

Innovation Archetypes: Matching Approaches to Circumstances

Because there is no single model of innovation, firms need to follow the model that is best for their culture and operations

BY STEPHEN WUNKER & GEORGE POHLE

Why do innovation efforts fail? We might expect individual innovations to fail—innovation is risky, after all—but that does not explain why companies often pull the plug on broad campaigns to accelerate innovation, sometimes after only short periods of time. While the business press hectors firms to try to become the next Google, many companies struggle with simply getting innovation initiatives off the ground. Frequently, companies try to copy outstanding innovators, but the efforts never catch on, quickly become moribund, and end up engendering cynicism.

Research by IBM Global Business Services, Innosight, and the benchmarking organization APQC has shown the fallacy in the assumption that successful innovation will come simply by replicating the approach used by successful innovators. A survey of 90 companies across multiple industries and 14 countries shows that the sourcing, shaping, and implementation of ideas at innovative firms tends to conform to a small number of innovation archetypes, which represent a self-reinforcing combination of culture and operations. Google is representative of one of those archetypes, but only one. Because there is no single model of innovation, companies get into trouble by trying to replicate characteristics that are not “natural” to their own business. Instead, firms should recognize the

see ‘Four Archetypes’ on page 6

Innovation Metrics

Measuring what matters

BY SCOTT D. ANTHONY & STEPHEN WUNKER

More than two decades ago, management guru Tom Peters penned an editorial titled “What gets measured gets done.” Indeed, one of the findings from the research that Peters summarized in the 1982 business classic *In Search of Excellence* is that excellent firms use measurements and metrics to make sure people spend time on the things that really matter.

The theory is simple. A senior manager hoping to influence behavior has no stronger lever than their choice of measures. Measures serve as tangible guideposts that help middle and junior managers make the critical on-the-ground resource-allocation decisions that

see ‘Innovation Metrics’ on page 10

INSIDE



Innovating Your Business Model

Companies are increasingly seeking to find new innovation levers beyond product innovation (adding a new blade to a razor) or process innovation (Six Sigma programs). True business model innovation can create astonishing new growth opportunities for your company. See page 14

- 2 Voices of Disruption:** In this issue, we feature Harvard Business School Professor Willy Shih describing how he followed the principles of discovery-driven planning to help Kodak build its digital imaging business.
- 4 Innovators' Update:** In a 2006 Insight, we discussed Boeing's failed attempts to launch an in-flight Internet service and gave our perspective on how the initiative could have been managed differently. With some new offerings emerging, what has happened since?
- 5 Innovation Assessment:** A disruptive comparison of two new solutions that seek to help consumers tackle the job of keeping their portable devices charged; plus, a look at three emerging technologies.

Voices of Disruption

WILLY SHIH

This issue we feature Willy Shih, who is presently a faculty member of the Harvard Business School. Shih spent 27 years trying to build new businesses at IBM, Digital Equipment, Silicon Graphics, Kodak, and Thomson. He currently is working on injecting his practical experiences into helping managers to do better at facing the challenges of creating new growth.

My first day at Kodak was July 7, 1997. That happened to be the cover date for an issue of *Business-Week* that featured Lew Platt of Hewlett-Packard taking a picture with a digital camera on its cover. The caption read: “Shootout! How HP plans to take on Kodak and revolutionize the way you capture and print images ...”

Now Lew was a gentleman and a great man, but that cover story was pretty scary. There was no question in the minds of senior Kodak executives at the time that, someday, digital photography was going to be important. The answer that everyone sought, but nobody really knew, was when?

It was a crucial question because the film business was immensely profitable for Kodak. Unfortunately, it was almost impossible to know the answer with any precision.

Exactly 26 days after that magazine hit the newsstands, I found myself running Digital & Applied Imaging (D&AI), the division that was responsible for coming up with a consumer digital play. Outside of switching offices, things were pretty uneventful for maybe a day or so. Then the questions started. “Willy, what’s our vision? What’s our plan? Where are we going?”

There were many anxious people at D&AI. They had seen one new division president a year for

the last three or four years, and there had been substantial management turmoil (22 out of 24 of the direct

reports to the division president had left in the last year).

One of our sales people even got up at a sales meeting in the ensuing two weeks and announced, “I’ve seen a new president every year, and I predict you will be no different and you won’t be here a year from now either.”

The questions about developing a vision and maintaining a “plan” kept coming up because people could not deal with the uncertainty. Finally, in frustration and in response to yet another question about our vision at an all employee town meeting, I announced:

“Look, the vision is we’re going to California, and we’re going to drive. That means pack for five days, and bring credit cards, but don’t ask me where we’re going to have lunch on Tuesday, because I can’t tell you.”

Since taking over the division, I had been struggling for a way to describe strategy-making under uncertainty. The “going to California” metaphor explained to the team how we were going to go about finding our way in this new market. In the parlance of disrupt-



STRATEGY & INNOVATION

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Subscription Information: Subscription price is U.S. \$149 (6 issues); single copy: U.S. \$26.95. To subscribe to Strategy & Innovation, call 617.393.4535. Web: <http://www.strategyandinnovation.com/subscribe>. To subscribe to receive Innovators' Insights alone for \$49.95, call 617-393-4535 or go to www.strategyandinnovation.com. For group subscription rates, call 617-393-4535.

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tive innovation, I told the team that we were going to use a “discovery-based planning” method.

Kodak had been enormously successful in film-based photography, and it had evolved sophisticated planning methodologies. Costs, volumes, distribution—the business was well characterized. For example, we knew that Mondays were big volume days for photofinishing and that where Easter fell significantly affected revenue for the quarter.

But consumer electronics was a different game, one that we didn’t know too much about—yet. To learn more about the market and develop the business, I needed employees to understand that our process would be iterative. We might make mistakes, but we’d quickly learn and continue on.

“And oh by the way, if you wake up one morning and you’re in Key West, you screwed up. But I want you to head in a generally Westerly direction, and show up in five days. Now if you run into snow in Wyoming, go on a more southerly route.”

In the traditional business, there was a firm foundation of knowledge, and not too many assumptions. There was years of data on trends, seasonality, costs, the price of silver, retail performance, anything one could imagine. But in the new business, we were in uncharted territory. We had little knowledge, but a huge number of assumptions. The knowledge-to-assumptions ratio in the new business was opposite of that in the traditional business.

(For more on the knowledge-to-assumption ratio, see “Do You

Know What You Don’t Know,” *Strategy & Innovation*, March-April 2007.)

As we learned more, we stuck with the metaphor. Just as we picked a specific destination (“go to California”), we focused on arriving at a target business model for the division. We honed in on this by using a method some people refer to as a reverse income statement.

