

Constraining Innovation

How developing and continually refining your organization's goals and bounds can help guide growth

BY JOE SINFIELD & SCOTT D. ANTHONY

During the dotcom era, many businesses focused their attention on creating a workplace environment that was thought to encourage creativity and innovation. Stories of offices full of bean-bag chairs, videogames, and ping-pong tables were commonplace. Managers were encouraged to “think outside of the box,” to dream up the best new idea that they could, and this often created an environment that let chaos reign. But does all that creative freedom really lead to meaningful innovation?

While there is some merit to the notion that talented people should be able to work when and how they feel most productive and creative, simply allowing employees to wear flip-flops is not a sustainable path to creating an innovative organization. In fact, our work with leading corporations in a wide range of industries has led to a perhaps surprising finding: Properly constraining innovation can actually lead to superior results.

There are three reasons why freeing an organization from constraints can hamper innovation efforts. First, managers that lack constraints can spend a significant amount of time pursuing ultimately fruitless paths. For example, a team at a company Innosight advised spent three months evaluating a potential acquisition. The target was following a classically disruptive strategy and, while small, was growing rapidly. Yet the company decided not to make the acquisition. Why? The target was a service busi-

Choosing the Path to Market Penetration

Your innovation dictates whether you should follow the 'superhighway' or the 'country road'

BY STEVE WUNKER

You've created the classic disruptive product. You see massive potential. Yet you are flummoxed by a simple question—what's the best path to market penetration?

Firms seeking to pioneer new markets or upend existing ones often face this dilemma. While there is extensive literature on stages of technology adoption and models on how early adopters influence uptake, all of this can be of little use in forecasting how quickly an innovation will catch on.

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eMusic.

No. 1 Site for Independent Music

Seven Principles of Disruptive Innovation

Often we refer to how the “disruptive principles” can be crucial to managing your new growth efforts. Which principles are most important to keep in mind? See page 14

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Voices of Disruption

BY PETER BLACKMAN

Each issue, we feature a person who is “in the trenches” of disruption. This issue, we hear from Peter Blackman, who leads the New Growth team at Infineum, a global petroleum additives joint-venture owned equally by ExxonMobil and Shell.

“Ignite Your Mind—Transform Your Business.” These words rang in my head as I sat on a train leaving London in January 2004. I had just spent two days at a “New Market Growth & Innovation” workshop featuring Clayton Christensen and Innosight. The topic? How disruptive innovation can be the basis for generating new market growth.

The workshop led me to realize that Infineum had a perpetually sustaining business model. In a mature, low-growth industry such as petroleum additives, it is difficult to drive earnings growth without innovation. *Disruptive* innovation offered opportunities for generating big rewards in new ways. To stand a chance of transforming

Infineum’s business, we had to incorporate disruptive thinking. My mind was “ignited,” but how could we achieve this transformation?

Sowing the disruptive seed

Infineum has business centers in the U.S., Singapore, and the U.K., as well as manufacturing, sales, and supply locations in 60 countries. The additives industry is technology orientated and Infineum is heavily populated with scientists and engineers. Gaining support for trying new business models is a challenge in these conditions—especially given our risk-averse culture. Things needed to change.

At the London workshop, I briefly discussed a new project that I was leading with several third-

party companies. Based on our initial discussion, it seemed our ideas had disruptive potential and I was eager to explore this further.

In April 2004—coincidentally on the same day I began working with Innosight—Infineum announced the formation of a “Growth Platforms” business structure. Apart from meaning a new boss for me, this provided an opportunity to sow the seeds of a disruptive mindset at Infineum.

Taking the first steps

Together, we built a program for an Infineum-Innosight New Market Growth Workshop. Attended by 30 colleagues, the workshop was a huge success and taught us a new language of innovation.

“Impatient for profit, patient for growth” is now a criteria for new growth activities. We are moving from thinking broadly about “customer needs” to identifying jobs that we can help customers get done—a powerful transition. Use of Innosight’s “Opportunity Assessment” and “Plan-to-Learn” tools helped us identify and address key assumptions.

Experimenting and adapting

By autumn 2005, 10 months of “soak” time had passed and we had experimented with these new concepts and tools. Exciting as this was, we needed a broader, company-wide awareness and recognition of when, where, and how to use a disruptive approach to innovation.



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Innosight is a boutique consulting and training firm that helps companies improve their ability to create innovation-driven growth. Its unique methodologies and proprietary tools facilitate the discovery of new, high-growth markets and the rapid creation of breakthrough products and services. Its approach builds on the research of its founder, Harvard Business School Professor Clayton Christensen, author of *The Innovator's Dilemma*, *The Innovator's Solution*, and *Seeing What's Next*. For more information, visit our website at www.innosight.com, call us toll free at 1-877-934-7787, or email us at inquiries@innosight.com

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We re-engaged Innosight to work with a number of our growth project teams and to carry out an “audit” of our disruptive performance. We wanted an honest appraisal. The results were not pretty!

Although we had made advances, we were still heavily entrenched in a sustaining mindset and approach. We needed to adapt to disruptive thinking and needed CEO-level support to make this happen.

The role of the CEO

Like many CEO's, Infineum's Dominique Fournier believes innovation is critical to long-term viability. Building off our earlier workshop, we scheduled a second for March 2006. Dominique attended the pre-workshop “refresher” and some of the workshop. This top-level engagement proved pivotal.

Dominique quickly saw the value of looking at innovation through a disruptive lens. Along with senior management, Dominique established a new corporate focus on innovation that aims to improve our innovation processes and free up resources to pursue disruptions.

Developing a common language

In October this year, more than 60 Infineum leaders from around the world gathered for a three-day Infineum Leadership Forum, chaired by our CEO and called “Innovation—Making the Difference.”

A set of pre-sessions ensured the attendees started with a common level of understanding. These meetings were not tethered to normal structures and agendas, allowing attendees to think differently.

The results were significant. We were able to state our own definition of innovation (“The activity of generating, selecting, and turning

good ideas into profitable reality”); introduce models, tools, and a common language of innovation; gain insight into our current capabilities and future challenges; and identify key topics and generate a wealth of ideas on how to make innovation work for Infineum.

Using a mix of presentations, hands-on activities, and carefully developed Infineum case studies, the forum created an experience of working in a “low knowledge” environment—which is particularly relevant to developing disruptions.

The Future

This has been a promising start to our innovation journey and now our focus is on implementation of an “innovation mindset” across the global organization. This will include making process changes and developing entirely new ways of working. Individual leadership behaviour will be a critical element of our success and we now understand that failure can be a step towards success—as long as you're learning!

Further innovation initiatives are underway. Regional forums are planned for 2007 to teach the concepts to more colleagues. We are well advanced towards the formation of a new, multi-functional Growth & Innovation team that will champion and drive innovation and new growth worldwide.

