

Strategic experiments are crucial to long-term growth – but exactly what does it take to get promising ideas out of the incubator and up and running as sustainable new businesses?



Building Breakthrough Businesses Within Established Organizations

by Vijay Govindarajan and Chris Trimble

FEW BUSINESS NARRATIVES are more evocative than that of the inspired leader boldly pursuing an extraordinarily innovative idea. So romantic is the notion that companies pushing for more innovation often devote the bulk of their energies and resources to generating ideas and encouraging individual initiatives. This is a good start, but nothing more. New businesses with the potential to deliver breakthrough growth for established companies face stiff headwinds well after launch. Ray Stata, a cofounder of Analog Devices, the \$2 billion semiconductor company, has lived this challenge for decades: “I came to the conclusion long ago that limits to innovation have less to do with technology or creativity than organizational agility. Inspired individuals can only do so much.” Emphasis must shift: from ideas to execution and from leadership excellence to organizational excellence.

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To find out exactly what it takes to get beyond ideas, we have spent the past five years chronicling initiatives at organizations such as the New York Times Company, Analog Devices, Corning, Hasbro, Cisco, Unilever, Kodak, Johnson & Johnson, Nucor, Stora Enso, and the Thomson Corporation. We have examined best practices for managing strategic experiments - high-growth-potential new businesses that depart from an organization's current business model and that target emerging industries in which no clear formula exists for making a profit. Strategic experiments constitute the highest-risk, highest-return category of innovation and require a unique managerial approach. We chose to focus on strategic experiments because dramatic forces such as globalization, digital technology, biotechnology, and demographic change are now creating nonlinear shifts in the economy-threatening stability but also opening up opportunities for breakthrough growth.

A new business with high growth potential (let's call it NewCo) rarely coexists gracefully with the most closely

of products, many designed for custom applications. There were only a few automakers, however, and because they valued cost and reliability over customization, they needed only a few variations on the basic crash sensor. As a result, the MEMS team had to alter all of its processes for selling, marketing, and manufacturing. The team also needed to *borrow* Analog Devices' semiconductor expertise and manufacturing plants. And it needed to *learn* whether MEMS devices could be manufactured at a profit and to what extent markets for MEMS applications outside the automotive industry would develop. The business ultimately became profitable but not without first having to confront each of the three challenges.

Forgetting, borrowing, and learning are monumental tasks. That's why it's crucial for a company to leverage the power of organizational design - a term we use in its broadest sense. In building NewCo, the CEO must be willing to challenge the status quo on an extraordinary range of issues: hiring, individual performance evaluation, needed competencies, reporting relationships, decision

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related established business unit within the company (let's call it CoreCo). The unnatural combination creates three specific challenges for *NewCo*: *forgetting*, *borrowing*, and *learning*. NewCo must forget some of what made CoreCo successful, because NewCo and CoreCo have elemental differences. NewCo must borrow some of CoreCo's assets - the greatest advantage it has over independent start-ups. And NewCo must be prepared to learn some things from scratch.

When Analog Devices decided to explore opportunities presented by a new semiconductor technology, it faced all three challenges. The technology, called microelectromechanical systems (MEMS), uses a chip with microscopic moving parts that act as sensors; the first commercial application was automotive crash sensors, which launch airbags. The MEMS team at Analog Devices needed *to forget*, because the company's core business model wouldn't work for MEMS. Analog Devices was accustomed to serving thousands of customers with thousands

rights, planning and budgeting, business performance assessment, metrics, compensation, shared values, and shared assumptions about success.

The three challenges are present throughout NewCo's awkward adolescence, from launch to profitability. And they're present all at once, which means tackling them requires an understanding of how they're related. Forgetting and borrowing are at odds, for example, and need to be balanced. A sole focus on forgetting would suggest isolation of NewCo, while a sole focus on borrowing would suggest full integration of NewCo. Also, failure to forget cripples the learning effort. If NewCo cannot leave behind CoreCo's formula for success, it will not find its own.

Forget

To build a foundation for success, NewCo must forget CoreCo's business model. NewCo's answers to the fundamental questions that define a business-Who is our cus-

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tomers? What value do we offer? How do we deliver that value? - should be different from CoreCo's. NewCo must therefore leave behind notions about what skills and competencies are most valuable. And it must forget the relative predictability of CoreCo's environment.