What we told the team was that in consumer electronics—the best comparable market for the digital imaging business—we could expect, at best, a gross margin percentage in the high teens or low twenties. As a result, we backed out that we could spend about three percent of revenue on R&D once we reached steady-state, but that we needed a pretty broad product line to get price point coverage.

All of this meant there was a volume point that we had to reach in order to afford enough R&D to reach a minimum efficient scale. We also knew we had to spend around seven percent on advertising, and that 100 gross rating points (GRPs) of advertising in the United States cost about \$20 million, dictating another operating point.

As we worked our model, we learned more. We made lots of mistakes initially, some more costly than others. But we analyzed those mistakes and tried not to repeat them. We learned to conduct experiments. In those days, Salt Lake City was a great place to do experiments because it was geographically isolated and people tended not to be influenced by adjacent media markets. We would do things like test advertising or retail execution.

Our approach was very incre-

mental and we monitored our progress toward reaching the target model. Now, we still had to fit in with Kodak’s traditional annual planning cycle. That was my top team members’ role: to “bridge” and keep the guys downtown satisfied, and to ensure that we had some maneuver room. Thankfully they were patient with us.

Kodak’s CFO, who was a former General Electric employee and a tough task master, was constantly plotting our data. About six months before we crossed into the black, he came into a monthly operations review for the company and announced, “Look at this data, these guys are going to make it.”

Discovery-based planning is much closer to what many start-ups and smaller companies use. I had come to Kodak from Silicon Graphics, where we would often determine revenue targets by sitting in my boss’s cubicle and taking a stab at what we thought we could do in the next quarter. We would then go out and “make it happen.”

Whether intentionally or simply because they have not yet evolved sophisticated planning systems, it gives start-ups a much more flexible and opportunistic view of the world. This might have something to do with why new entrants are such good disrupters.

Interestingly, just before I left Kodak, I heard that another division started using the “going to California” metaphor for their planning. A friend in that division told me that the president of that division had just said, “Willy says we need to go to California.” Well, at least we know the weather is better there. ♦

Reprint # 050202A

Innovators' Update: Flying High?

In-flight Internet access just might be rising from the ashes

Each issue, we take a look back at a past Innovators' Insight to see how our analysis has held up. This issue, we look at Insight #70, "The Bid Bet Hangover." The Insight said Boeing had invested too much to create an in-flight Internet offering. What has happened since?

You have to love entrepreneurs. In 2006, Boeing pulled the plug on its much-hyped Connexion in-flight Internet service. Normal people would look at this and say, "Well, if the world's leading airline manufacturer can't make this work, no one can." Instead, the entrepreneur says, "How can we succeed where Boeing failed?"

Emerging companies seeking to revitalize the in-flight Internet market would be well-served to remember a core disruptive principle: start simple.

Boeing's efforts were a well-publicized flop. The promise? Customers could watch streaming video and download emails. Given the Boeing's \$1 billion investment, it had to make the service expensive: \$9.95 an hour or \$29.95 for more than three hours. The high price tag, however, made the service unpalatable to all but the most demanding customers.

While Connexion's annual revenues grew to \$25 million, the unit couldn't attract enough customers to make the big bet pay off.

A lesson one might take from Boeing's struggles is that people just don't want in-flight Internet. Indeed, when announcing the service's shuttering, Boeing Chairman and Chief Executive Jim McNerney said, "Over the last six years, we have invested substantial time, resources, and technology in Con-

nexion by Boeing. Regrettably, the market for this service has not materialized as had been expected."

There are dozens of signals that suggest this is the wrong lesson. Consider the executive surreptitiously keeping her Blackberry on until the last possible moment or the manager frantically searching around the airport for a wireless connection to send 27 emails.

Without a doubt, some business travelers want nothing more than to disconnect during a flight. But signs suggest a clear job to be done: Make it easy to send and receive email messages while in the air.

Our hunch is that a service optimized around this job would be a real success. Not only is there consumer pain, the problem is much simpler to solve than providing high-quality, high-speed access.

The disruptive models teach us that many of history's great growth stories began simply. eBay is a good example. The auction powerhouse didn't start by asking, "How can we allow people to auction off expensive goods like cars?" Rather, it began by asking, "How can we make it simple and easy to trade collectibles that can't efficiently be traded today, like Beanie Babies?"

The advantage of such simple starting points is that they typically require less investment. Not only does this result in lower-priced products, it gives a company more

flexibility to adapt once it figures out what is wrong with its initial strategy. Since the odds are high that first strategy has some kind of fatal flaw, such flexibility is critical.

Recent developments offer hope for in-flight Internet. Companies moving into this space are following straightforward approaches, creating simple solutions that get the innovation job done.

For example, AirCell paid about \$30 million to obtain radio frequency used by expensive (and infrequently used) in-seat phone services. It plans to couple that frequency with a relative rudimentary ground network to offer in-flight Internet service that costs no more than \$10 a flight. (One warning sign: That price is the same as Boeing's service on relatively short flights.)

Additionally, JetBlue's satellite TV arm, LiveTV, paid \$7 million for even more limited frequency that could be the basis of an in-flight service. After snagging the spectrum, JetBlue founder David Neeleman wrote that the company planned to offer a "silent" e-mail or messaging connection service. "The challenge is to offer something most customers want and will use, and to do it without adding unbearable implementation and maintenance costs to our bottom line," Neeleman noted.

The disruptive spirit might yet satiate the desire of air travelers hungering for in-flight connectivity. Companies that start simple and cheap could end up succeeding where Boeing, Verizon, MCI, and AT&T—which collectively have squandered more than \$2 billion trying to provide in-flight Internet access—have failed. ♦

