the basis for the development of strategic platforms, around which the company will transform the business to focus on key growth segments of the future.

Case study 2: X by Orange – Developing and launching a new, non-core business using the Breakthrough Incubator model

Orange, one of the largest operators of mobile and Internet services in Europe and Africa, wished to build a new type of cloud-native operator for the enterprise market that would become the blueprint for the future Orange digital offering and operating model. To ensure rapid delivery and maximize innovation without the normal constraints of the corporation, Orange Spain, the sponsor of the project, created an independent external incubator, managed by Arthur D. Little as lead delivery partner, to take the project from conception through to launch and operations. The project was started in June 2017.

The project was conceived from day 1 as a "step-out" approach – a fully owned subsidiary of Orange Spain was created, with ample freedom to hire and contract without the constraints of the corporation. Strategic goals, concepts, scoping and a project plan were developed over six weeks. The business was successfully designed and delivered using

agile approaches within 15 months up to public pre-launch, and a further operational and continuous development phase of 18 months is now in progress. The project resulted in a disruptive, fully digital operator, meeting very aggressive targets on schedule and attracting top-class external talent. It created a new capability to allow Orange to significantly grow its business in its current markets and develop new markets with new business models.

Key to success was the seamless orchestration of the core team with around 100 ecosystem partners, which was coordinated by a small team of three from Orange, five from Arthur D. Little, and 10 associates. Technical, commercial, marketing and operational capabilities were integrated from the beginning of the development and delivery phase.

Insight for the executive

Working with start-ups is seen today as an essential part of any corporate innovation effort, and it is a trend that is here to stay, as companies need to find new growth in mature markets and defend against disruptions. But as experience in working with start-up incubators grows, companies are increasingly looking at new vehicles to create businesses of scale, not just incremental opportunities which are orders of magnitude smaller than the core business. The conventional corporate incubator model is not able to deliver against these requirements.

Companies therefore need to look to next-generation models for start-up incubation. These move away from running a number of experiments in peripheral business areas, towards scaling up and de-risking new businesses. Companies need to sharpen objectives, trust lead teams to deliver against them, release the teams from corporate shackles, and work in an agile way, simultaneously integrating technical, commercial, operational and strategic inputs to ensure de-risked and scaled-up new businesses. Finally, they need to take comprehensive measures to transition their new businesses back into the mainstream, which will enable true transformation.

Continuing to rely on striking it lucky with the right start-up to achieve breakthroughs is not enough. Companies that are able to master these next-generation incubator approaches are likely to be the ones that achieve major growth in new business areas in today’s challenging environment.

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