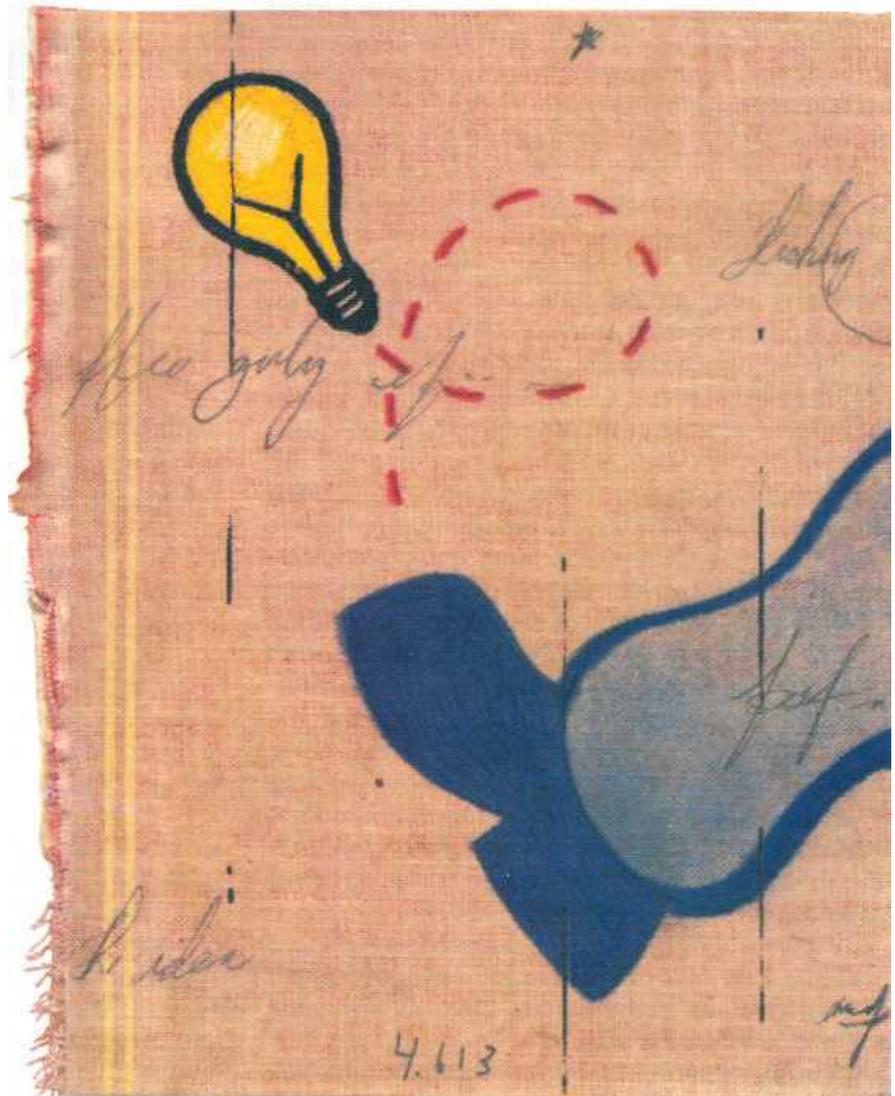
It is easy to underestimate the magnitude of the forgetting challenge. And it is easy to conclude too quickly that NewCo has succeeded in forgetting. Awareness of the differences between NewCo and CoreCo is not enough. Forgetting is about changing behavior. Often, we have observed, NewCo talks like NewCo but acts like CoreCo.

Many powerful sources of institutional memory—instincts developed through past experiences, relationships between employees that are grounded in CoreCo's business model, performance measures, planning templates, norms for individual performance evaluation, and even often-told stories about the company's history—can interfere with forgetting. Some companies have especially strong memories. (See the sidebar "Warning Signs That Forgetting Will Be an Uphill Battle.")

Many firms make the mistake of duplicating CoreCo's organizational design when they create NewCo. Doing so minimizes hassles, since making NewCo an exception to rules about such things as hiring, compensation, and status can lead to resistance, even resentment, within CoreCo. But the only way to erase memory is to overhaul NewCo's organizational design.

To understand what it takes to forget, consider Corning's venture into the genomics industry. Through the 1990s, advances in biotechnology spawned an industry dedicated to serving the needs of genomics researchers, who were trying to unlock the secrets of DNA and unleash a revolution in medical therapies. Millions of new experiments became possible, and researchers desperately wanted to automate and accelerate the experimentation process.

One crucial piece of laboratory apparatus was the DNA microarray—a glass slide with thousands of tiny DNA samples adhered to it. Because of issues of quality, reliability, and ease of use, many researchers "printed" their own



microarrays—a time-consuming and costly process. The opportunity for Corning was clear: to leverage its world-class expertise in specialty glass and microscopic manufacturing processes so it could offer genomics researchers a reliable and inexpensive supply of microarrays. When Corning launched Corning Microarray Technologies (CMT) in 1998, analysts were projecting explosive growth for the industry.

Over the years, Corning had been effective in part because its business units shared a common formula for success. Each sold components to industrial manufacturers. Each emphasized high quality and reliability. Each depended on strong intellectual property rights that limited competition. Each relied on excellence in the manufacture of glass and ceramics and on mastery of related scientific fields. Each planned in a disciplined fashion, and each held managers accountable to those plans.