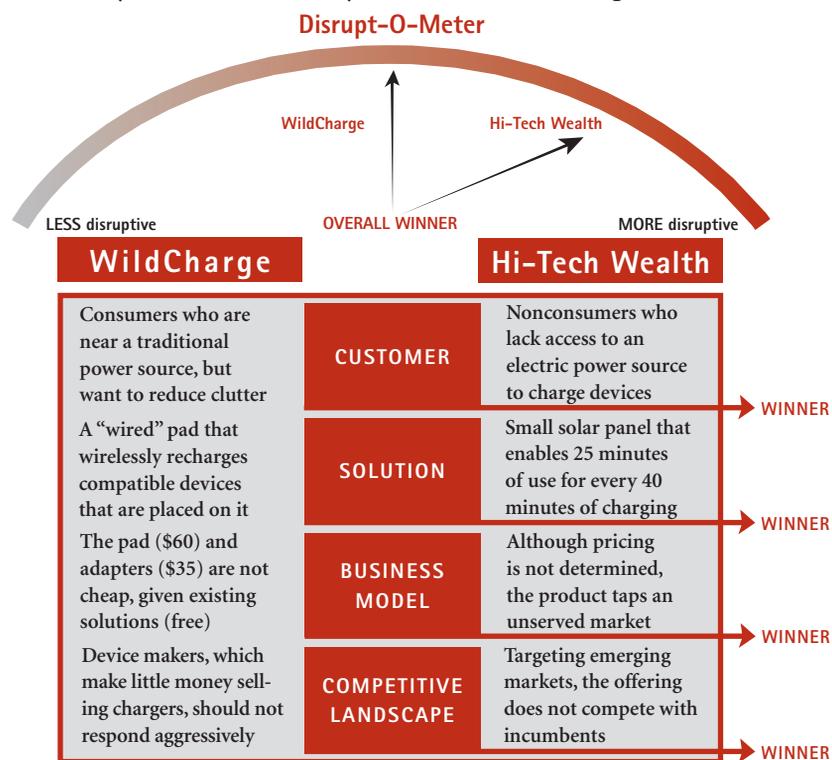
Reprint # 050404A

Disrupt-O-Meter

Tale of the Disruptive Tape: WildCharge vs. Hi-Tech Wealth

“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 emerging solutions for recharging portable electronics without wires.

Anyone who has a cellphone and a laptop (not to mention an iPod) know the hassle of carrying around multiple chargers. An American company called WildCharge Inc. has developed a “charging pad” that recharges electronic devices that come in contact with the pad (any such device needs to have an adapter installed). Hi-Tech Wealth, a Chinese company, recently announced the launch of a solar-powered cellphone that does away with cords entirely. Which is more disruptive?



More Disruptive: Hi-Tech Wealth. WildCharge has clearly identified a job that some consumers want to get done: Reduce my annoying tangle of power cords. Incumbent device makers are unlikely to feel challenged by the offering, which does not compete with how device manufacturers make money. That said, it’s not clear how many people will spend more than \$100 to solve this problem. Hi-Tech Wealth’s solution has many of the signs of a classic disruptive play, enabling consumption in entirely new contexts (places without reliable electric power) and targeting nonconsumers that incumbents would have difficulty reaching. While the technology is vastly inferior along traditional dimensions—40 minutes of charge for 25 minutes of use—the company has many viable foothold market in which to test and improve its capabilities. ♦

Reprint # 050405A

EMERGING TECHNOLOGY WATCH

Listen and learn

Since its launch in 2001, the iPod has been blamed for distracting teenagers from their studies. Recently, Kaplan Test Prep and Admissions launched a set of Scholastic Aptitude Test (SAT) preparation courses that can be downloaded from Apple’s iTunes service and played on the company’s iPod portable devices. While it may seem counterintuitive to offer teaching aids on a device that kids use for fun, the offering has the potential to enable busy teens to consume test prep services in new contexts. Hitting on one of the classic levers of disruption—convenience—Mark Ward, Kaplan’s president of pre-college programs, said: “Students don’t go anywhere without their iPods and Kaplan has always sought to make test prep as convenient as possible.”

Smart concrete

Poured concrete has enabled the low-cost building of all sorts of residential homes and commercial buildings. Although most people may not think about making “innovative concrete,” new technologies are emerging to improve the building process. Concrete technology actually has been advancing steadily over, from the introduction of fly ash in the early 20th century to the introduction of new plasticizers today. One recent breakthrough involves the introduction of nanofibers into the concrete. Recent research indicates that these fibers may improve the strength of concrete. There is some speculation that these fibers could enable “smart-sensing” concrete that is able to self-diagnose cracks or measure temperature changes.

Racking it up

Automobile roof racks are commonplace for many types of consumers, from surfers to mountain bikers to families on their way to an outdoor vacation. Because of the hassles associated with removing and replacing the racks, most consumers leave the racks on their car all the time, leading to substantially reduced fuel efficiency. A British company, HandiRack UK Ltd. recently introduced an inflatable roof rack that can be set up in seconds and fits on any car, unlike traditional metal racks that are designed to fit individual models. While the rack cannot handle the heaviest loads of some traditional racks, it can hold more than 130 pounds, more than enough for many common uses. Hitting on a couple of disruptive notes, the HandiRack retails for less than \$100 (compared to more than \$500 for some of the leading metal racks) and can be deployed in minutes, a convenience feature that should lead to use in new contexts

Reprint # 050405B

benefits of the innovation archetype they inhabit, compare their approach to others in their archetype, and borrow very selectively from other categories.

Understanding the archetypes

It is incredibly difficult for firms to be great along every dimension of innovation. A company cannot have both a strong visionary leader driving innovation from the top and a marketplace of ideas bubbling up from the bottom. Firms have difficulty relying on both deeply-ingrained processes for internal idea development and plug-and-play external partnering. When firms try to combine these contrasting models of innovation, the result is most often a traffic jam—people lose their daily compass.

That compass—culture and operating processes—informs the hundreds of daily decisions that senior managers make and defines how a company innovates.

Our research indicates that there are a small number of self-reinforcing “archetypes” of innovation and each represents a different approach for driving corporate innovation. The four archetypes are:

1. *The marketplace of ideas*

In the marketplace archetype, employees are charged with creating new ideas, shopping them around to gain support, and implementing them rapidly to test feasibility and market acceptance. It is an environment that is somewhat chaotic by design.

Google typifies this model. The company puts great emphasis on hiring bright, creative people and tells them that up to 20 percent of

their time may be spent pursuing personal ideas. While the firm has portfolio guidelines—currently 70 percent of projects focus on core search and ads, 20 percent on extensions to search such as news, and 10 percent on speculative ideas—there is a highly decentralized system to determine which projects move ahead. Employees create ideas, post them on internal web bulletin boards, and engage in dialogue with others around merits, risks, and near-term action plans.

Those ideas that generate the most support through this process move into rapid prototyping. Product requirements are kept as simple as possible so that features may evolve as users provide feedback. Early versions are quickly released for internal use, then for Beta release through the website's Google Labs.

We find this model pursued by several other innovative firms, including 3M, Best Buy, and many television companies. People are lauded for coming up with ideas, trying them quickly, and learning from experience. Failure is expected and even rewarded, so long as it improves the company's understanding of technology or the market.

Because the marketplace model relies on high quality inputs of ideas, these firms tend to seek opportunities from many sources, including close interactions with clients and partners. Once they vet ideas, firms in this archetype tend to have a relatively short time to market and launch many new businesses. This speediness is due partly to the companies' preferences for validating ideas in the market rather than with detailed up-front analysis.