Today, looking back, the impact on Infineum of attending that January 2004 London workshop is apparent. We have a long way to go, and many challenges to face, before we can declare success. Nevertheless, the future for Infineum has never looked so bright. ♦

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A LETTER FROM CLAYTON M. CHRISTENSEN

Over the years, I have spent a great deal of time thinking about why smart, motivated, hard-working people find it so difficult to innovate well and sustain success into the future.

As readers of *Strategy & Innovation* are aware, we have identified a number of reasons in the past:

- Companies' biases toward taking care of the desires of their best, most demanding customers often makes it difficult to appreciate the full potential of new, seemingly inferior disruptive innovations.
- Traditional market segmentation tools, such as customer demographics and product categories, frequently fail to identify important jobs that customers are trying to get done.
- Entrenched processes that enabled a company to capitalize on a past innovation can paradoxically hinder it from taking advantage of a new innovation that requires a different approach.
- Managers with an ideal “school of experience” for optimizing a vibrant core business are often ill-suited to running a small, disruptive venture.
- And companies that outsource seemingly less important parts of the value-add of business can later learn that these suppliers have gained the skills and customer relationships that will fuel future growth.

In the next two issues of *Strategy & Innovation*, I will present some of my latest thinking on this topic, which identifies several fundamental problems with both the financial tools managers have been taught to use when evaluating new technologies and the very notion that the objective function of a firm is to maximize shareholder value.

While some well-accepted methods of analysis, such as discounted cash flow and internal rate of return formulas, have a variety of meaningful uses, I believe these methods more often than not lead companies seeking to create growth through innovation in the wrong direction.

I look forward to presenting this research to you next year. As always, we would love to hear your thoughts on these topics at editorial@strategyandinnovation.com.

Clayton Christensen

Innovators' Update: Air America Signs Off?

Impatience for growth sealed upstart radio network Air America's fate

Each issue, we take a look back at a past Innovators' Insight to see how our analysis has held up. In this issue, we look at Insight #14, "All Clear for Air America?" The Insight suggested that one reason for the liberal talk radio station Air America's early struggles was an impatience for growth. What has happened since?

It's a result that would leave hardened conservatives crowing: On October 13, the parent company of liberal talk radio station Air America declared bankruptcy.

"Nobody likes filing for bankruptcy," said Scott Elberg, the chief executive of Piquant LLC, Air America's parent. "However, this move will enable us to concentrate on informing and entertaining our audience during the coming months."

The news hasn't been all bad for Air America since its 2004 launch. At its peak, the network claimed carriage by more 100 affiliate networks that reached almost 2.5 million listeners a week.

But Air America just couldn't translate that success into a vibrant venture. The channel lost more than \$40 million trying to develop an offering that would appeal to its liberal listeners. After Air America declared bankruptcy, many local affiliates quickly announced plans to switch to new programming.

So what caused Air America's struggles? A possible explanation is that there just isn't an audience for liberal talk radio. Maybe people just don't want to listen to Al Franken, Randi Rhodes, Steve Earle, or the other Air America hosts.

But this explanation doesn't seem plausible. There certainly are hundreds, if not thousands, of vi-

able radio stations that reach fewer than 2.5 million listeners a week.

The real problem seems to be that the approach Air America followed wasn't the right one to capitalize on the underlying business opportunity. It's strategy was rotten.

It's too easy to blame its struggles on a bad startup strategy, however. Just about every new business begins with a flawed strategy. In fact, if you want to play the odds, a pretty safe bet is that the first strategy a company follows in a new market is wrong in some meaningful way. So there has to be another, deeper reason for Air America's struggles.

Our belief is that Air America was set up to fail. The combination of hype and heavy investment made it difficult for the venture to adapt its strategy once signals started coming in that its business model wasn't quite working.

The conclusion of *The Innovator's Solution* provides the following words of advice for managers: "If you start from a good place, then the choices that lead to success will look like the right choices." What that sentence means is that a venture's "initial conditions" play a huge role in determining its ultimate success.

If you believe that any new venture's initial strategy will contain some fatal flaws, the appropriate

initial conditions place a premium on being able to maintain freedom and flexibility. Air America launched loudly in major U.S. cities, attempting to quickly canvass the nation. Its investors claimed to be willing to sustain years of losses to establish the network. Rather than emphasizing flexibility, this approach emphasized impatiently scaling the business.

An article in *Rolling Stone* right after Air America's launch hit the nail on the head: "Critics argued that Air America should have started smaller, following the path of Rush Limbaugh and Howard Stern, who launched in a single market."

If Air America had started in a single market, it could have sharply limited its investment and then finely tuned its offering until its expansion path was clear. By going for a big bang, Air America created conditions that almost guaranteed early struggles.

The problem wasn't that Air America started with the wrong strategy—almost everybody does. The problem was that Air America's initial conditions made changing course difficult. The network continued to plow money into a doomed strategy until its parent had no choice but to say, "Enough."

Could bankruptcy protection offer a ray of hope for Air America? Perhaps. If the venture comes out of bankruptcy trying to take another run at a strategy that clearly didn't quite work, expect history to repeat itself. But if bankruptcy precipitates an appropriate shift in strategic direction, Air America might yet find success. Without these components, expect the hype to dissipate. ♦

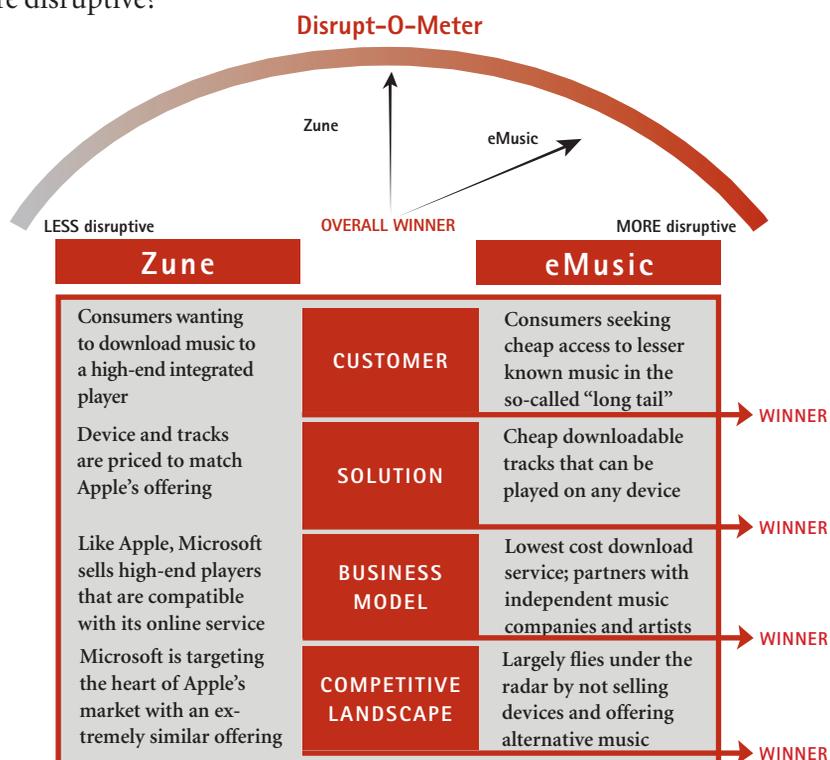
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Disrupt-O-Meter