But CMT was different. CMT sold to an unfamiliar customer—senior laboratory administrators. It needed to

emphasize cost and convenience instead of the highest possible quality. It had to work in an unfamiliar, emerging scientific field where patent protection was unlikely. It needed to balance expertise in glass manufacturing with expertise in molecular biology. And it faced a much higher level of ambiguity.

The differences between Corning and CMT are clear in hindsight. But at the time, Corning naturally assumed that what had worked for its established business units would also work for CMT. Therefore, CMT had its own manufacturing, sales, and marketing functions and shared Corning's centralized research and development functions. CMT also adopted Corning's rigorous five-stage model for new product development, along with clear expectations for hitting certain milestones. Because CMT was small, it reported to the existing life sciences business unit. Corning did depart from its tradition of hiring and promoting from within - CMT hired several outside experts in molecular biology, many of whom were assigned to the centralized R&D groups-but all management positions were filled by Corning insiders. As a result, CMT did not develop a culture or identity that was noticeably different from Corning's.

Nonetheless, within months, CMT achieved its first success. It offered researchers who printed their own microarrays a much-improved unprinted glass slide (without DNA adhered to it) with a special coating. Customers were thrilled with the improved consistency they achieved in printing their own microarrays.

Ambitions for CMT escalated. Its leaders thought that if they simply stuck to the plan, breakthrough growth and profitability would certainly follow. But CMT soon faced unanticipated difficulties.

Working with DNA presented unfamiliar challenges. DNA from different suppliers had chemical inconsistencies, and Corning's usual methods for identifying and correcting manufacturing problems were confounded by the peculiarities of DNA fluid. One day the process would appear to be working fine; the next day a mysterious new problem would arise.

Soon CMT started missing deadlines established in the business plan. The leadership team felt intense pressure. Corning held managers accountable to the plan. Falling short was failing. Plus, falling behind meant that CMT would drag down the profitability of Corning's life sciences unit, which was just as concerned about hitting its numbers. Rather than reexamine fundamental choices, which would have meant admitting failure and asking for more capital, CMT leaders viewed their struggles as minor setbacks, and they urged their team to work harder.

Despite the high level of urgency, CMT was unable to meet expectations. In an environment of perceived failure, the cohesiveness of the leadership group frayed. The team often settled disagreements by reverting to what had worked in the past. Antagonism also developed be-

Warning Signs That Forgetting Will Be an Uphill Battle

-  The company has only one business model.
-  All business units within the company are at similar points in the business life cycle (starting up, rapidly growing, steadily expanding, maturing, or declining).
-  CoreCo has well-established standards of business performance that do not apply to NewCo—often because NewCo has a different cost structure.
-  The company has a well-defined culture and has effective socialization mechanisms built into its hiring and acquisition processes.
-  The company has a history of promoting primarily from within.
-  The company has a strong culture of holding people accountable to plans.

tween the molecular biology experts that CMT had hired from outside Corning and the CMT leadership team. The molecular biologists took issue with the way the leadership team allocated resources and evaluated outcomes. The biologists also disagreed with decisions to delay product launches to achieve quality standards they knew to be unnecessary in the imperfect world of biotechnology.

All of CMT's struggles stemmed from failures to forget. And all were probably inevitable from the moment CMT adopted Corning's organizational design.

Two years into CMT's operations, turnover in Corning's senior staff led to a reevaluation. Corning's leaders decided to rebuild the CMT organization. First, they appointed a new general manager, someone who had the ability to manage in ambiguous contexts and had a knack for facilitating communication between businesspeople, engineers, and scientists. Second, they reduced the extent to which CMT was integrated with the existing research and development functions by having CMT's heads of R&D report to CMT's general manager. Third, they changed to more subjective criteria for evaluating the general manager's performance, focusing on factors such as how quickly he learned and made adjustments. Fourth, the general manager no longer reported to the head of the life sciences business but to the president of Corning Technologies, who would dedicate significant time and energy to advising CMT.

CMT's new general manager subsequently made his own changes. He hired an outside molecular biology ex-

pert to manage the product development effort and another to manage relationships with suppliers. He also moved numerous CMT employees working in distant Corning facilities back to Corning, New York, to help CMT develop a distinct culture.

All of these changes took several months, but it was time well spent. CMT was able to restructure its relationships between research, development, marketing, and sales and to follow a more iterative innovation process. The molecular biologists were given a stronger voice and were able to help CMT make more rapid technical progress. And Corning's senior management team treated CMT's projections as though they were informed estimates rather than a nonnegotiable basis for judging performance. Knowing that he would be evaluated on how quickly he learned and made adjustments, CMT's general manager frequently updated the president on setbacks, lessons, and new directions. When CMT launched its first microarray product in September 2000, customers rated the product a "home run."

