Open Innovation:
Bring Change from the Outside

There are many ways to approach innovation, both internally and externally, and the best model is often a hybrid strategy. However, when dealing with third parties, starting off with a Venture Client approach offers a number of advantages.

By Nathalie Bontems, Dubai

No one can do it all by themselves. That's the hard lesson that organizations looking to transform and innovate are – or should be – learning. Open innovation, that uses multiple external sources to drive change and growth, is all but unavoidable to tackle today's transformational challenges. "[Organizations] have to understand that if they do business like they have done for the last 50 years, they will fail. Open innovation in general, injecting knowledge from the outside, is a key point of differentiation going forward," Joerg Niessing, Affiliate Professor of Marketing at INSEAD, told *Trends*.

Gregor Gimmy, Managing Director at 27pilots, a company that helps organizations benefit strategically from startups through the Venture Client model (VC), said: "Competitiveness has always depended on your ability to bring externally technology into your company. You're only as good as the external technology you bring in. So, in that sense, open innovation was always relevant."

Why startups can best help

Open innovation is itself evolving in line with the business environment's own transformation. Although it has been around as a management model for over 20 years – especially since 2003, when Harvard Business School Professor Henry W. Chesbrough came up with that theory – the dramatic increase in the supply of external innovation resources, both in number and quality, has profoundly transformed the way companies can benefit from outsiders having different expertise than their own. "What changed is not so much the willingness of corporates to work with outside technology providers, but the nature of those providers of technology," said Gimmy.

More and more, startup companies are becoming the primary source for external ▶

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innovation, and with good reason. As Gimmy explained, "Startup companies have two advantages over the incumbents: they have significantly more capital than the big corporations to solve a specific problem; and they have intellectual property nobody has." Therefore, investing in a startup allows the organization to gain a specific competitive advantage. "Why would a company invest millions of dollars in a startup? When the startup has the unfair advantage; when it has something that I cannot imitate, I cannot do myself, and my current suppliers cannot do; when it's the only choice," said Gimmy.

Startups have another advantage over legacy corporations: their mindset and their culture. As Niessing explained, "Many corporates are just not able to think [the startup] way. Startups will be the dominant source because of the entrepreneurial management thinking they bring to the table – which we call red management. The traditional management – which we call blue management and which is all about maximization, monetization, execution – doesn't work in an era of higher uncertainty. It's one of the key reasons why it's better for a corporate to work with a startup rather than to work with another corporate that thinks like a dinosaur."

Creating the proper infrastructure

Open innovation can take many forms – crowdsourcing with customers, joint ventures, collaboration, etc. Similarly, there are many ways organizations can integrate startups. However, the common denominator, regardless of the investment format, is to adopt a structured approach.

"We know there are 150 to 200 million startups founded every year. There's so much knowledge out there. A structural approach that will bring you to a point where you can scale at low costs, is the way to tap into this knowledge you have not tapped into before," said Niessing.

Such an approach starts with creating a special unit working on identifying, analyzing and integrating startups. Gimmy, who founded and headed the BMW Group's VC unit Startup Garage in 2015, explained: "Corporates need to set up a startup department; a dedicated infrastructure with the right startup competency, with the objective to harness the best startup technologies for their competitive advantage."

Once this unit is set up, it's essential to establish it and brand it clearly, so that it can be recognized and understood both internally and outside of the organization. "At BMW, we called it the BMW Startup Garage. The primary objective was that, if Startup Garage is the infrastructure to bring in outside startup technology to the various business units, those business units need to know that we exist, that what we do makes sense, and that we can help them access interesting startup technology. At the same time, you need to make yourself known to the outside startup ecosystem, so that VCs and startups know that there is a corporate that has the right processes, which makes it easy for them to do business with you," said Gimmy. The next step is to set up a specific set of processes and resources to, first and foremost, be able to identify needs that are known and not known; which, in turn, allows the unit to find startups that match that need. "80 percent of the time, organizations are looking for solutions to a problem they know they have. And most startups today are attacking problems that everybody knows exist. So automatically, the venture capital flows into solutions where the VC has some assurance that there's actually a market need for

that technology," said Gimmy, who went on to explain that organizations next "need a process in order to evaluate fast if a transfer of that technology can happen and how. Then, you need to enable the transfer so that the technology is used within the corporate. And last, you need to be able to manage the rollout of that technology so that it generates a benefit to the corporate in the long term."

Changing the culture

Niessing warns that this all looks very good on paper but is not sufficient if the organization doesn't work on its culture. "Even if you put out this process, even if you create this startup department, if you don't change the culture in the organization or at least try to, you will still struggle. You still want to make sure that the teams accept what new startups come up with and don't fall back into their own thing," he said.

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Now, implementing a cultural change at an organization level cannot happen overnight, but has to be done in parallel. "The infrastructure that you implement also needs to be able to change the attitudes, the ignorance and the myth that happen around startups. At Startup Garage, for example, we had an event that we called Minimum Viable Pizza (MVP): every month or every week, we invited people from the company to pizza, which by itself was a cultural change. It was a very informal setting in which we tried to eliminate some of the myths around the startup. We made people aware and helped them change their mind and their attitude," said Gimmy.