Tale of the Disruptive Tape: eMusic vs. Microsoft Zune

“Is company X disruptive?” Whenever we’re asked this question—and we’re asked it often—we run through a simple mental checklist that looks at the target customer, the solution, the business model, and the competitive landscape. In this issue, we use our “Disrupt-O-Meter” to analyze new solutions hoping to challenge Apple’s iPod and iTunes in the digital music market.

Apple’s iPod and iTunes have dominated digital music with about a 70 percent share. In September, Microsoft launched its own device and online service, dubbed Zune and Zune Marketplace. The offering largely mimics Apple’s strategy, emphasizing expensive hardware and downloads of individual tracks for \$0.99. eMusic, currently the second largest download service after iTunes, has taken a radically different approach, offering music from independent labels that can be downloaded for as little \$0.27. eMusic does not sell devices, but offers music in the MP3 format, which is compatible with all existing digital players, including the iPod. Which is more disruptive?



More Disruptive: eMusic. By pursuing a “long-tail” strategy of partnering with independent record companies that are largely overlooked by other retailers, eMusic can offer the cheapest music online. The company does not sell hardware, but its music can be played on any device, meaning it does not have to battle Apple and Microsoft head on in the competitive device market. Microsoft has opted for a direct assault on Apple’s business. It’s player and service are remarkably similar, save a few new features—ones that Apple can easily copy. Microsoft clearly has the money to fight, but its “me-too” strategy will require lots of marketing dollars to attract new users and even more to dislodge devout iPod owners. ♦

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EMERGING TECHNOLOGY WATCH

What can’t you buy on Amazon.com?

Amazon.com has a remarkable history of unbundling its intrinsic resources to create value. It has profitably leased out space on its retail web pages to other merchants and has used its world class e-commerce engine to power websites and fulfillment programs for enterprises large and small. Now, it is leveraging its massive network of servers in a new program called Elastic Compute Cloud (EC3), which leases computing horsepower over the web. Use of the equivalent of one server costs about 10 cents an hour. Instead of making expensive capital equipment investments, computing-hungry but cash constrained startups can now lease the processing power they need when they need it at a very reasonable price from Amazon.

High-tech low-end phones

Often in electronics, we associate advanced technologies with expensive, high-end products. It is surprising then, that one of the largest initial applications of “e-paper,” powered by Cambridge, MA-based startup E Ink, may be in a low-end phone placed in India. The technology plays a critical role in extending battery life while reducing the cost of the battery itself. In addition, the handset maker, Motorola, has made some conscious tradeoffs in tailoring the phone to the Indian market, introducing some features, like voice prompts in seven languages, while stripping out many of the applications (calendar, games, and such) that we would associate with a normal phone. This low-end phone in conjunction with the drive for laptops under \$100 may open up business opportunities in new contexts.

The game wars play on

A year ago, we pointed to the likelihood of overshoot in video game consoles—Microsoft and Sony have invested massively in development—and saw disruptive potential in Nintendo’s approach of reengineering the game playing experience rather than mega-charging the processor. Now, the early returns are in. Both the PS3 and the Wii were launched in mid-November; the PS3 has stumbled out of the gate, while Wii has taken off. Sony has been beset by countless problems and manufacturing and supply chain issues are restricting sales. Trade reports indicate that they’ll only ship between 500,000-800,000 units by the end of the year, compared to some 4 million Wii’s. This is a pretty big deal: The \$600 PS3 is actually a loss leader for Sony, which spent billions developing the system. The Wii, which retails for about \$250, has been immediately profitable for Nintendo and looks like it could be a disruptive game changer that expands the gaming market. Reprint # 040605B

ness, a business which our client—a mass-market manufacturer of low-priced consumer goods—decided just wasn't close enough to the core for comfort. Deciding beforehand that service-based businesses were out of bounds could have saved the team from going down what proved to be a blind alley.

On the flip side, managers can sometimes pass on good ideas because they assume that a company won't do something that it *will* do. In any company, middle management plays a vital role of screening and filtering innovation ideas. When senior management asks, "Why do we never see any good ideas?" a likely answer is that middle management is screening out or discarding ideas that it assumes are out of bounds.

In the absence of explicit information, middle managers' natural inclination is to reject things that don't fit what the company does today and to impose

sharply stricter mental constraints than senior managers intend.

Finally, when managers lack a good definition of what the organization wants to do and what it absolutely won't do, there can be strong tendencies to try to "bet the farm" on any idea that seems to offer an opportunity outside the core business. They layer risk after risk on an idea until it has little chance of success. While companies should avoid being constrained by their current definition of the core business, breaking too far from the core business can be dangerous too.

To avoid wasting scarce resources on ideas that will never be com-

mercialized, companies need to provide clear guide posts that let employees, customers, and even the broader market know what is within the scope and what is outside of the scope for the organization. We suggest that companies define these guide posts by developing explicit "goals and bounds."

The goals and bounds concept

At the most basic level, goals and bounds clearly differentiate the types of opportunities a company prioritizes from those it eschews. As these goals and bounds become more nuanced and widely

are *desirable* to an organization, those that are *discussable* within an organization, and those that are *unthinkable* to an organization.

Having a clear view of what is *desirable* can help a company focus its innovation efforts. Typically, desirable qualities are those that are well-aligned with the core value-creating capabilities of the company. While not all core businesses are candidates for innovation, such as those that are already overshooting customers' needs, these traits tend not to require a company to develop new competencies, to enter unfamiliar markets, or to create

new business models.

Understanding what is *discussable* helps explain to managers their degree of freedom when innovating. This region of the target defines the frontier for innovation and new growth: Discussable areas represent places the company could branch off to cre-

ate skills or capabilities. Making what is discussable within an organization explicit allows companies to explore spaces that can be envisioned as future business opportunities and to avoid the classic disruptive trap of remaining too close to an existing core.

Finally, knowing what is explicitly *unthinkable* ensures that resources aren't wasted on ideas that would never be pursued by senior executives.

