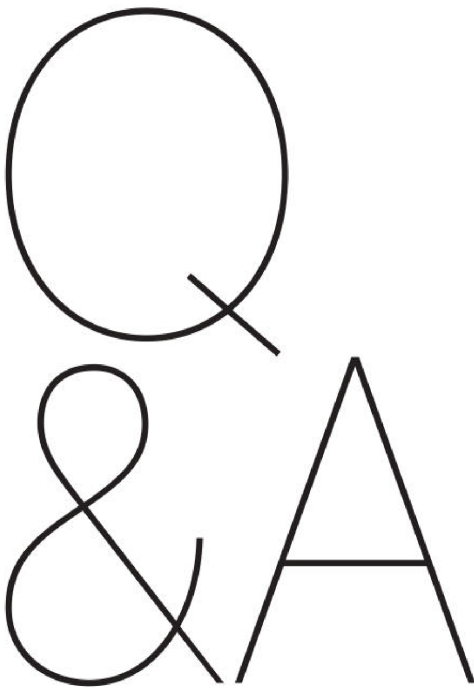


The Innovation Mindset



A leading innovation expert describes the powerful mindset that leaders should adopt to face uncertainty.

Interview by Karen Christensen

You believe a particular mindset is extremely valuable right now for decision-makers of all types — whether they work in an office tower or a factory, in marketing or supply chain. What is it?

I have studied venture capital, start-ups and corporate innovation for over two decades, and early on it became clear to me that VC investors have a unique approach to decision-making compared to traditional organizational leaders. VCs are intermediaries who connect innovators with *good ideas* but *no money* to investors *with* money but no ideas, and they are known for their extraordinary ability to spot opportunities. They are able to identify emerging trends, how to bring new industries into being, and when to hold them and when to fold. Their unique mindset has made them the force behind world-changing companies such as **Amazon**, **Google**, **SpaceX** and **Zoom**.

In our book [*The Venture Mindset*], **Alex Dang** and I describe nine distinct aspects of the venture mindset and argue that it is a new mental model for making decisions in environments of high uncertainty, where disruption is everywhere. Some of the key characteristics of the venture mindset include providing incentives for experimentation, being highly tolerant of failure and making decisions as a group. Importantly, in those groups, people are allowed to deviate from the consensus. The venture mindset also accepts that it takes time and patience to achieve the most important outcomes.

The book isn't about how to be a successful venture investor; it's about how every decision-maker — in any sector — can up their game and help their organization reach new heights.

How does the story of Zoom personify the venture mindset?

If investors had approached **Zoom** with a traditional mindset, our lives would have been very different during COVID-19. Back in 2011, Zoom already had lots competition, including **Webex** and **Skype**, and as a result, many investors weren't interested. The VCs that invested in Zoom followed the principle, 'Agree to Disagree,' which meant that even though most of the decision makers in their group were