How to Forget

From studying Corning's experience - and comparing it to similar efforts at other companies - we have isolated a number of best practices for forgetting:

Don't be insular. NewCo should hire outsiders in key management roles and strongly consider an outsider to head the business. Outsiders challenge institutional memory and are instrumental in building new competencies.

Don't assign status based on size. NewCo should report at least one level above CoreCo in order to reduce the pressures on NewCo for short-term results and to ensure that CoreCo does not hoard resources.

Rearrange the moving parts. NewCo should reconsider how major business functions such as marketing and product development interact. Established patterns of interaction within CoreCo are usually incompatible with the new business model.

Build a new dashboard. The company should not base NewCo's performance on CoreCo's metrics. Doing so reinforces CoreCo's formula for success, not NewCo's.

Dare to make complex judgments. The company should not judge the performance of NewCo's leader too heavily against plans.

Promote new thinking about success. NewCo's leader should create a unique set of beliefs about actions that lead to success and regularly reinforce them. CoreCo's beliefs may not apply in NewCo's environment.

Borrow

NewCo forgets most easily if it is isolated from CoreCo. But complete separation is impractical. CoreCo's tremendous resources are too valuable to ignore.

NewCo *could* borrow a lot from CoreCo - everything from unique assets such as a brand, a network of sales relationships, and manufacturing capacity, to more routine items such as hiring policies, accounting systems, and purchasing processes. We suggest a more measured approach. Borrow too much, and it becomes too hard to forget.

NewCo should borrow when it can gain a crucial competitive advantage - crucial enough that the company would highlight it in a pitch to outside investors. Corning, for example, could not credibly talk to shareholders about its investment in CMT without directing attention to its existing expertise in glass manufacturing. That's a sign that Corning's expertise in glass manufacturing is something CMT should borrow. Usually, there are only one or two such areas that meet this criteria. Incremental cost reductions are never sufficient justification for borrowing.

Links between NewCo and CoreCo should be selected carefully because if NewCo has been properly designed to forget, interactions will be difficult to manage. In fact, once the links are in place, the crux of the borrowing challenge then becomes anticipating the tensions between NewCo and CoreCo - and never allowing them to escalate beyond productive levels. Managing these interactions deserves substantial attention from senior management. Otherwise, cooperation between NewCo and CoreCo can easily disintegrate.

The story of the New York Times Company's venture into the interactive world demonstrates the difficulties of borrowing. The company launched its Internet business unit, eventually named New York Times Digital (NYTD), in 1995. At first, Internet operations were kept closely integrated with newspaper operations. The Internet team prepared content by altering headlines, adding hyperlinks, resizing photos, changing captions, and so forth, keeping the Web site up-to-date throughout the night until the final edition went to press. NYTD added many new features in the early years, but it soon started lagging behind competitors, which were more fully utilizing the rapidly expanding capability of the Internet. Though the NYTD staff pushed to keep pace, it felt constrained to a simple "newspaper.com" operation.

Soon, the company decided on a complete organizational overhaul, choosing an approach similar to Corning's. The head of NYTD began reporting directly to the president rather than to the general manager of the *Times*. NYTD's managers created their own policy team, including a CFO and heads of human resources and business development. They hired so many outsiders with Internet experience that, by the end of 2000, only one-fourth of the staff had come through internal transfers. They altered planning norms and focused on different measures of performance. They moved to a separate building. And they made an effort to redefine their culture and values.

An explosion of creativity followed. The NYTD employees were now operating under the assumption that

they served a different set of readers and advertisers than the *Times* and met distinct needs. They experimented with potential revenue sources and added a great deal of content that was not in the daily newspaper, including material from other news sources, audio and video content, interactive features, continuous news breaks, and *Times* archives.

Unfortunately, the organizational overhaul that enabled NYTD to forget also hindered its borrowing. Tensions heightened in the daily interactions between NYTD and the *Times*. And borrowing was absolutely crucial. NYTD needed two links in particular to the *Times*. Most obvious, NYTD could not survive without the newspaper's branded content, the main attraction for its readers. And NYTD needed to tap into the newspaper's existing base of advertisers, which required the coordination of sales processes.

Some tensions arose from substantive business conflicts. For example, the *Times* circulation department, quite understandably, was not enamored with NYTD. Making newspaper content available on the Internet at no charge gave people a powerful reason not to subscribe to the print version of the newspaper. Also, the *Times* editorial staff was concerned about protecting the newspaper's brand. NYTD was primarily a software operation and, as such, was designed to encourage cross-functional collaboration, something strictly limited within the newspaper to ensure that journalism was not influenced by commercial pressures. Finally, the *Times* group that sold display advertisements (as opposed to classifieds) viewed coordination with the NYTD sales team as a distraction, since the *Times* print ads were much bigger sources of revenue.