Companies in different industries will have different factors that are crucial to defining innovation goals and bounds. (For an example of some of the most common di-

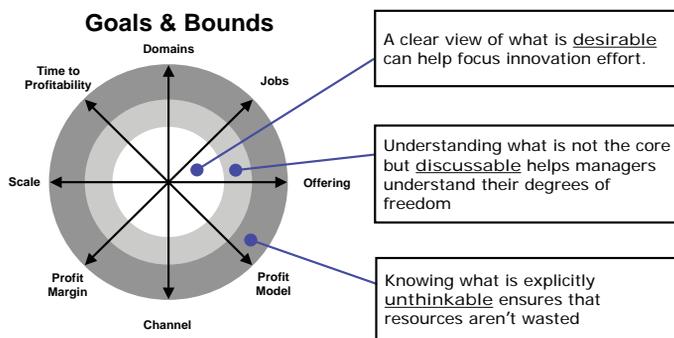


Figure 1: A sample goals and bounds target

understood, they help delineate key dimensions around which a company is willing to innovate. The "goals and bounds target" (see **Figure 1**) is a tool that shapes and communicates the acceptable attributes of new innovations.

The target, which can be customized to fit different circumstances, allows companies to quickly evaluate opportunities along an array of innovation characteristics, which are depicted by the arrows coming out of the center of the diagram.

For each dimension, goals and bounds are organized into three regions (depicted by the concentric circles in the diagram): those that

mensions, see **Figure 2**.)

In pharmaceutical settings, for example, companies might want to incorporate perspectives on medical efficacy claims: Do new products require clinical proof or can a perceived benefit be sufficient? In chemical industries, allowable environmental impact—none, manageable, or severe—may be a defining characteristic of any conceivable new product. In the media world, organizations may wish to consider advertising reach: Can a product entice only local advertisers or must it reach national, or even international, advertisers?

Importantly, there is no right or wrong answer regarding which dimensions should be captured on the chart. Each organization needs to decide the criteria that separate ideas that it wants to pursue from those that it won't pursue. The value in the exercise stems from highlighting dimensions that can quickly characterize an opportunity and drive its acceptance or rejection.

Defining your goals and bounds

In our experience, this simple framework yields a significant level of actionable insight for an organization, often changing the way senior executives view their objectives. Companies tend to invest a great deal of effort in the development of statements of strategy, vision, and mission. While these pronouncements are meant to unify a diversity of perspectives on the appropriate direction for an organization, they are actually subject to broad interpretation.

In fact, when queried individually, organizational leaders often

recount very different perspectives on overall business objectives. In other words, they're unsure of the accepted goals and bounds for their business unit and of the organization as a whole. Thus, while conceptually straightforward, the exercise of defining and communicating goals and bounds can be quite challenging. To facilitate the development of goals and bounds, we suggest a five step process: Introduce concepts, survey leaders, build consensus, communicate, and assess and adjust. The following describes each step in detail.

Step 1: Introducing goals & bounds

It is crucial to engage the upper-most management team at the corporate level in a general discussion of the goals and bounds concept. Here, the intent is not to develop the specific goals and bounds themselves, but rather to communicate what goals and bounds are, why it is valuable to develop them, and how they can help shape and improve the organization's overall approach to innovation.

Step 2: Surveying company leaders

After transferring a clear understanding of the definition and purpose of goals and bounds to the corporate leadership group, it is important to collect their views on the desirable, discussable, and unthinkable aspects of each dimension on the target chart.

From our experience, this process is best conducted at an individual level and in an anonymous manner, ensuring that truly unbiased views are obtained. We have found that administering an online survey is often the most effective way to garner leadership opinions.

The survey itself should be tailored as much as possible to the nature of your business, but should also prompt thinking beyond traditional parameters. For example, if you have historically developed and sold technology-heavy products, ask if people would consider licensing or selling intellectual property. If your organization has been historically confined to third-party distribution channels, assess

Figure 2: Common goals and bounds dimensions

Dimensions	Explanation
Domains	The sectors or markets in which a company may operate (for example, biologically derived drugs, small business financial solutions)
Jobs	The jobs a company could satisfy for its customers (providing commodity raw materials, assembling value-added modules)
Nature of Offering	The good or service delivered to the customer (such as physical products, intellectual property, consulting services)
Profit Model	The way in which money is made through the supplied offering (for example, fabricating, distributing, brokering)
Channel	The path used to access the target customer in the domains of interest (distributors, internet, physical store fronts)
Profit Margin	The gross margin expected from the steady-state business (are 15 percent margins acceptable or must they be 40 percent?)
Scale	The annual revenues of the business at steady state (for example, \$80 million)
Time to Profitability	The time it can take before an opportunity becomes profitable (for example, one year or five years)

whether senior managers would entertain pursuit of e-channels. If existing business units are all in the range of \$250 million in revenue, see if leaders would embrace a \$50 million line of business.

The key is to ensure that the survey includes a range of possible choices for every dimension on the goals and bounds target that span from the desirable to the unthinkable. In addition, it is also helpful to give respondents the opportunity to record additional thoughts in open-ended responses.

The results of this survey activity should be synthesized to capture the breadth of opinions of the collective leadership team, highlighting areas of agreement and areas of disagreement.

Step 3: Building Consensus

Once the data have been collected, convene an in-person meeting (typically at least three-hours long) to explain where the leadership's viewpoints overlap and to attempt to build consensus in the areas of disagreement. The "desirable" areas will likely be readily agreed upon, but this still represents an opportunity to ensure that the entire senior leadership sees attractive, close-to-the-core opportunities in the same way.

Areas of disagreement, however, are likely to arise in what is discussable or unthinkable. These conversations are often the most fruitful: They truly challenge the leadership to be explicit about what it may do and what it absolutely will not do.

Step 4: Communicating the goals & bounds of your organization

Defining goals and bounds is by

necessity a top-down process at the outset. However, once a company defines its goals and bounds, it should communicate those guidelines both within and outside the organization, albeit at different levels of detail.

Within the organization, it is important to communicate corporate goals and bounds to business unit leaders, middle management, and "shop-floor" employees. At the business unit level, the corporate goals and bounds target must be transferred in detail. Further, unit leaders should have the opportunity to tailor the goals and bounds to their specific business.

While the goals and bounds of the units should fall within the broader umbrella created by the corporate "target," there may be differing interpretations of the corporate message that warrant dialogue. Capturing the way in which these mid-level leaders internalize corporate strategy can be enlightening and can influence the views of the upper management tiers, ultimately leading to adjustment of the corporate goals and bounds. Such a feedback mechanism should be encouraged, as it can be both directive and empowering for the organization.

The goals and bounds can be communicated at a higher, more synthesized level to middle managers and shop floor workers. This provides employees with a perspective on the organization's overarching strategy, mission, and vision, going well beyond typical "plaque on the wall" communications.

