Stop Kissing Frogs

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"The growth opportunities that hold out real promise for mature companies are rare. Success comes from careful selection and a willingness to reject all projects until a good one emerges".

Mature companies attempting to grow by entering new businesses fail more often than not, as numerous studies confirm. Clayton Christensen estimates the failure rate to be over 90% and a study by the Corporate Strategy Board suggests that it may be as high as 99%. Regardless of how the terms are defined – what can be called a new business, what is core versus non-core, and what constitutes success – the finding still holds.

There are two explanations offered. First, researchers point to the venture capital industry, observing that venture capitalists have to kiss a lot of frogs before they find a prince. The proposition is that companies need to research 100 business ideas, and invest in 10, to get one success. Hence high failure rates are to be expected. Second, researchers find fault with the processes that companies use to create new businesses. Companies, they argue, are too risk averse, have inappropriate cultures, fail to provide sufficient incentives, involve the wrong managers, and make many other errors. If companies would only copy more of the best practices from the venture capital industry or from serial new business creators like 3M, they could reduce the failure rate.

Our research suggests that these explanations are not only missing the real reason but may also promote practices that will makes things worse, not better. The research, by Ashridge Strategic Management Centre, involved shadowing managers responsible for developing new businesses in large companies, gauging the success rates of corporate venturing units, and looking for patterns from a database of success stories. All three research avenues led to the same conclusion: most companies are guilty of too much activity rather than too little, too much investment in risky new ventures rather than too much risk aversion.

The shadowing research included companies like Shell, McDonald's, and BG, the international gas company. In every case, we found managers facing few, if any significant opportunities that had a reasonable chance of success given the company's strengths and weaknesses. In a typical case, 24 separate ideas were seriously considered and 11 were launched as new ventures. However, when our team applied a screen based on the principles of good strategy, only one of the ideas showed an honest chance of succeeding; two others were marginal (see the Exhibit for more information about the screen). At the time of writing, only three of the 11 ventures are still alive, only one has the potential to be significant. And the total write-offs owing to failed projects exceed $750 million.

Our second arm of research, involving a sample of corporate venturing units, also pointed to a lack of suitable opportunities. Many of these were launched with gusto in the second half of the 1990s, to mimic the processes and methods of the venture capital industry. Corporate funds and third-party venture funds were available for all promising projects. In other words, the normal rules of corporate risk aversion were temporarily suspended. Yet, our survey of more than 100 such units revealed that less that 5% created significant new businesses for their parent companies. Moreover, the total costs far exceeded even optimistic forecasts of the value created by the few successes. Corporate venturing units do have uses (see "The Future of Corporate Venturing, Sloan Management Review, Fall 2003), but do not solve a growth problem.

Finally, our database of successes suggests that frog-kissing is not the way forward. Less than 5% of the successes in the database were launched as part of a "new businesses development process." The majority, instead, resulted from more deliberate strategy decisions. A good example is a venture launched by the Prudential, Britain's largest insurance company, which had its genesis in a convenient, if not very visionary, solution to a business need. The company recognized that its insurance customers, when their policies matured, needed to put the money they received somewhere—and it decided in 1996 to create an option within the company itself, called the Prudential Bank. When Sir Peter Davis became CEO of the Prudential, however, he was concerned about the rise of direct-to-consumer channels. He chose to build the Prudential Bank into a significant new direct-to-consumer business. He hired the best person in the industry to lead the project (Mike Harris had previously started and run First Direct, Britain's leading direct/internet bank) and, over the next 5 years, invested around £500 million. That venture, renamed Egg, is now, despite a set back in France, one of the world's more successful internet banks.

Undoubtedly, strategy decisions also have high failure rates. However, the surprise from the database was that the presumed best practice – increase your rate of investments in new businesses and set up dedicated processes for developing new businesses – accounts for such a small percentage of successes.

The explanation our research points to – that most companies have few opportunities for new businesses worth investing in – might be unattractive. It might even sound defeatist. ("You are asking me to commit premature suicide" one manager complained to us.) If, however, the problem is an opportunity shortage rather than a lack of skill or courage, the implications for managers are important.

First, companies need much tougher processes for screening out wild ideas and new venture suggestions. Most books encourage managers to take more risk, fly more kites and launch more ventures. The opposite is probably what is needed.

Second, some companies need to face up to a lower growth future. A successful company with zero top line growth can still produce an average return for investors. Making this the target and using cash to increase dividends and buy back shares is the easy part. Much harder will be to learn how to communicate with shareholders and motivate managers in a low growth organization. Most mature businesses have more mileage in them than their managers presume. Continuing to drive the existing businesses forward is often the most value creating option.

Third, just because a company has few opportunities for new businesses today does not mean that it will never have good opportunities in the future. Rather than pushing water uphill with new business initiatives, companies may need to learn a much harder skill – patience. A company may need to wait 5 years or more before the right "new growth platform" is identified.

Fourth, managers may need to develop a deeper awareness of the grow/mature/die cycle of business and let go of the seductive grow/grow/grow view of business. Companies grow when they have a unique proposition that enables them to outperform competitors. During this phase management's duty is to exploit this advantage as fully as possible. In the mature and die phases the art is to return as much money to the financial markets as possible, while still keeping a watching eye for other unique propositions.

Exhibit - A Screen For New Businesses

The researchers developed a screening process for new businesses that could be applied to projects prior to the development of a business case. Since the process of developing a business case can take up significant resources and often builds momentum behind a project that becomes hard to kill off, the team wanted to find a screen that could reject projects earlier in the process. The purpose of the screen was to identify whether managers were investing their time in suitable projects. The screen involved four Traffic Lights:

1. Is the profit pool for this new business likely to be "a rare game" (green), average (yellow), or "a dog" (red)? Judgments about variables, such as Porter's 5-forces, were critical to this assessment.
2. Do we have a significant value advantage (green), a small or uncertain advantage (yellow) or a disadvantage (red) when compare to likely competitors in this new business? Judgments about the value of our contribution, about the percentage of our contribution that could be turned into value without the risks of entering a new business and about the likely costs of learning the new business were critical in this assessment.
3. Do we have leaders of this new business (and sponsoring managers in the parent company) especially insightful or skilled (green), average (yellow) or less skilled than likely competitors (red)? Judgments about the status, drive, business acumen and knowledge of the market, technology or business model of the likely leaders were critical to this assessment.
4. Is the impact of this new business on the existing businesses likely to be significantly positive (green), small or uncertain (yellow) or significantly negative (red)? Judgments about the likely distraction effects and synergy effects were needed to make this assessment.

Any green light, with no reds, signaled a good project. Any red light signaled rejection. As we shadowed managers responsible for developing new businesses in 10 large companies, we found that few, if any, of their ideas were good projects. More information about these Traffic Lights can be gained from andrew.campbell@ashridge.org.uk.