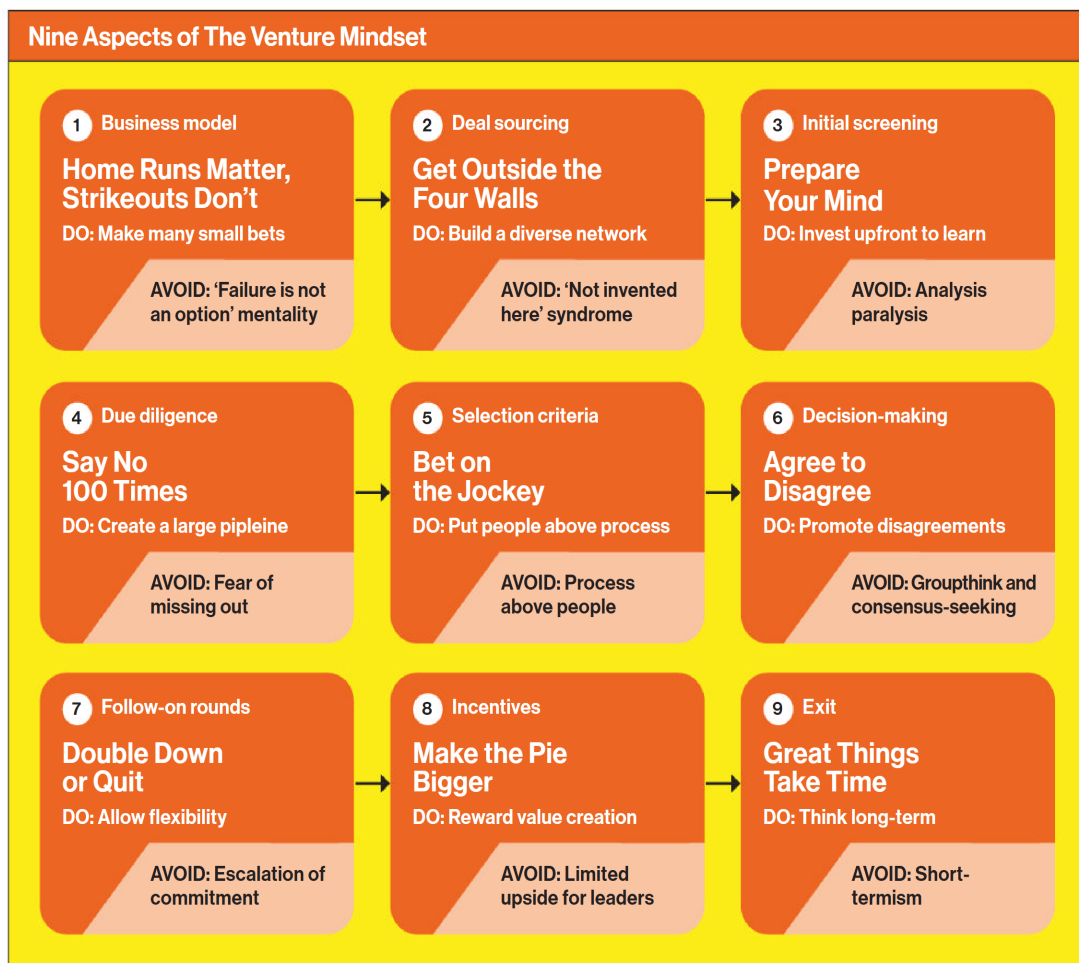


FIGURE ONE

against the investment, they were still allowed to write cheques. In traditional firms, this wouldn't have been possible because typically either one person makes the decisions or they are taken by consensus.

Tell us about incentives in the venture mindset.

VCs really care about incentives — for start-up founders, for themselves and for their partners. As a condition of investment, they insist that everyone who matters to the project's success becomes an owner, and they ensure that the share of the pie is meaningful. To paraphrase **Gordon Gekko** from the 1987 movie *Wall Street*, in the VC business, greed is not good. By designing smart contracts, they make founders' upside essentially unlimited while protecting them

against the downside risk. If they fail, the founders won't become rich, but they are not punished. VCs also make sure that the whole team benefits from success by setting aside a significant pool of equity for that purpose. As they say, 'a rising tide lifts all boats.'

Broadly speaking, VCs achieve their goals through two powerful mechanisms. They make people work hard by providing incentives, but the incentives also attract innovative, talented, productive, risk-seeking, failure-tolerant people. As research has demonstrated again and again, these two mechanisms reinforce each other. If you celebrate and pay bonuses only for successfully achieving targets, don't be surprised if employees set low-risk, easily achievable targets.

One of the nine principles of the Venture Mindset is 'Home Runs Matter, Strikeouts Don't.' Please unpack that for us.

Statistically, only about one out of 20 VC investments becomes really successful — a home run. In many corporate settings, one failure can ruin a career. In contrast, many VCs tell us they are worried if they don't fail often enough. For them, failure isn't just an option — it's a must.

So how do they hit the home runs? By making relatively small bets and acknowledging up front that most of them will fail. Smart VCs know they can't reliably pick winners, so instead, they spread their bets by diversifying. Diversification, of course, is nothing new; it's a mantra for many investment advisors. But the diversification VCs pursue is of a different variety. VCs are betting on individual companies — not on the market as a whole.

If you are seeking incremental gains in a typical market — whether in the world of finance or a large corporation — this mindset is generally not useful. But if a company is seeking to achieve extraordinary growth and to leave its competition behind, the VC mindset is the only one that works. I advise modern leaders to take this principle and reverse it to make it even more applicable to them: unless you embrace strikeouts, you will not have home runs.

Speaking of home runs, you've done a lot of research on unicorns — start-ups that surpass \$1 billion in valuation, like Zoom, SpaceX, Instacart and DoorDash. What things do unicorns do that even successful start-ups don't?

There are many elements to it, but one of the most important things is that they recognize it takes time. Unicorns raise many, many rounds of funding — on average, seven. That takes a lot of patience all around — from the founders, the employees and the investors. If you are a highly impatient person, you shouldn't become a start-up founder. When considering where to invest, one of the most important things VCs look for is, how patient are you? What is your time horizon? Patience is one of the most common and important characteristics of unicorn founders.

Are there examples of colossal failure within unicorn companies?

Definitely. One dramatic example is **Amazon's** Fire Phone, released with great fanfare in 2014. After four years of hard work by hundreds of employees, **Jeff Bezos** personally

introduced the product at the company's studio in Seattle. But once the phone was released, at a price of \$650, customer feedback was brutal. The Fire Phone sold only 35,000 units in its first two weeks. In the same year, Apple's iPhone sold four million units — at the same price as the Fire Phone — in its first 24 hours on sale — a humiliation for Amazon. The device was too expensive for what it could do and critics complained about its unnecessary features and clunky user interface. A few months later, Amazon wrote off the project.