This perspective will inevitably shape how employees apply their innovative energy, focusing it on

ideas that are likely to align with the company's desired or discussable areas of interest. This further avoids the disappointment that can result when employees put forward good ideas only to learn after the fact that it is not something the company would pursue.

Outside the organization, it may also be desirable to communicate goals and bounds, at least directionally. Clear external communication of what an organization will and won't do, without revealing issues of competitive significance, will build market confidence that management has developed a well-honed plan to innovate and will also serve, almost autonomously, as both a filter and a beacon for acquisition and partnership opportunities.

Step 5: Continually reassessing the agreed upon goals & bounds

It of course will be impossible to create goals and bounds that frame every aspect of all future businesses that may be encountered. As a company's competitive landscape changes, its capabilities evolve, and new information about markets becomes available, what was once unthinkable may become discussable or even desirable.

For this reason, the goals and bounds should be thought of as a living representation of a company's corporate strategy and should be refined over time. Senior managers should continually reassess the goals and bounds target, analyzing both the appropriateness of dimensions captured on the target and the specific classifications of what is desirable, discussable, and unthinkable.

When a new idea is not explicitly contemplated in the existing goals and bounds target, management could ask if the idea is most similar to something that is “desirable” or something that is “unthinkable.” If such a comparison yields little insight, then the target itself likely needs to be refined.

Growth with goals & bounds

Defining goals and bounds forces leaders to think through and specifically state their corporate strategy. This process leads to a level of specificity about leadership’s focus, business model interests, financial considerations, and risk tolerance that is not achieved in most organizations. Armed with this clarity of purpose, the organization becomes more agile and better able to make sound growth decisions.

Overall we have found that the existence of organizational goals and bounds yields benefits on at least four dimensions.

- *Filtering ideas:* As ideas for growth or innovation emerge, each idea can be “plotted” on the goals and bounds target based on its alignment, or lack thereof, with the key dimensions captured on the chart. If many of the attributes of a new idea fall in the desirable range, there is clear justification to examine the idea more closely. However, if the idea tends to plot at the outer edge of the discussable boundary or in the unthinkable region, the idea warrants no further action.

- *Identifying external ideas:* Just as the goals and bounds target can act as filter for internal ideas, it also can work as a searchlight for external ideas. When senior leaders are contemplating acquisitions or business unit managers are confronted with potentially competing or complimentary products, the attributes of these outside businesses can be judged against consistent, agreed upon criteria. Mapping against the goals and bounds can identify both where synergies may exist and where pitfalls loom.

- *Focusing idea development:* If the goals and bounds of the organization are clearly communicated both internally and externally, they help shape the nature of ideas submitted for consideration. While no organization would share its

bounds as guide posts reinforces the efficiency and quality of the whole idea generation and collection process.

- *Recognizing and managing risk:* Breaking down the characteristics of an opportunity by plotting it on the goals and bounds chart provides visibility into the risks actually involved in capturing the opportunity. Given that the desirable range on the chart generally represents characteristics of your core business, the more aspects of an idea that lie outside the desirable range, the more likely it is that the idea involves entering unknown territory.

Research by Bain & Company partner Chris Zook has found that companies that take too many steps from their core tend to struggle because of the compounding nature of risk. As a result, companies should try to limit the stretch points—the areas of unfamiliarity—to only one or two of the key target dimensions, otherwise a project will be set up for failure

(see **Figure 3**).

Rather than letting chaos reign, taking a thoughtful approach can allow organizations to develop a robust set of goals and bounds that provides a much needed sextant to rapidly and safely navigate the creative waves of innovation. ♦

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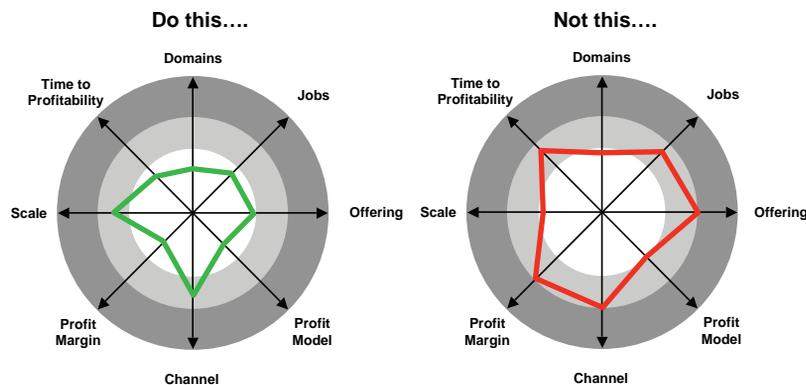


Figure 3: Prioritize opportunities with the most “desirable” and “discussable” traits

strategic perspectives externally, even high-level communication of a company’s domains of interest will sharpen the unsolicited ideas arriving at your business development doorstep.

Internally, communicating goals and bounds in great detail can stave off superfluous idea submissions and give confidence to those who may have been holding back concepts that seemed out of scope. Over time, the role of goals and

Why does it matter? Companies that have plotted a route of adoption can better choose which projects to invest in because they will have some insight into how soon revenues will increase and where those revenues will come from.

Unfortunately, many firms approach these decisions blindly. They lack a clear idea of how to choose foothold markets, how rapidly adoption will progress, and how market penetration will blaze the trail for future innovations. They err either by taking a shot in the dark ("We'll get two percent of a huge market!") or by believing in false precision ("Our sales in year three will be \$237.52 million.")

Choosing the appropriate pathway to market penetration is not always intuitive. For example, the U.S. Department of Energy reports that air conditioning consumes 16 percent of the electricity used in American homes. One therefore might think that an innovation in air conditioning efficiency would rapidly penetrate the market.

But such seemingly logical connections do not always play out. For example, one company developed an innovative, inexpensive variable frequency drive that enabled an AC unit to change speed based on use, saving considerable energy. Determined that adoption would be quick and widespread, the company ramped up quickly. But this simple, cost-saving technology was largely shunned and has taken 30 years to gain widespread adoption.

Conversely, consider U.S. mail-order DVD rental company Netflix, which began operations in 1999.

Unlike the AC company, Netflix had to create a totally new distribution system and consumer awareness about an unfamiliar business model. Yet in just a few years, it has nearly 6 million customers and ships 1.4 million DVDs each day.

How can you understand these different paths and surprising rates of adoption? We recommend thinking about innovation adop-

Innovation adoption is like a journey: You need a sense of your destination and the path you plan to take to get there

tion as a journey. Like any journey, you need to have a sense of your ultimate destination and the path you plan to take to get there. Start by thinking about the viability of potential "foothold" markets, then consider the pace with which you can penetrate those markets. Finally, pick the route you will follow to penetrate the chosen market and to move into other markets.

Identify a viable foothold market

Before starting down a specific path, a company needs to assess its potential foothold markets. It may target a single niche segment or it may have the resources to tackle multiple segments, but the company must have a relentless focus on its customer to ensure that the innovation does not turn into a "one-size-fits-none" offering.