2. *The visionary leader*

The visionary leader model revolves around a senior executive who understands the future better than customers may, motivates employees to zealously pursue that vision, and keeps generating ideas that are unexpected and profound.

Steve Jobs of Apple is the paragon. His visions have included creating one of the first personal computers, commercializing the Graphical User Interface on the first Macintosh, bringing design to computing with the iMac, and developing the iPod. While the firm has created many innovations, it tends to launch only a few key products at a time and in fact spends less on R&D than the industry average.

Apple's big ideas often have not started with Jobs. A little-known product designer named Tony Fadell thought up the iPod, for instance. Jobs's great talent is the ability to spot high-potential concepts, champion them, and inspire teams to pursue them.

Other successful visionaries include Henry Ford, who once famously said, “If I'd asked people what they wanted, they would have asked for a better horse.” Ford innovated both in product design and production process, designing unthinkably inexpensive cars produced in a very new manner.

Sony's Akio Morita closely observed consumers as they went about their daily lives. Morita believed that markets that did not yet exist could be accurately measured and analyzed, so he relied on his observational insights to design some of the company's most successful new products. His thinking about how Sony technology could

improve their experiences was a leading source of the company's innovations, such as the Walkman.

Sometimes the vision is not of an end product or a process, but of a new method of approaching the customer. Harrah's CEO Gary Loveman, for instance, came to the company after teaching service management at the Harvard Business School. He had a compelling view of how the firm would use intensive data analysis to lead the gaming industry in customer targeting and he united the organization to pursue that goal with impressive results.

This model goes beyond executive inspiration. These organizations typically construct formal mechanisms through new ideas flow. These mechanisms, from formal processes for collecting customer intelligence to the development of portfolio plans for innovation initiatives, are designed as conduits for operationalizing the ideas of the visionary.

3. Innovation through rigor

Most companies aren't Google or Apple. Their culture, their people, and their environments are very different—causing them to take another route to innovation: They create processes designed to produce results systematically.

It is easy to believe that such efforts only generate bureaucracy, endless meetings, and me-too products that yield tepid growth. After all, if companies have similar processes and similar people, they will likely create similar outputs. However, it's possible to use rigor in mold-breaking ways.

Samsung provides an example. Over the past 15 years, innovation has helped set the company apart from fierce competitors. This vast company creates more products in a year than any visionary could possibly conceive, and it does so within a Korean company culture not historically inclined toward bottom-up idea generation.

The firm succeeds through a

mix of executive prioritization and team processes. Samsung's leadership prioritized design as a critical competency in 1993 and significantly increased the design budget to support the emphasis. It developed Design Centers in London, Los Angeles, San Francisco, Tokyo, and Shanghai to look for emerging customer trends. It created an Innovation Design Lab as an in-house school for promising designers, and it sends people on internships in industries as diverse as fashion and cosmetics to gain new ways of thinking.

The company invests about 10 percent of its revenues in R&D—a very high figure for the industry—and it devotes 15 percent of its R&D team to looking at needs and lifestyles 10 years from now. The firm unites its disparate businesses through leveraging a common core of semiconductor components, a field in which it holds a strong position. Importantly, senior management strives to create a culture

ARCHETYPE	LEADERSHIP	STAFF	PROCESS	ENVIRONMENT
Marketplace of Ideas	Executives content with "leading from behind"	Staff recruited for their creativity and passion	Well-stated goals and boundaries; ability to trial quickly; clear metrics for success	Should allow for and encourage experimentation
Visionary Leader	An executive with insight and creativity who motivates employees to pursue a vision	Staff who are adept at teamwork and can execute leaders' plans	Well-understood mechanisms that link executive vision to daily activities	Few interdependencies with outside parties; a business model that supports pursuing just a handful of big initiatives
Innovation through Rigor	Strong executive leadership that sets priorities, raises urgency, and allocates resources appropriately	Staffing policies that dedicate small numbers of employees to discrete tasks and do not penalize for failing for good reasons	Cross-functional approaches and a high tolerance for dissent, experimentation, and iterating toward success	Diffuse product lines that are impossible for a small set of individuals to dictate and control
Innovation through Collaboration	Humility to recognize when to outsource; prowess in forming strategic alliances and navigating inevitable conflicts with partners	Staff empowered to make deals with outside vendors without onerous approval policies	Competency in finding external partners; technology or infrastructure that enables dynamic reconfiguration	Excellent understanding of customer needs, an advantage (economic, brand, channel) that maintains differentiation

of perpetual crisis that forces the company to look seriously at competitive threats and develop new growth businesses.

At the working level, Samsung breaks down barriers to look at challenges holistically and speedily. For example, more than 2,000 people a year cycle through its Value Innovation Program (VIP) Center outside Seoul, where designers, engineers,

By understanding which archetype a firm inhabits, leaders can enhance innovativeness.

planners, and programmers gather for days—or months—on end to hammer out detailed specifications for new products.

The center was established to bring together critical team members at the start of a project. These cross-functional teams work long days in windowless rooms to shape ideas and resolve differences, returning to their ordinary jobs only after the task is complete. Fifty “value innovation specialists” facilitate the work. The teams strive to break down stale cultural norms and encourage junior members to challenge senior staff. Output is rapidly prototyped and tested.

Rigor organizations conceive of innovation in both strategic and tactical terms. Strategically, they pay relatively high levels of attention to the landscape in which the innovation is to take effect. Tactically, they focus on project execution, seeking efficient and fast implementation.

In addition to Samsung, Procter & Gamble and Goldman Sachs typify this approach.

4. Collaborative innovation

The archetypes explored thus far rely primarily upon internally-generated innovation to create growth. Another archetype is more externally-oriented, featuring companies that team with outside firms to evaluate a wide range of opportunities, rapidly select the ones to trial, and frequently implement the idea through these partners.

Vodafone illustrates the model. The company excels at servicing customers and building a global brand. However, its network equipment is supplied by outside firms such as Ericsson, its customers are often acquired by third-party dealers such as Carphone Warehouse, and its software applications are sourced from a range of third-parties. Vodafone has even partnered in owning wireless networks, whether in the U.S. with Verizon or in Bahrain with the Kuwaiti firm MTC.

The company excels at understanding customer needs, outlining what it’s looking for, seeking the appropriate solution from its partners, performing quick but thorough quality control, and plugging the innovation into its network. If the solution proves off-the-mark, the firm can swap in an alternative relatively easily. Its technology infrastructure facilitates this flexibility, as does its large idea pipeline.