Tensions rooted in rivalry were also disruptive. NYTD received a great deal of media attention, especially when the company proposed, though never launched, a NYTD tracking stock that would have given NYTD employees a chance at a large payoff. And because NYTD had made it so clear that it was trying to build a different kind of organization, interactions took on an "us versus them" undertone. NYTD communicated that it aimed to be fast moving, antibureaucratic, risk taking, and experimental. Naturally, the *Times* aspired to be the same and winced at the implication that it was not.



These tensions are hardly unique. They are an inevitable part of the challenge of managing strategic experiments. We observed similar tensions in every company we studied. (For more on these tensions, see the sidebar "Warning Signs That Borrowing Will Be an Uphill Battle.")

Whereas other companies in our research struggled to create effective cooperation, the New York Times Company succeeded because the senior management team acknowledged and proactively managed the tensions. The president, in particular, closely monitored interactions between NYTD and the *Times* and intervened when necessary to keep interactions productive.

In addition, in performance reviews of individual managers, the company stressed collaborating across business units. And to minimize tensions over subscription cannibalization, the senior management team conducted an analysis showing that cannibalization was minimal and that the Web site was actually generating new subscriptions by inducing trial use of the product online.

In most cases, the company empowered NYTD in its interactions with the *Times*. For example, to help NYTD

establish a clear price in the market, the senior management team prohibited any initiative on the part of the *Times* to give away Web advertising as part of a larger print advertising package. (Editorial was one area where the company didn't empower NYTD. To protect the *Times* brand, the newspaper retained substantial control over alterations to editorial content on the Web site.)

NYTD reached profitability in 2001, in part because company leaders carefully managed interactions between NYTD and the *Times*. By 2004, NYTD was earning more than \$30 million annually on revenues of approximately \$100 million.

How to Borrow

Ultimately, NewCo has a much better chance of success when it can leverage CoreCo's assets. The trick, however, is borrowing only where the leverage is highest and ensuring that the senior management team is engaged in monitoring and facilitating. By comparing the New York Times' approach to those of other companies we studied, we were able to identify a number of best practices for borrowing:

Balance the yin of forgetting with the yang of borrowing. Create links, yes, but only to lend NewCo a crucial competitive advantage. Avoid links where conflicts are severe. Avoid links to the IT or HR departments.

Find common ground. Reinforce values that NewCo and CoreCo share. In most cases, CoreCo will have some values that are inconsistent with NewCo's business model. Still, the senior management team can facilitate cooperation by creating a "metaculture" composed of more general values.

Be careful what you ask for. To promote collaboration, reconsider individual incentives. Evaluate and reward CoreCo managers, in part, according to their willingness to cooperate with NewCo. Avoid strong incentives tied strictly to CoreCo's short-term performance.

Co-opt CoreCo. To eliminate resistance from CoreCo's general manager, make borrowing as painless as possible so that he can focus strictly on CoreCo. Replenish CoreCo's resources when NewCo borrows heavily. Set transfer prices high enough to ensure that CoreCo will consider it a priority to help NewCo but not so high that NewCo cannot realistically achieve profitability. NewCo's profitability is a powerful symbol. CoreCo will always be more enthusiastic about helping when there is evidence that NewCo is succeeding.

Be alert to tremors. Assign a senior executive to anticipate tensions between NewCo and CoreCo and to intervene should those tensions become destructive. The senior executive must be willing to commit a lot of time and energy and must be influential and respected within the corporation. She must continually explain the rationale for the differences between NewCo and CoreCo.

Warning Signs That Borrowing Will Be an Uphill Battle

-  CoreCo perceives that NewCo will cannibalize CoreCo revenues.
-  CoreCo perceives that NewCo could render a CoreCo competence obsolete.
-  CoreCo perceives that NewCo might damage CoreCo assets, such as brands or customer relationships.
-  NewCo's losses are rising, even as its leaders are succeeding in growing revenues, and CoreCo managers are questioning the wisdom of allocating capital to a business incurring a loss. Bonuses tied to corporate profits exacerbate the situation.
-  Resources are scarce or becoming scarcer as CoreCo goes through a downturn. CoreCo is resistant to allocating capital, manufacturing capacity, employee time, and other resources for NewCo.
-  CoreCo managers are unfamiliar with the varying needs of units at different stages in the business life cycle, such as the need to evaluate business performance differently, the need to place more emphasis on flexibility than on efficiency, and the need to hire, promote, and compensate based on unique criteria. In fact, if NewCo managers receive large bonuses when NewCo succeeds, CoreCo may specifically resent the fact that NewCo's success was dependent upon CoreCo resources.
-  Establishing trust between CoreCo and NewCo, two very different organizations, is proving difficult.
-  CoreCo managers are jealous of NewCo. This is likely if NewCo starts to receive strong public endorsements from analysts, the press, outside consultants, or the CEO. CoreCo managers have worked for years or decades to advance within CoreCo, and now CoreCo may appear inferior to a much younger and sexier division.
-  Stereotypes persist about the capabilities of new and old companies. NewCo may assume that big companies cannot be agile or entrepreneurial, and CoreCo may insist that status should be based solely on resources under command. Such attitudes rarely constitute healthy rivalry—and they can easily disrupt cooperation.
-  CoreCo is so disciplined about process efficiency that it refuses to alter any processes on NewCo's behalf.