Begin with a blank-slate view of the innovation. What jobs does it help people do? Many of these jobs are obvious, but some are less so. Look for markets that are hungry for the solution, particularly ones

where it competes against non-consumption rather than existing offerings. Even if the markets are small, they will be prime candidates to prove the innovation's viability and will provide real feedback.

Returning to the air conditioning example above, the innovation was much more reliable than other solutions. Instead of initially marketing such a product to all customers, the company should have focused on those who would greatly value this attribute, such as those in very hot climates or in buildings with hard to

access roof-mounted units.

Netflix took such an approach by identifying two segments that would highly value its unique service: parents of young children who lack the flexibility to make a quick run to the video store and to those seeking movies that aren't available at a typical store.

Having identified potential customer segments, a firm needs to understand the context in which users will view the innovation. Is there a broad system into which the innovation must be inserted or is it plug-and-play compatible? Some compelling innovations have been stymied through interdependencies with other systems that are unlikely to change fast.

For example, customers won't adopt even the most innovative air conditioning system if it does not easily integrate with the footprint of the overall unit, requiring expensive changes to how water piping systems are routed.

Conversely, by building distribution centers near postal sorting

facilities, Netflix has plug-and-play compatibility with the U.S. Postal System. Netflix's online ordering system also leverages the Internet in a plug-compatible fashion.

After you've discerned markets that hunger for the solution and that have few interdependencies or complex standards to stymie adoption, ask a series of questions:

Are we competing against non-consumption or incumbent competitors? Will anyone try to block us out; will they ignore us; or will they flee? The basic architecture of most AC systems has not changed for decades. A firm seeking to displace an existing technology has to tackle long-entrenched competitors with strong customer relationships.

Dissimilarly, Blockbuster originally found Netflix's business model irrelevant to its highly local, immediate-gratification rental experience. Blockbuster's business model further impeded response: It made most of its money on late fees, which Netflix does not charge.

What are the switching costs from current solutions? Even if retrofitting an energy-efficient AC saves a customer a few hundred dollars a year, she still has the hassle of a service appointment. The switching cost of Netflix is \$5.99 per month.

What is the risk to customers of adopting the innovation? How critical would failure be? A faulty air conditioner is indeed an unpleasant thing on the hottest day of the year. A movie being delivered a day late is no great loss.

Does the channel have the incentives to support us or do we need to create new routes to market? Many buyers of air conditioning units are not the users, but are builders

and landlords. These gatekeepers usually do not pay for the ongoing energy costs and the companies that install units often make more money from service than from installation. To them, reliability is not a selling point. For the U.S. Postal Service, Netflix is an outstanding new customer that pays for shipping over a million DVDs each day.

What kind of decision is required? How many parties, in how many organizations, need to be involved? With air conditioning, one problem has been that adoption can require cooperation of a building owner, an architect, a general contractor, and a supplier. Netflix sign-up takes someone five minutes.

Structural differences such as those highlighted in the comparison of the air conditioning market and the video rental market have enormous implications for how quickly firms can penetrate markets and what routes they should take.

Evaluate the speed of adoption

Asking the questions above should winnow your potential markets to a manageable number. You can then evaluate the potential speed of adoption in each market. Too frequently, firms grasp the great prospects of an innovation, but under-estimate how long it will take to penetrate the chosen market. They then lose patience and pull the project's plug too early.

For example, in 1995, four of the largest American newspaper companies formed the New Century Network, a partnership to sell Internet advertising to offline firms. Unfortunately, they scrapped the initiative in 1998, as the market

materialized more slowly than they expected. Today, newspapers are forced to retrace these steps, but now they must partner with behemoths such as Yahoo! and Google.

In quantifying the potential speed of adoption, ask:

How many channel partners are needed? A software company may require a broad ecosystem of allies, an industrial firm might require sales and service partners, and a consumer electronics firm might be able to get its first foothold by selling direct and online.

What is the lifecycle of the preceding product? Air conditioners can last 30 years, making penetration an inherently slow process.

What is your ability to pre-sell prior to launch? If customers need to see the innovation working prior to buying it, you will experience a painful period after development before revenues materialize.

What is the sales cycle? Many firms with energy efficiency technologies initially target the automotive industry, given its huge size. Yet the industry's long development cycles typically lead to at least a year-long cultivation of purchasing decision makers and then two years between being designed into a vehicle and ultimate production. Look for markets that can absorb the innovation more quickly.

How long does someone need to use the product to count as a reference customer? If reliability is a key consideration, buyers may want to see a relatively lengthy customer experience before signing on.

Be careful about quantifying penetration rates too precisely when many variables are unknown. Instead, focus on the underlying

logic and key assumptions. You may ultimately need to make specific estimates, but understand where the uncertainties lie. Many firms model base, high, and low cases, but lack detailed understanding of the role of individual variables.

Of course, you may choose to avoid the markets with the fastest expected adoption rates. A good reason would be if those markets have little influence on other, larger markets you ultimately wish to enter. A bad reason to avoid such a market is that it simply seems too small—often relatively tiny markets are less demanding, have a real need for the product, and can influence much larger markets.

Alongside figuring out the speed of penetration, take a fresh look at your business assumptions. Can you redesign the offering to address bottlenecks or reduce interdependencies? Change the product's attributes to compete better against nonconsumption? Change aspects of the business model to overcome hurdles by, for example, charging less for sales and more for service? Bundle the product with other systems? Lock up channel partners by offering a limited-term exclusive?

Assess whether your decisions will lock you into a business model or whether they will give you flexibility to iterate. Remember the entrepreneur's lore: The average *successful* new enterprise changes its business model several times before finding a winning formula. Many corporate ventures take the opposite tack: They lock into an approach early on and spend heavily in an attempt to raise competitive barriers only to discover they are defending the wrong business.

Pick a route: The superhighway versus the country road

Once you have ascertained where you'd like to focus first, think about the longer-term ramifications of your path to market. Innosight's work has shown two general routes to commercialization—the superhighway and the country road. By understanding which archetype is appropriate for your innovation, you can properly align a host of variables in the business and increase your chances of success.

The Superhighway

Innovations that are commercialized through well-traveled routes are on the superhighway. On this road, the market easily slots the innovation into existing categories and a supporting ecosystem—suppliers, channels, and developers of complementary products or services—gladly provides assistance.

Because many others are driving down this road, it is essential to be traveling in the same direction as the prevailing traffic. Partners' incentives must be aligned along traditional metrics. Competition can be fierce, but the business model is familiar and compatible with important influencers in the marketplace. The destination is clear, but making detours is difficult.