Collaboration organizations gather “innovation intelligence” by building formal relationships with other firms that can help them not only shape the innovative concept but actively help implement the

solution. For example, most movie studios are collaboration organizations, partnering with independent producers to generate ideas, technology companies to create special effects, and advertising agencies to promote new releases.

These organizations work to develop a performance vision shared by their partners and pay close heed to creating an “innovation culture” that provides the basis for organizational cooperation.

Working with the archetypes

By understanding which archetype a firm inhabits, leaders can gain perspective on how actions and investments can enhance innovativeness and how a near-term action plan can create change. The process involves three steps:

1. Understand your archetype

In order to map where to go, a company needs to understand its starting point. This first means figuring out which archetype best describes your firm, then examining how you can improve your innovation processes.

Once you have thought through what comprises a like-for-like comparison, benchmarking can generate fruitful ideas for areas of improvement. Unfortunately, many companies either benchmark too widely—trying to compare themselves to different firms in other archetypes—or too narrowly by looking only at their competitors and missing approaches that could be borrowed from other industries.

Perhaps the company is attempting to straddle various archetypes, and it is difficult to characterize the firm (or business unit) accord-

ing to this schema. If so, managers should zero in on traits that seem to cross archetypes, and think carefully about their impact on company culture and decision-making. Do they liberate thinking or create confusion? Do they create passion or cynicism among staff? Do they produce differentiating or me-too results? And most importantly, do they link to—and reinforce—the existing characteristics of the firm?

Crossing archetypes isn't inherently bad. It can shake up entrenched mindsets and differentiate firms from their competition. However, often firms cross categories unintentionally and in the process sow uncertainty among staff about expected behaviors. This creates a disconnect between activities and operational processes. It is a recipe for failure.

For example, many rigor companies deploy idea marketplaces in the hope that a robust community of innovators will emerge to guide the company in unanticipated directions. Often there is an initial burst of enthusiasm as people unleash ideas they have been harboring for some time. But when senior managers begin to ask questions that would require ideas to be much more fleshed-out, enthusiasm and the overall initiative slowly fade away. The initiative fails because the marketplace mechanism does not "fit" with the rigorous processes and cultural norms.

2. *Selectively target new approaches*

These archetypes are not absolutes. There is no reason why a rigor company cannot partner with outside firms, for example. However, the firm should understand how

new initiatives impact the interlocking norms that already exist and how current behaviors and processes must change to accommodate the new approaches.

Concerted actions are required to create the right environment for innovation crossing archetype boundaries. Among the behaviors required, firms may need to set detailed goals and boundaries around the efforts, ensure visibility of these initiatives, train staff, reward desired behaviors, ensure leaders set appropriate examples, create new processes for idea evaluation, and even set up separate organizations embodying a new culture. The effort must be multi-faceted, as the implications of crossing archetypes can be broad.

For these reasons, innovation initiatives must be targeted. Too often, firms set out trying to create a "Culture of Innovation" on myriad fronts. The challenge is multi-dimensional, to be sure, but when efforts become too diffuse they lack the critical mass to overcome inertia. Managers would be better off by targeting a handful of changes, letting those diffuse throughout the organization and firmly take root, and then move on.

3. *Measure it and make it count*

When progress goes unmeasured, innovation efforts may lose their momentum. When budgets are tight, it is all too easy to cut initiatives that require uncomfortable behavior and produce uncertain returns. This danger is even more acute when it is hard to say what the efforts have achieved. Therefore, leaders should define from the start of an initiative what "success"

entails and create a balanced set of metrics that track progress.

(For details on which metrics might help your organization, see the page one article titled, "Innovation Metrics," in this issue.)

Metrics can also assist with diagnosing problems in an apolitical way. Through targeting pain points, managers can then address shortcomings in a focused manner rather than debate whether the whole innovation initiative should be killed or expanded.

Getting Started

There is no single formula for successful innovation. Large and small, established and entrepreneurial, companies can accelerate innovation as long as the approach takes focused and relevant steps that are consistent with the existing archetype of its business. Changing your archetype is extremely difficult, and requires many years, whereas improving how you execute within your archetype is comparatively easy.

To get going, identify the characteristics that best represent your company and its innovation archetype. That analysis gives you the degrees of freedom you will have in bolstering or adding new capabilities in your approach to innovation. Then focus your efforts at change in areas where they will really make an impact.

Step by step, real progress can occur, and the ultimate potential is limitless. ♦

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Reprint # 050401A

more than any senior management fiat ultimately determines a company's innovation strategy.

The challenge for companies seeking to improve their ability to create growth through innovation is that the metrics that many companies utilize to measure innovation run a high risk of actually leading companies in the wrong direction.

After describing some key measurement traps, this article spells out 15 potential innovation metrics that companies can use and provides tips for executives seeking to start implementing their own set of innovation metrics.

Measurement traps

Putting metrics on innovation is admittedly difficult because innovation is a complicated, diffuse activity. Even metrics that seem to make all the sense in the world can actually lead to behavior that is antithetical to the long-term pursuit of profitable growth.

Consider a company that tracks its total investment in innovation. Makes sense, right? After all, you can't innovate if you don't invest. However, simply measuring total investment in innovation can lead companies to land into a classic innovation booby trap: Cursing projects with too much capital. Remember, sometimes the worst thing to do is to spend too much money on innovation. Companies seeking to "prove" they are serious by making big splashes can end up investing in a flawed strategy, get badly burned, and never recover.

More generally, there are three measurement traps companies should be mindful of: a too-short

set of metrics, having metrics that funnel activities towards low-risk (and low reward) activities, and biasing inputs over outputs.

Trap 1: Too short a list of metrics

Many companies fixate on a single innovation metric. For example, some companies try to calculate the return on their innovation activities. While this metric can be quite useful, *on its own* it can lead companies to inadvertently prioritize measurable markets over difficult-to-measure, but higher potential, markets.

There is no one magic innovation metric. Companies that are good at innovation master the ability to introduce different *types* of innovation. They also recognize that getting good *outputs* requires tracking the right *inputs* and the right *processes*. Single-minded metrics can lead to companies prioritizing the wrong things.

Trap 2: Having a sustaining mindset

Many metrics implicitly—or explicitly—encourage companies to overly focus on close-to-the-core sustaining innovations that at best promise incremental returns. These incremental innovations aren't bad, but they are insufficient for companies seeking to create substantial growth.

For example, one popular metric is the percent of revenues that derive from new products. The metric seems sensible. After all, the intent of innovation is to create something new that has material impact, and this metric ensures that innovations lead to real results.