The story of the Fire Phone's failure is nothing unusual in itself. The unusual aspect is Amazon leadership's attitude toward that failure. In a traditional organization, the VP in charge would have been demoted or fired, and the CEO would have swept the story under the rug. At Amazon, however, the opposite happened. Jeff Bezos still refers to the Fire Phone more often than almost anything else Amazon does. He even brags to journalists, "We're working on much bigger failures right now. And I am not kidding. And some of them are going to make the Fire Phone look like a tiny little blip."

Of course, failures like the Fire Phone need to be balanced by successes like the Echo, Amazon's smart speaker. To say the least, it was a big hit. Well, guess what? Both product launches were led by the same person, **Ian Freed**. When the Fire Phone failed, Bezos assured him "You can't, for one minute, feel bad about this. Promise me you won't lose a minute of sleep."

Delegation is also important in this mindset. Apparently, Steve Jobs wasn't even aware of the experiments under-way to create the iPhone. Is that typical?

It is typical of this mindset to delegate, especially at the creativity and experimentation stage. The trick is that you allow — in fact, you incentivize your creative people to come up with new ideas, to experiment and become 'intrapreneurs.' That is one of the most important and underappreciated words in the lexicon of the modern business leaders. You need to encourage and incentivize your intrapreneurs.

It's not about pointing at Steve Jobs as being unaware of what was going on around him; at some point, things bubbled up to him and without his support, they would not have happened. I believe the same was true of the iPad and a lot of other stuff that happened at Apple. And the same is true of most other venture-minded leaders.

You note in the book that Microsoft, despite being a generation older than Google, is now threatening the search giant on its home turf. How did Microsoft achieve this?

Around 2011, many people had given up on **Microsoft**. But its board of directors made the best possible decision. In 2012, they hired **Satya Nadella** as CEO, and he showed himself to be one of the most venture-minded leaders in modern history. In less than a year, he transformed a very traditional, old-fashioned, bureaucratic, not very venture-minded company. He proves that the leader of any traditional organization can do this. As indicated, there are nine principles of the venture mindset, and I believe Satya and Microsoft adhere to all of them.

Google is another very venture-minded organization. I'm not the first to say this, but one of the biggest challenges it faces is that it has exactly one cash-flow-generating product [advertising]. As was the case with **Kodak** many years ago (and many other firms), it is very challenging to make decisions that could potentially disrupt your only cash-flow-generating product in the short-term, especially if you don't have anything else in the pipeline.

Even though Google and its parent **Alphabet** are extremely profitable and successful, they haven't managed, despite all of their experiments, to expand into a portfolio of products like Microsoft has over the last 10-plus years. This has allowed Microsoft to be even more aggressive in terms of experimentation.

As we speak, VCs are out there quietly discovering the next big thing long before it hits the mainstream. What might we expect on the horizon?

I work closely with the CEOs and chairs of large global companies on this exact issue, so I can tell you what I tell them. When I came to Stanford 20 years ago, there were only a few industries — or as we say in Silicon Valley, spaces and verticals where venture investors were active. And those spaces were software, IT, biotech, etc.

Twenty years later, looking at my data, I cannot name a single space or vertical industry where venture investors are not active. So, my main prediction is not about which industry is going to be the most disrupted; it is that in every single industry — however old-fashioned or traditional you think it is or however far away it is from Silicon Valley — *start-ups are going to come*. Outsiders are going to become either your

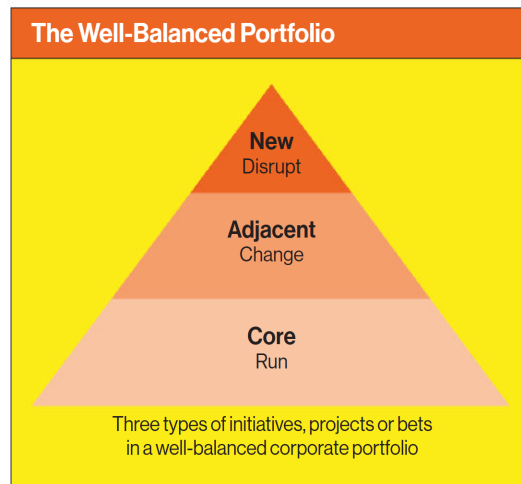


FIGURE TWO

main competitors or they are going to completely change your industry by introducing new business models. Traditionally, industry leaders have only paid attention to their existing competitors, but these days, that is a big mistake.

My second prediction is that we will see dramatically new business models in a wide variety of industries around the world driven by the application of the venture mindset. Most people, however smart they are, don't really understand Silicon Valley. Most people think venture investors invest in tech. I'm going to claim that is not the case. What smart VCs are doing is investing in either startups that, if successful, will change the business model and the competition in the industry, or will launch entirely new industries or new sub-industries. Historically, it's been in technology and in biotech, but that is changing. That is my main prediction.

I urge corporate leaders to pay attention to this and adopt the venture mindset, because sooner or later, there will be an Amazon or a Netflix in their industry. It might already be lurking in a Silicon Valley garage or in a small office in Berlin or Shanghai. **RM**

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