The Country Road

The country road can be lonely. With fewer partners to support the innovation, a firm develops new business models to access potentially untapped markets and provide customers with the support they need. The company may define performance in ways that are unfamiliar to the channel, but will

resonate with the customer.

The customers may even be nonconsumers; they may not have been able to participate in this market before and so may not have been important to others in the industry. Ultimately, the country road may bring you to a different place than you originally planned, but that destination might end up being even more interesting.

Energy efficient air conditioning wrongly traveled down the superhighway. AC manufacturers are concentrated, so it seemingly made sense to go to them first. The channel is diffuse, so the firm thought it needed critical mass to get the channel's attention. Unfortunately, the channel had little interest in selling this unfamiliar equipment, and the buyer—who seldom pays the electric bill—had even less. So the market was limited mainly to retrofitting and aftermarket sales.

By contrast, Netflix traveled the country road. While it leveraged a massive distribution network—the U.S. Postal Service—it built 41 local warehouses to speed DVD delivery. It makes use of a huge marketing infrastructure—the Internet—but markets largely on its own direct to the end consumer.

Choose the right approach for you

Neither approach is inherently better. It depends on the circumstances. (For a comparison of the paths, see the chart on page 13.)

Many firms with a disruptive innovation choose the superhighway. This route makes a great deal of sense for disruptions of existing markets, such as mini-mills' penetration of the steel industry with a cheaper, but lower quality, product.

Why? The existing channel was motivated to sell such lower-margin goods. You can't move against traffic on the superhighway.

Companies trying to pioneer new markets often mistakenly travel the superhighway. Pressure for fast growth, recognizable business models, and orthodox routes of adoption forces firms to pour resources into developing marquee accounts. As a result, the companies adapt the product to meet the needs of these demanding customers. The result is often long sales cycles, escalating costs, frozen business models, and huge distractions.

Instead, companies pioneering new markets should entice the right customers by taking the country road. This means selling to customers who will tolerate a less-than-perfect solution and then learning by doing. Real market feedback is infinitely more instructive than countless hours at a whiteboard mapping the hypothetical solution.

By taking the country road, a company also enjoys far greater flexibility to adjust the offering. Because it takes discipline to forsake large channels, it can help to have generalized rules encouraging this choice. For instance, a large consumer products company is fond of telling marketing managers, "If Wal-Mart is in your initial launch plan, it's not disruptive."

Sometimes it is simply not possible for a disruptive innovation to follow the country road. Industrial products, for instance, must often move through established channels that "own" the customer due to service capabilities.

In these cases, the company should at least be aware that it is traveling down a dangerous and inflexible path. It should place bets narrowly so that the consequences of frustration are relatively minor. It is not inconceivable that success will occur; it's just less likely.

The firm should also think

broadly about how much flexibility it actually has. Airlines seem like companies that are locked into a value network of aircraft manufacturers and airports, but air taxi services such as Linear Air have shown you can create viable businesses standing on different foundations.

Keep moving forward

As you begin to gain market traction, you may harbor ambitions for exponential growth. Think again about the leverage points. What will it take to gain new customers? Is this a case of depending on reference customers, one of waiting for customer needs to evolve to match your offering, or one of gradually switching out an installed base?

How concentrated are new customers? How inter-connected are they? How similar are they to lead users? Do customers have an incentive to wait, perhaps because the product is getting cheaper quickly?

Finally, like any seasoned traveler, listen to the traffic reports. How are customer needs changing over time? In the next customer segment that you've targeted, will you be overshooting or undershooting needs? Can you own the piece of the offering that is likely to not be good enough for that customer? That is where the greatest value creation opportunities likely reside.

The road to market penetration is fraught with uncertainty. Companies should be humble about how much they can predict. Yet they do have the power to choose their foothold market, their basic route, and subsequent destinations. ♦

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Which path is right for you?		
	Superhighway	Country Road
Customer	Recognizes the innovation and has immediate need for it	Unfamiliar to existing customers. Caters to nonconsumers who need time to view reference customers and recognize need
Channel	Incentives are aligned – innovation helps to sell higher margin products or services to important customers	Established channel lacks motivation to support the innovation. New channels need to be created or supported
System of Use	Plug-compatible with an existing system of use. Others on the superhighway need give little thought to how the innovation will impact them	Interdependencies with other systems prevent rapid take-up, and limit the first customers to the most desperate
Competition	Motivated to respond, and have few barriers against their doing so	Ignores or flees the market
Flexibility	Firm is confident that it has the answer. Little need to iterate	Firm is discovering the market and its risks, needs to iterate the business model or understand customers better before launching the innovation broadly

Seven Principles of Disruptive Innovation

Use these guideposts to help direct your company's new growth innovation initiatives

BY SCOTT D. ANTHONY, DAVID J. K. GOULAIT & CHARLES MCLAUGHLIN

A core underpinning of the research we present in *Strategy & Innovation* is the belief that strategies based on disruptive innovation have a disproportionate chance of creating blockbuster growth. Indeed, Innosight co-founder and Harvard Business School Professor Clayton M. Christensen's original research identified that companies that tried to enter markets with a disruptive strategy increased their chances of success six-fold.

Recent research by Innosight found that half of the U.S. companies that had the highest market value when they broke through \$1 billion in revenues since 1980 started with a disruptive strategy. (For more information, see "Blueprint to a Billion," *Strategy & Innovation*, September-October 2006.)

Often, we refer to how the "disruptive principles" can be crucial to guiding your new growth efforts. Which principles are most important to keep in mind? Fifteen years of academic research by Christensen and six years of applied work by Innosight at more than 50 operating companies has led us to highlight these seven.

Principle 1: Seeing disruptive opportunities requires looking at markets in new ways

Why exactly did Christensen decide to title his first book *The*

Innovator's Dilemma? His research indicated that even the best run companies tend to under allocate resources towards disruptive opportunities that appear to threaten their core business.

Companies do this for sensible reasons. Why would Digital Equipment Corporation invest to commercialize a \$2,000 personal computer when its current customers were purchasing \$250,000 mini-computers? Why would video-rental retailer Blockbuster mimic Netflix's no-late-fee business model when late fees drove its profits?

Use this principle to your advantage by considering how you can get a start in a space that competitors would initially ignore. Procter & Gamble's Febreze brand started in the then nonexistent "fabric refresher" market before extending its brand into the core of the plug-in air freshener market. Remember, disruption naturally feels uncomfortable and requires looking at the world through different lenses so that you can spot the great growth opportunity that is lurking in every disruptive threat.

Principle 2: Look for the "job" that cannot be adequately or affordably done

Christensen's second book, *The Innovator's Solution*, presents a game plan for companies trying to

create successful growth strategies. One core element of the game plan involves a way to look at consumers beyond traditional market segmentation schemes and product categories.