Imagine, though, you are a product manager at a company that

makes toothpaste. You know that moving the needle of this metric increases your year-end bonus. You have a choice between working on a raspberry-flavored toothpaste where every unit sold will replace a unit of another flavored toothpaste, and investing to create a new teeth augmentation category that will take five to seven years to mature. What are you going to do?

Companies that focus on the percentage of revenues from recently launched products have to carefully watch to ensure that they don't subtly encourage very close-to-the-core, low-risk innovations.

Trap 3: Focus on inputs over outputs

Ultimately, the goal of any company's innovation efforts is to improve financial performance. Companies that only track input-related metrics run the risk of having resources (particularly scientific ones) work on interesting but ultimately low impact projects.

As a simple example of the limits of focusing on input-related measures, consider a 2006 study by Booz Allen Hamilton that highlighted the private sector companies that had the largest R&D budgets. Leading the pack in the U.S. was Ford, which isn't on anyone's short list of innovative companies.

Technology-focused companies often carefully track the number of patents awarded to their scientists. IBM proudly touts the fact that it obtains more patents than any other company. It should be proud; patents can be a source of competitive advantage and can indicate that a technological community is on top of its game. But patents for patents' sake can be a waste of time.

Remember, there is a marked difference between invention and innovation. In his excellent book *They Made America*, Harold Evans describes how Thomas Edison would implore his scientists “to come up with something. We can’t be like those German professors who spend their whole lives studying the fuzz on a bee.” Put simply, the output matters. (For more on this see, “Innovation is Inventiveness Put to Use,” *Strategy & Innovation*, September/October 2005.)

Suggested innovation metrics

Organizations like the Boston Consulting Group that have studied innovation metrics suggest using a balanced mix of metrics to assess a company’s innovation-related activities. We agree. The metrics described below come in three categories: input-focused metrics, process-focused metrics, and output-focused metrics.

Implicit in these metrics are many of the core disruptive concepts that we talk about frequently in *Strategy & Innovation*, such as encouraging a balanced innovation portfolio, encouraging iteration and learning, ensuring there are dedicated resources for innovation, and so on.

Input-related measures

1. Financial resources dedicated to innovation. Although in isolation this variable can be dangerous, innovation requires real resource commitment. One warning sign: a company just starting out

that apportions a huge budget to innovation. A company following this approach can fall prey to the trap of the “big bet.”

Beginning the innovation journey need not be expensive. In fact,

Remember, there is a marked difference between invention and innovation.

limiting funding has benefits. Scarce resources can force teams to zero in quickly on critical assumptions, find cheap ways to test those assumptions, and develop lean, flexible structures. Start with “just enough” and add more.

2. Human resources focused on innovation. This metric insures that there is dedicated time for people to spend on innovation. In many companies, the real scarce resource isn’t money; it’s time. Core operations often squeeze out capacity that might be available for other activities. Ensuring that people spend a non-trivial portion of their time on innovation can help innovation efforts to progress.

3. Ring-fenced resources for non-core innovations. The previous two metrics ensure a company generally allocates resources to innovation. It’s important that some of those resources are focused on non-core innovations and that those resources are fiercely protected, even when times get bad.

Companies that put all of their innovation resources in a single pot often find that low risk (and lower return) core initiatives crowd out investments that might have higher

risk and take longer to perform but have greater growth potential.

4. Senior management time invested in new growth innovation.

If senior management is serious about creating new growth, it has to demonstrate its commitment by allocating personal time toward innovation. Those innovations that are most different from core initiatives require careful nurturing from senior management.

5. Number of patents filed.

Again, on its own, this measure (or an equivalent for non-technology companies) can be quite meaningless. But combined with the other metrics, it can be a good interim measure that ensures a constant effort to develop new technology.

Process and oversight metrics

6. Process speed. An ideal innovation process quickly moves ideas from conception to critical decision points. That decision point might not always be market launch, it might be a decision to kill or enter a trial. A target for this metric obviously is industry specific—some industries can move from the sketchpad to test market in a matter of weeks, others can require years of scientific work before there is even a meaningful prototype.

7. Breadth of idea-generation process. Senior management does not have an exclusive on good ideas. In fact, the best ideas can originate from people who are close to markets, such as a sales force. For example, Starbucks encourages its baristas to contribute new product and service ideas from customers.

A good idea generation process seeks ideas far and wide, from customers, channel partners, even competitors. Measuring the percent of ideas that come from outside the company is a good proxy for the breadth of the idea-generation process. For example, in 2004 Procter & Gamble announced that by 2010 it hoped that 50 percent of its ideas would come from outside.

8. Innovation portfolio balance. A good innovation portfolio is a balanced innovation portfolio. Balance can exist along multiple

Suggested Innovation Metrics

1. Financial resources dedicated to innovation.
2. Human resources focused on innovation
3. Ring-fenced resources for non-core innovations
4. Senior management time invested in new growth innovation
5. Number of patents filed
6. Process speed
7. Breadth of idea-generation process
8. Innovation portfolio balance
9. Current growth gap
10. Distinct processes and tools for different types of opportunities
11. Number of new products or services launched
12. Percent of revenues in core categories from new products
13. Percent of profits from new customers (or occasions)
14. Percent of profits from new categories
15. Return on innovation investment

dimensions, such as the stage of development, the target domain, and the amount of risk. Clorox ensures that investments are balanced in diverse areas ranging from introducing line extensions to creating new categories by classifying its projects into three categories (sustaining, breakout, and disruptive) and investing accordingly.

9. Current growth gap. Senior managers should regularly calculate the gap between the company's strategic objectives and the expected outcomes from its innovation investments. Remember, the results of the analysis must be reasonably risk adjusted; if success requires that every innovation project meets its current projections, a company should think about developing more (or different) projects.

10. Distinct processes and tools for different types of opportunities. One bedrock principle of Innosight's work is that ideas can look different through different lenses. Tools that help screen and shape core initiatives can unintentionally weed out great—but different—ideas. A company's core stage-gate process can ruthlessly re-shape even the most novel idea to resemble what a company has done before.

This metric ensures a company has different screens and tools for different types of innovation. For example, IBM classifies opportunities by time-to-market and risk-level, applying distinct innovation processes to distinct opportunities.

Output-related metrics

11. Number of new products or services launched. Clearly, a well-oiled innovation machine should

produce tangible output. Tracking the number of outputs makes sure the engine is running well.

12. Percent of revenues in core categories from new products. As mentioned above, this metric in isolation can unintentionally encourage needless line extensions. But this metric coupled with others can ensure that a company has appropriately seized critical close-to-the-core opportunities.