Force authority uphill. Unless NewCo is in danger of damaging one of CoreCo's assets, particularly a brand, empower NewCo in its interactions with CoreCo. Without intervention, power will naturally shift back to the larger, more entrenched CoreCo.

Learn

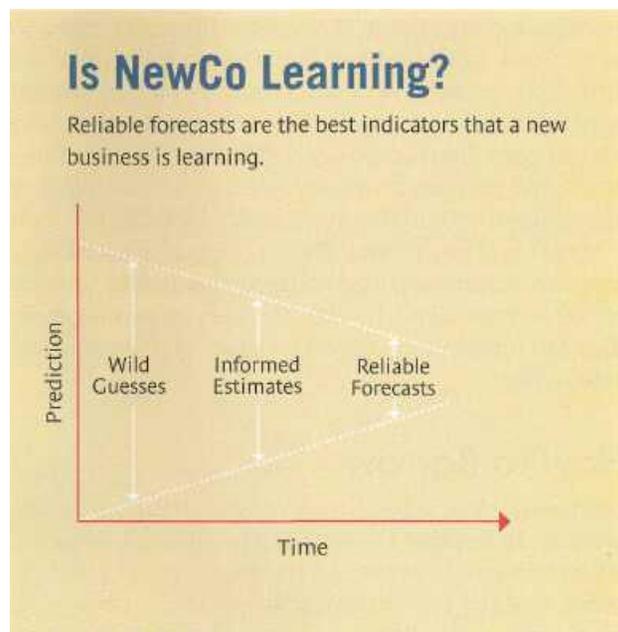
Strategic experiments are highly uncertain endeavors. Regardless of the level of prior research and analysis, NewCo will face several critical unknowns. The faster it can resolve these unknowns - that is, the faster it learns - the sooner it will zero in on a winning business model or exit a hopeless situation.

Any new business has a great deal to learn - new skills to hone, new processes to perfect, new relationships to master. These are important. But the fundamental uncertainties in the business model itself will make or break the business. NewCo's leaders can resolve the critical unknowns most quickly by focusing on a specific task: learning to predict NewCo's business outcomes. At the outset, predictions are always wild guesses. It is not uncommon for revenue forecasts for three years out to be off by a factor of ten. But as the management team learns, wild guesses become informed estimates, and informed estimates become reliable forecasts. (See the exhibit "Is NewCo Learning?")

Because predictions are bound to be wrong, especially early on, it is tempting to put little effort into them or quickly discard them. This is a trap. You cannot get better at making predictions by avoiding them. Predictions are important not because of their accuracy but because of the learning opportunities they present. In fact, the crucial learning step for NewCo is analyzing disparities between predictions and outcomes. This analysis must be open and candid. And it must be conducted with speed, rigor, and discipline.

The learning challenge is the most difficult of the three. (See the sidebar "Warning Signs That Learning Will Be an Uphill Battle") In fact, none of the companies we studied implemented a robust learning process that led to the quick resolution of critical unknowns. Thus, in our field research, we learned much more about what can go wrong than what can go right. The story of Hasbro Interactive illustrates several of the possible pitfalls associated with learning.

In 1995, Hasbro's traditional game business, with iconic brands such as Scrabble and Monopoly, was under threat. The ubiquitous PC, with its rapidly expanding multimedia capabilities, appeared to be the future of gaming. Viewing the threat as an opportunity, Hasbro created Hasbro Interactive. With a distinct organizational design and limited links to the core business, Hasbro Interactive succeeded both in forgetting and borrowing. But it would soon struggle with learning.



Hasbro Interactive's initial strategy was conservative. Executives there focused on converting existing Hasbro products to an interactive format. The new products were a quick success, generating \$80 million in revenues and earning a profit in 1997. Hasbro touted Hasbro Interactive's potential to Wall Street analysts.