The concept is simple: Consumers don't really buy products, they hire them to get "jobs" done in their life. The ticket to growth, then, is making it easier for frustrated consumers to get important, unsatisfied innovation jobs done.

For example, Intuit's QuickBooks software made it easy for small business owners to achieve an important job: make sure my business doesn't run out of cash. Some alternatives, such as pen and paper and Excel spreadsheets, didn't work so well. Professional accounting software packages were confusing and filled with unnecessary features. QuickBooks did the job better than any alternative and quickly took over the category.

Another example is P&G's Crest WhiteStrips, which enabled consumers to whiten their teeth easily and affordably in the comfort of their home. WhiteStrips provided a convenient alternative to costly and time consuming professional whitening.

Always start the quest for innovation by looking for problems that customers can't solve simply or affordably.

Principle 3: Don't let perfection crowd out the "good enough"

Quality is truly in the eyes of the beholder. In the pursuit of perfection, companies often create over-engineered, complicated, and expensive products. The consumer might prefer a simpler, cheaper solution with less performance.

A Kodak FunSaver disposable camera with a plastic lens can't compete against a high-end camera on the basis of photo quality. A consumer comparing the product to nothing at all, however, considers the FunSaver to be a gift from above.

For instance, a vacationer who forgets her high-end Nikon at home would be happy to record memories on a FunSaver when the alternatives are either to go without or to buy another expensive camera. A less-than-perfect but affordable product that gets the job done can often delight consumers.

Disruptive solutions are not bad, they are just different. A disruptor trades off pure performance for simplicity, convenience, or affordability. The customer considers the solution great because the alternative is often nothing at all.

Principle 4: Be prepared for low knowledge-to-assumption ratios

When companies move away from core businesses and into new market spaces, the amount they know goes down and the amount they assume goes up. Implicit assumptions that might hold true in the core business might not hold true in the new business.

When Disney opened EuroDisney, for example, it assumed that European consumers would follow

the same patterns as consumers in other markets. But European consumers were used to lower admissions prices, didn't stay in hotels for as many nights, ate less food, and bought cheaper merchandise. Failing to address those assumptions led to an ill-conceived EuroDisney strategy that lost a lot of money.

Even worse is when companies base decisions to enter new markets purely on analytical data. Markets that don't exist can't be measured or analyzed. And remember, glorious spreadsheets do not always translate into glorious businesses. It's not hard to manipulate numbers so they look good in Microsoft Excel. As Intuit Founder Scott Cook puts it, "For every one of our failures, we had spreadsheets that looked awesome."

In disruptive circumstances, carefully spell out all of the assumptions you are making, thoughtfully identify the critical areas of uncertainty, execute smart experiments, and adjust based on their results.

Principle 5: Expect that the initial approach will be wrong

An overwhelming amount of evidence suggests that companies entering into new markets tend to start with the wrong strategy.

This simple statement has profound implications. No one would willingly pour money in a fatally flawed strategy, but companies time and again make this mistake when they step up investment in a strategy too early.

For example, Apple's initial foray into the Personal Digital Assistant market—the Apple Newton—was a \$350-million flop. Apple assumed that people would want a personal

computer replacement, where what they really wanted was a personal computer complement. The initial high investment made it hard for Apple to adjust once it realized its intended strategy was wrong, leaving room for Palm to take control of a high-growth space.

In circumstances in which you are dealing with entirely new markets or are encountering great deal of uncertainty, pick an early point of learning and adjustment where you can invest a little, earn a little, learn a lot, and adjust your strategy towards success.

Principle 6: Be patient for growth, but impatient for profit

If you don't know much, are following the wrong strategy, and can't measure the target market, the worst thing you can do is plunk down a large investment that commits you to a particular course that you know is wrong.

Try to have early profitability to demonstrate that you are on the right course. Be patient for growth because there just aren't that many unexploited \$200 million markets sitting around. Approaches that start small and build have a much greater chance of finding success than "big bangs."

Ask yourself: What are the biggest unknowns in this new market? Frame them as killer assumptions. Then ask: How do I figure this out in 90 days? Success with disruptions requires getting as many "at bats" as cheaply as possible. Making money (even a little) is key to continued investment and support.

Do not do as Independence Air did. In 2004, Atlantic Coast Airlines—a successful commuter car-

rier and United affiliate—broke off its relationship with the larger airline, changing its name to Independence Air. Independence sought to become a discount airline using small, 50-seat regional jets. However, profits never left the ground. The company grew rapidly, but burned through \$240 million of its initial \$300 million in cash. Losses roughly equaled revenues for the first half of 2005 and the company filed for bankruptcy in the fall. Had the company worked out its business model on a small scale before expanding, the story might have ended much more happily.

Principle 7: Disruption requires new, different capabilities

Organizations are good at doing what they are designed to do. Unfortunately, the very strengths that allow a core business to hum along can hinder disruptive growth.

People have to be comfortable working in environments characterized by low knowledge. Processes have to explicitly manage circumstances with low knowledge-to-assumption ratios. The company has to be willing to prioritize opportunities that start small and follow a different path. Processes optimized to create perfect products in known markets might inhibit the iterative, fumbling approach so often required for disruption.

Consider the organizational antibodies that could stand in the way of success and begin proactively working to create a strategy to fight back against those antibodies. Make sure key senior managers lead or at least come along with the journey, because their experience, influence, and support are critical.

Follow the example of Hewlett-Packard, which gave its inkjet printer business a high degree of autonomy by locating it far away from the core laser printer business. This autonomy let the inkjet business—initially much smaller and technologically less advanced than the laser business—develop along its own trajectory. By protecting the inkjet business from the influences of the laser printer division, H-P gave the inkjet side needed protection so it could grow into a highly successful business.

The results can be substantial

Following these principles leads to demonstrated, repeatable success. Project teams can simultaneously make an idea bigger (higher revenue potential), faster (shortened time to market), and cheaper (less investment). Stalled teams can re-start and gain deeper consensus around their strategy. Senior managers can help create an environment that fosters the repeated creation of booming businesses.

It is important to remember that the seven items discussed above are *principles*, not rules. While innovation is less random than most perceive, we are not yet at the stage where innovation is paint-by-numbers predictable either. The principles can be important guideposts that can help managers, investors, and innovators to systematically avoid pitfalls and quickly find the path to ultimate success. ♦

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Benchmarking Best-in-Class Innovation Practices

A Joint Study by Innosight, APQC, and IBM

Have you ever wondered how innovative your organization is compared to top performers? Or what innovation investments have the biggest impact on performance? Innosight has teamed with APQC, a leading nonprofit research firm, and IBM to offer you the opportunity to compare your organization against top performers at **NO COST**. Visit www.apqc.org/innosight to benchmark your organization's innovation performance today!

The findings of this survey will be published in a future issue of *Strategy & Innovation*.