13. Percent of profits from new customers (or occasions). New growth innovations should create legitimately new growth. This metric tracks what percent of profits come from new customers, or usage occasions. Why profits? An important innovation lever is the business model. Focusing on profits gives innovators the freedom to tinker with the profit formula, charging lower prices but increasing velocity or actually charging higher prices and earning more attractive margins.

14. Percent of profits from new categories. Not only should innovative companies be able to reach new customers or new usage occasions; they should be able to create (or play in) entirely new categories that didn't exist several years ago. This metric forces innovators to look beyond today's business to spot innovative opportunities, remembering that most great growth businesses will start a step or two away from the core.

15. Return on innovation investment. Return on investment can again be a dangerous metric in isolation, forcing innovators to prioritize sure bets that promise modest-at-best returns over riskier but potentially more lucrative propo-

sitions (Net Present Value, which doesn't suffer from this sizing problem has its own complement of issues). Nonetheless, companies shouldn't fritter away innovation resources on activities that don't demonstrate returns.

Advice for senior executives

Implementing innovation metrics is not a trivial task. We have the following pieces of advice for senior management seeking to create and utilize innovation metrics:

1. *Focus, focus, focus.*

In his classic parable *Animal Farm*, George Orwell wrote, "All animals are equal, but some are more equal than others." The same is true of innovation metrics. All the metrics described above matter, but some matter more. Furthermore, what matters depends sharply on a company's circumstances, capabilities, and strategic objectives.

To determine the metrics that should be on every executive's dashboard, a company needs to come to consensus around its innovation strategy and zero in on the company-specific barriers that inhibit its ability to create growth through innovation. Attempting to calculate the growth gap, while difficult, can be a very useful input into this process.

Furthermore, no one manager should feel like they are on the hook for delivering against a dozen different metrics. The list of metrics for any one manager needs to be limited in number so that it can provide a mental map that supports the right behavior. Too many metrics can lead managers to pri-

oritize what they think is important instead of what really matters.

2. *Remember relativity.*

A company can look great along each of the metrics but still find itself falling behind competitors. It is always important when using metrics to analyze not just internal progress, but progress against external benchmarks. Admittedly, the fact that many of the metrics described in this article require internal knowledge makes external tracking difficult, but it's still worth the effort.

When looking externally, companies should evaluate more than just their natural competitors. For example, consider evaluating companies in other industries that are similarly sized and have similar growth needs or best-in-class innovators. (For more on this see the page one article "Innovation Archetypes," in this issue.)

3. *Innovate the innovation metrics.*

Any company that installs a batch of metrics needs to make sure that it is willing to constantly update those metrics. Oftentimes the right metrics are only available in hindsight, so by all means, be ready to add, drop, and change any metric you adopt. Changes shouldn't happen speciously, but a regular process to evaluate the evaluation process can maximize its usefulness.

4. *Gain alignment up and down the corporate chain.*

It does no good for a business unit within a conglomerate to adopt metrics that differ markedly from those in the head of the con-

glomerate's Chief Financial Officer. The unit that tries to push in new directions will ultimately find itself pulled back to the corporate path. Hold workout sessions to build alignment throughout the corporate chain.

Summary

Following the steps described here can help companies implement a series of innovation metrics that can give them greater clarity into their innovation efforts. The right metrics can help align managers in ways that ultimately increase a company's odds of developing a robust, well-balanced innovation portfolio.

One simple way to get started is to sit down with a colleague to catalog the metrics that your company currently uses to track innovation. Can you and your colleague see signs that you are running into one of the metrics traps discussed in this article?

To get more people involved in the process, consider holding a brainstorming session to identify the key barriers to innovation at your company. Try to identify metrics that could focus attention on overcoming the barriers. As you progress, remember to think as holistically as possible about innovation: Multi-faceted problems require multi-faceted solutions. ♦

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Steven Fransblow, an Innosight senior associate, contributed to this article. This article is adapted from the forthcoming book "*The Innovator's Guide to Creating New Growth Markets*." It will be published in 2008 by the Harvard Business School Press.

Reprint # 050401B

Business Model Innovation

Many of the most celebrated new growth innovations have succeeded when companies have learned how to move beyond focusing only on product and process innovation

BY MARK JOHNSON AND JOSH SUSKEWICZ

When Amazon.com emerged as a new entrant in the bookseller space, analysts cited its enormous inventory as a core advantage. Retail outlets, bound by the limits of floor space, could never compete with the millions of titles. The young technology behind online retailing was trumping years of careful market analysis and predictive stocking algorithms.

The magic that has powered Amazon.com to an \$11 billion market capitalization, however, was not in the Internet. Dozens of online retailers failed, as unlimited inventory does not naturally result in competitive advantage.

The true source of Amazon's success was in its business model innovation, leveraging technology to profit not from the sales of books but from the timing of payments. Amazon collects on its accounts receivable weeks before it pays its suppliers, and, taking a page from the financial services industry, creates profit from the float. Business model innovation, not technological innovation, created sustainable advantage for the new entrant into a centuries-old business.

Companies are increasingly seeking to find new innovation levers beyond product innovation (adding a new blade to a razor) or process innovation (Six Sigma programs). True business model innovation—exemplified by clear triumphs such as Southwest Airlines,

Apple iTunes, and WalMart—has created astonishing growth in many industries. While a 2006 IBM survey found that 30 percent of CEOs say business model innovation will be crucial in the next eight to 10 years, we have found that only about 10 percent agree actually undertaking such innovation efforts.

Business model innovation can clearly impact long term company success. Yet important questions remain unanswered. What is business model innovation? For that matter, what defines a business model? Innosight and SAP have conducted extensive research to demystify and explain the complex dynamics driving business model innovation.

While there are lots of definitions of business model innovation, many are either too broad to be actionable or too limited to be useful. Through our research, we have attempted to create a concise yet comprehensive definition that can help business leaders actively pursue, execute, and transform their firms and their industries.

A business model is the foundational architecture of a business, describing in sum how a number of key pieces of the business system fit together. The business model should be viewed as a part of an overall business strategy, but it also is a unique category of management discipline—related to, but distinct from, competitive strategy,

product and process innovation, operations, and organization.

At the most basic level, a business model consists of four interlocking, interdependent components. These components are:

- The customer value proposition that defines the product(s) and/or service offering(s) an enterprise delivers to its customers at a given price
- The profit system or company value proposition that an enterprise employs to deliver economic value to its stakeholders
- The key resources a company deploys to create value
- The critical processes that guide and shape operations, leveraging key resources in delivery of the value proposition to the customer and value proposition to the company

This definition highlights three questions that companies should ask to spot seemingly invisible opportunities for business model innovation.