The division planned to double revenues in 1998. But to get there, Hasbro Interactive would have to pursue much more experimental possibilities. At this point, learning became even more important. Starting in early 1998, Hasbro Interactive bought licenses to produce games based on television shows. They purchased old video game properties, hoping to resurrect classics from the 1980s. They created deals with sports franchises. They acquired other video game producers. They expanded the video game platforms to serve more than just PCs. They began developing their own titles from scratch. And they invested heavily in a new Internet platform, Games.com.

Overall, the heightened ambition was consistent with the anything-is-possible atmosphere of the late 1990s. But the way that Hasbro Interactive pursued growth brought a tremendous number of additional unknowns into the business. For example, did Hasbro Interactive have the skills to develop products from scratch? Could it turn other companies' products into video games as successfully as its own? How quickly would video game players migrate to the Internet? Hasbro Interactive needed an effective learning process to quickly resolve these and other unknowns. Instead, it kept moving ahead aggressively for as long as possible.

Results were strong once again in 1998. Consequently, even though many of the new initiatives had yet to prove themselves, Hasbro Interactive set an audacious tar-

Warning Signs That Learning Will Be an Uphill Battle

-  NewCo's leader perceives that NewCo is in a tremendous rush to get to market first—and therefore has little time for planning.
-  The company has a tradition of very detailed and exact planning.
-  The company has a history of insisting on common planning approaches for every business unit.
-  Data on NewCo's performance (other than financials) are difficult to gather or highly ambiguous.
-  The nature of NewCo's business is such that it demands major onetime commitments and thus has little opportunity to change direction.
-  The company strongly penalizes managers who fail to make their numbers.
-  One or more measures of business performance are viewed as important throughout the company. Senior executives judge NewCo by the same measures, even though the measures are probably irrelevant to NewCo.

get: \$1 billion in revenues within three years. The goal was initially just conversational, but it affected decision making and fueled ambition.

Nobody could know it at the time, but as the goal of reaching \$1 billion coalesced, Hasbro Interactive entered a new period in its history - the beginning of the end. Results in the first quarter of 1999 were disappointing because of unexpectedly high returns of unsold product from retailers after the 1998 Christmas season. Senior executives at Hasbro became more alert. They had many questions. Concerns heightened when Hasbro Interactive reported a significant loss at the end of 1999—in the tens of millions of dollars. The pressure was on, and it only got worse when Hasbro's core business suffered a slight decline in 2000.

Hasbro Interactive was unable to quickly restore profitability. It had invested a great deal in experimental opportunities and did not want to abandon them before they had a realistic chance to succeed. The end came late in 2000, when turnover in Hasbro's senior management team led to a change in sentiment. The new team would not endure additional losses, and Hasbro Interactive was sold at a disappointing price.

Had Hasbro Interactive been engaged in a learning process from the beginning, a more favorable outcome would have been likely. The business would have been able to part with the specific initiatives that were failing, and it could have continued to build on those that were succeeding. But Hasbro Interactive did not learn quickly because its predictions were not treated with care. They were ignored, they were manipulated, and they became too rigid.

For a variety of reasons, Hasbro Interactive *ignored* its own predictions. First, it dismissed the importance of making them, believing they would be wrong anyway. Its executives felt they were in an all-out race for first-mover advantage and should be focused on doing, not planning. Second, like most companies, Hasbro's planning cycle was annual. But the planning cycle is also the learning cycle. Thus, Hasbro Interactive ignored the fundamental assumptions underlying predictions throughout the year, and learning slowed to a crawl. A quarterly or even monthly frequency would have been a better match for Hasbro Interactive's fast-changing business.

Managers of Hasbro's established toy and game business *manipulated* Hasbro Interactive's predictions by imposing their own performance measures. Starting in 1999, Hasbro held monthly meetings to review the performance of all Hasbro business units. Naturally, the instinct was to evaluate Hasbro Interactive just like any other Hasbro division. For example, Hasbro placed heavy emphasis on short-term profitability - an unrealistic measure, given Hasbro Interactive's risky initiatives. And when Hasbro Interactive's returns from the retail trade were excessive by toy and game standards, it looked bad - even though the terms of trade are very different in software. Finally, when Hasbro Interactive argued that its product development expenses could be capitalized rather than expensed, a practice common in the software industry, others became uncomfortable because the practice was unfamiliar in toys and games. Thus, the measures that shaped the perceived performance of Hasbro Interactive were not those that could help resolve critical unknowns.

Hasbro Interactive also made the mistake of letting its predictions become *too rigid*. For years, Hasbro had applied relatively forgiving standards of accountability to plans because of the inherent unpredictability of the toy business. At the prodding of a senior executive hired from the outside, however, Hasbro had stiffened its standards, which made it unlikely that predictions for Hasbro Interactive could be revised.