However, none of these steps matter without the right drive from leadership, added Gimmy. "The other thing that has to change is the culture of the five guys who sit on top. Everybody says the quality of a startup depends on its team. Well, the quality of the corporate also depends on its team. How difficult can it be for a board of directors to, for example, define a KPI called a startup quota: 'I want to spend two percent of my whole purchasing budget on startup technology, and I want to see that number at the end of the year.' How difficult is that? If the top management doesn't recognize that startups bring technology that makes you more competitive, then you've got the wrong board."

Choosing the right tool

Identifying the best tool to benefit from startups also plays an instrumental role ▶

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in the future success of transformation, and there are several ways a company can do that: by acquiring the startup (M&A), buying an equity stake in the startup (CVC), or buying the product of the startup.

Naturally, M&A allows the acquirer to own the technology and to fully use it within its system. "The amount of acquisitions that Silicon Valley companies do is amazing. A company as young as Google conducted over 200 acquisitions over the last 20 years. You bring in outside innovation to help with very specific technologies, which saves you two years in development time. You own the technology, you own the people, you just need to develop a competency to make that merger work," said Gimmy

However, Gimmy and Niessing advocate for a newer, more innovative tool to work in tandem with acquisition: Venture Client (VC), whereby the organization becomes the client of the startup at an early stage, when its product, service or technology is not yet mature.

"VC means you have a much lower cost and much lower risk of bringing in a massive amount of technologies, which you can evaluate and place within your corporate, compared to any other corporate venture tool that's out there," said Gimmy, who added that "VC is complimentary to acquisition – it's not either/or. For 100 venture client transactions, you would have one acquisition."

Taking the example of a robot in a car assembly line, Gimmy explained that the manufacturer doesn't need to own the technology behind that robot. That would increase the cost of manufacturing because this carmaker would be the only one to buy that robot in the industry, and the unit cost of the robot would be too high, impacting negatively the production cost of the car. On the other hand, if you own a critical piece of software developed by a startup, that recognizes people in autonomous driving, nobody else will be able to do that and you'll have the only car that can recognize people. "Now, you want to own that [technology], and it won't increase the cost of production because it's a software. So here, you would acquire the company," said Gimmy. However, he argued, VC would allow you to first test the software, do a pilot project, before you become an acquirer.

"Venture Client is, in many ways, a way to reduce the risk of acquisition and to also be a more attractive acquirer. If I'm a startup and BMW says they want to acquire my company, if I have worked with BMW before in a commercial relationship, I will trust [them much more]. Venture Client is like the base model that definitely feeds into acquisition and into other models. M&A can greatly benefit from the insights and the intelligence that come out of the richer client relationship with the startup," he explained.

Moreover, by keeping the cost of risk low, client venture leaves room for companies to invest in 'stupid ideas' that could turn out to be the jackpot: a product nobody needs yet but that eventually becomes a game-changer. "A famous example is former super angel investor and first investor in Twitter Chris Sacca […] He basically turned down Airbnb because he thought it was a stupid idea. That cost him around half a billion dollars. It's the very few startups that solve problems that nobody thinks about but that are out there, that you shouldn't miss. A very important task of open innovation is to keep the risk of the cost so low that you can even say yes to stupid ideas," said Gimmy.

By contrast, "If you, as a company, decide you want to benefit from startups via CVC, suddenly, you are spending so much money on that, that you can't do anything else. The budget is gone. You're drowning all the resources that you would be able to put into other tools," he added.

Thinking outside in

Indeed, a CVC approach to investment in startups reflects an 'inside out' mindset that, according to Niessing, is a major hurdle in the road to innovation and transformation. "Inside out means: 'What can I do in house? What business model can I do because of my current capabilities? And because of this, what can I offer to the customer?' Outside in is bringing in the outside in perspective. What do the customers want? What business model is required for this? And what capabilities do I need? Even with a CVC, where you would argue [investors] have understood [they need to] bring in open innovation from the outside, they still think inside out. You build this as an internal function and you go out there, invest in startups; but you still think in your own traditional thinking. This is the biggest reason why we don't see many successes. They get the wrong startups, they don't have a structured approach, they acquire a stake in a company that does not give them the technology, instead of literally getting the technology. That's the other big difference between the classical CVC and the Venture Client model," he said.

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Gimmy added that "With CVC, the board thinks that they've spent so much money that they've solved the startup problem. It's a little bit like still using fax machines not knowing there's email and believing that this is the best communication tool out there. [But] CVC doesn't really address the core problem of using [new technology] effectively, because you're just buying a piece of equity – which is useless. CEOs and board members should recognize that CVC is really just an intermediary to a strategic benefit; it's not generating the strategic benefit. What you can do today with the VC model is to intermediate this process and go directly to the strategic benefit."

According to Gimmy, VC can yield even more strategic benefits by nurturing a healthy startup ecosystem. As he explained, "If VC is adopted by many corporates within your region, this will create a pull that will attract startups; it will also generate a pull towards new entrepreneurship, because, obviously, entrepreneurs and companies go where the clients are. Silicon Valley is not only great because of its products and its investors; it's also great because, primarily, of its clients for startup companies. You have very important corporates that are continuously clients of startups, as well as acquirers. A big strategy for a region to attract startups and to become an ecosystem for the creation of new startups, is to have a healthy system not only of providing capital, which is not sufficient to survive, but also of providing demand for startup products and revenue from local clients. That would definitely give a boost to your ecosystem." ■