1. What else can we sell?

In an increasingly complex world of outsourcing and supply chains, companies are finding that, apart from their core business, they have developed strengths in supporting areas that meet or exceed the best industry benchmarks. The

collaborative research between SAP and Innosight highlighted repeated examples of companies that isolated those strengths and found ways of monetizing them.

Amazon.com, having built up a broad customer base, started leasing its virtual real estate to other vendors, trading on the branded asset it developed. This new line of revenue was a business model innovation for the firm. DHL, having developed an exceptional competency in logistics management, started selling those services to its customers. Again and again, companies are finding that they can transform strengths in what appear to be “cost centers” into flourishing lines of business.

What back-office processes is your firm able to handle exceptionally well? Are there cost centers that could be turned into profit drivers? Can an organization be built to monetize them?

2. How else can we sell it?

In some industries, the sales model is driving widespread transformation. The media and advertising industries are in the throws of change as the combined threats of increased piracy, dropping barriers to entry, and new delivery models challenge sales of music, movies, and written content.

In other industries, individual companies are driving this change. Hilti, the Liechtenstein manufacturer of relatively-small construction tools, is increasingly leasing its tools, bundled with maintenance, insurance, and replacement service offerings, for a monthly fee.

Look at how your customers want to buy your product, their

sensitivities to variable and fixed costs, and what additional goods and services could be bundled.

For example, consider how discount retailers have disrupted department stores. Traditional department stores earned gross margins of about 40 percent and turned over inventory three times per year, for a 120 percent return on capital. Discounters came in with a low-cost business model that supported gross margins of about 20 percent and turned inventory six times per year. The discounter is achieving the same return on capital, but is doing so with an entirely different business model.

To begin, find areas where your firm can augment a basic product sale into a partner-friendly solution. There may be alternatives that better suit your and your customers' needs. In what contexts are your customers using your products? Are there services, financial support structures, or delivery mechanisms that might alter your value proposition to those customers?

3. Can we change the profit system?

Traditionally, firms cut costs, and try to grow market share in order to drive growth. However, there are other, more fundamental, ways of altering the profit structure of a firm. With much lower overhead costs, newly established ventures or groups often generate profits at significantly lower dollar revenues per unit sold. Or, companies can manipulate the resource productivity of their key assets, turning around inventory faster or using fixed assets more efficiently.

Countless examples of this sort

have emerged, among them the case of Xiameter, a business unit of Dow Corning created to sell large quantities of basic silicone at market-prices online. This low overhead/low margin channel differs dramatically from the high touch/high overhead model that bundles silicone with services and support. Together, the two business models support Dow Corning's position in the silicone market.

In the consumer space, MinuteClinic, a recent CVS acquisition, shifts the profit model associated with basic medical care by providing basic services like flu shots and strep tests at the local drugstore, administered by a nurse practitioner. With lower overhead than a doctor at a medical office and lower prices to the insurance company or individual payer, MinuteClinic trades convenience and accessibility to the patient for a tidy profit.

What assumptions have you made about your current profit model? Is it possible that some of these can be manipulated to create new types of profits?

Circumstances that often require business model innovation

Emerging trends and the role of business model innovation can create tremendous growth opportunities for those that adapt their strategy efficiently and execute business model innovation successfully, whether through organic growth or acquisitions. Some of the signs can be from threats (current business theories no longer work), while others signal opportunities to fulfill unmet jobs. The trends that senior executive shouldn't ignore include:

1. Mature markets whose products are on the verge of commoditization

The forces of globalization and increasing customer sophistication are pushing more and more products to commoditization. Going from a specialized, high-end business model to a mass-production, low-end model can be excruciating. Think of the travails of PC makers such as Compaq (now part of Hewlett-Packard) and Dell, and consider how, in contrast, Apple transitioned to the iPod.

Many product companies are not only creating high-value services for revenue and profit growth, but are also wrapping these services in entirely new business models, such as charging for cubic-feet of cooled air rather than for an air conditioner and service.

2. Disruptors democratizing or decentralizing products and services

As globalization opens up new markets and advancing technology enables the consumption of formerly complex products by less sophisticated end-users, companies in industries as varied as software, defense, healthcare, and consumer packaged goods are coming under pressure to innovate their business models to tap into new growth.

A clear sign that business model innovation is needed is when competitor's develop new, disruptive businesses in your industry. Enterprise software companies, for example, are targeting small businesses to find growth beyond the crowded corporate market, and retail health centers like those operated by MinuteClinic are moving basic care from the doctor's offices into more consumer-friendly settings.

4. Harnessing new technologies

Entry of new customers in the global market and increased market transparency enabled by enhanced access to information has triggered a tectonic shift of power to the customer. Many companies fail to reap benefits from technological developments because they attempt to fit them into an existing business model. Often new technologies require entirely new models. For example, many print media companies have thus far failed to exploit the power of the Internet and are struggling to replace revenue lost from the migration to the web.

Explore the Alternatives

There is little doubt that business model innovation can clearly impact the long-term success of a company. CEO surveys show that innovation in business models is rapidly becoming as or more important than product and service innovation as a driver of competitive advantage and growth.

Our ongoing research will continue to study these transformations to isolate drivers and enablers, such as flexible information technology and organizational structures, to lend predictability and enable growth through business transformation. But what we have learned thus far has already colored our strategic thinking: Understand your business model, your peers, and your competition. Don't be afraid to explore the alternatives. And find ways to profit from your hidden strengths. ♦

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Reprint # 050414A

INDEX

3M	6
AirCell LLC	4
Amazon.com, Inc.	14
Apple	5,6,13,15
APQC	1
AT&T	4
Best Buy	6
Boeing Company, The	4
Booz Allen Hamilton	10
Boston Consulting Group	11
Carphone Warehouse Plc.	8
Cisco Systems, Inc.	16
Compaq	15
CVS Caremark Corp.	15
Dell	15
Deutsche Post	16
Dow Corning Corp.	15
eBay	4
Ford Motor Company	10
General Electric	5
Goldman Sachs	8
Google	1,6
Handirack Ltd.	5
Harrah's Entertainment	7
Harvard Business School	7
Hewlett-Packard, L.P.	15
Hi-Tech Wealth	5
IBM	1,10,12,14
JetBlue Airways	4
Kaplan Test Prep	5
Kodak	2
Linksys	16
MCI	4
MinuteClinic	15
MTC Technologies	8
Procter & Gamble	8,12
Samsung Group, The	7
SAP AG	14
Sony Corporation	6
LM Ericsson	8
Verizon	4
Vodafone Group Plc.	8
Wal-Mart Stores, Inc.	14
WildCharge Inc.	5

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