Leaders of potentially high-growth businesses often view themselves as bold visionaries, and this also can interfere with the necessary revision of predictions. When it became clear that 1999 revenues would fall short, Hasbro Interactive's leader reaffirmed his belief in the original plan. He insisted on staying the course and continued to promote the \$1 billion goal.

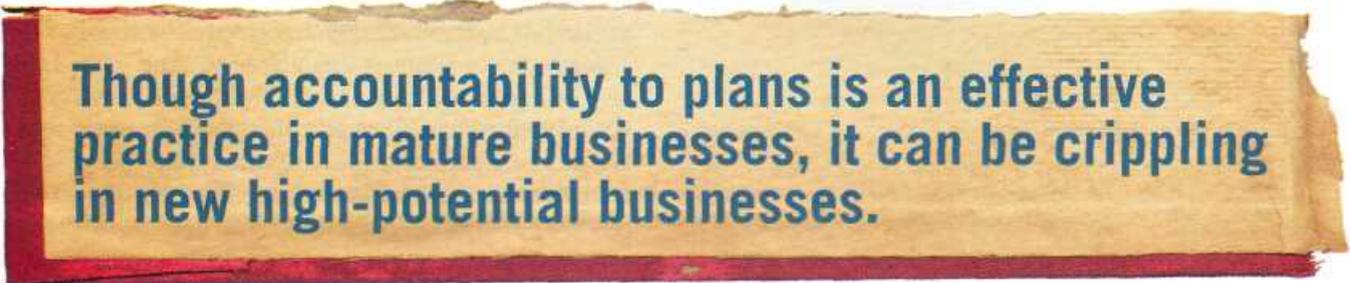
CEOs can also inadvertently make predictions inflexible. They may speak loudly of a new business's potential-as Hasbro's top executives did-both to insiders and outsiders. The intent may be to get investors excited, or it may be to increase CoreCo's support for NewCo. But doing so can lock in an overly aggressive prediction. The voice of the CEO is extremely powerful, and expectations can stick.

Rigid predictions, especially long-term ones, often lead to "guardrail-to-guardrail" decision making - that is, aggressive investment followed by complete abandonment. Such a pattern is the opposite of the gradual zeroing-in pattern that marks a healthy learning process. Hasbro Interactive went guardrail to guardrail in large part because of its heavy focus on the \$1 billion revenue goal. Tensions escalated as time went by, and people's ability to rationally assess the situation became almost impossible. In the end, those who never believed that \$1 billion was

high-potential businesses. If NewCo's leader is held accountable to the business plan, he will become defensive once targets are missed - a highly likely outcome in any strategic experiment. He will have a hard time being open and candid and may even hide information, perhaps even taking the senior management team out of the learning process altogether.

Do less, faster. That is, simplify plans, but plan more often. Each cycle through the planning process creates a learning opportunity, so planning more frequently increases the learning rate. To make a higher frequency practical, plans must be simplified. Detailed plans (broken down by region, product line, sales channel, and so forth) are useful for mature businesses, but NewCo should focus on resolving critical unknowns, which can be accomplished at a more aggregate level.

Analyze through a new lens. Compare predicted and actual *trends*. Because strategic experiments are dynamic,



Though accountability to plans is an effective practice in mature businesses, it can be crippling in new high-potential businesses.

feasible managed to drown out the voices of those who saw the potential in Hasbro Interactive - and Hasbro Interactive was abandoned altogether.

rates of change are often more valuable information than current results.

Measure what you don't know. Identify metrics that are most useful in resolving critical unknowns. These are usually nonfinancial measures and are rarely the most closely watched metrics at CoreCo.

Opportunities to lead strategic experiments do not come along every day. In fact, we have encountered very few managers who have led such experiments more than once. Strategic experiments are adventures, and they are challenging - perhaps the "triple flip with a quadruple twist" of general management.

Thus, it is imperative that companies try to learn from others' experiences. The central lesson of history is this: To convert breakthrough ideas into breakthrough growth, you must forget, borrow, and learn. Each has straightforward principles.

Today's executives celebrate an innovation myth focused on gifted visionaries. But the capabilities of the organizations that surround these visionaries will make or break the visions. 

How to Learn

Learning is the most difficult of the three challenges. It requires stepping away from tried-and-true, disciplined, and rigorous approaches to planning and moving to something very different but just as disciplined and rigorous. To promote effective learning:

Don't try to mix oil and water. Hold separate meetings for evaluating the business performance of NewCo and CoreCo. These meetings must be handled very differently, and combining them can be impractical, if not destructive.

Protect predictions. Ensure that executives involved in NewCo's planning process understand the importance of improving predictions and are aware of how this learning process can go astray when predictions are ignored, are manipulated, or become rigid.

Avoid being defensive. Evaluate the leader of NewCo not on results but on his ability to learn and make good decisions. Though accountability to plans is an effective practice in mature businesses, it can be crippling in new