STRATEGY & INNOVATION
Breakthrough Insight and Ideas for Driving Growth
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Made To Stick: Communicating Your Strategy

Overcome three common barriers to better share information with and get information from frontline employees

BY CHIP HEATH & DAN HEATH

Whit Alexander, a co-founder of Cranium, the company that manufactures the hit Cranium board game, recalls a time that he called a Chinese manufacturing partner to discuss a concept for a new plastic game piece. The piece would be purple and made of multiple parts that would need to be glued together. The Chinese manufacturer balked. "It's not CHIFF," he said. Alexander was astonished. His supplier, halfway across the globe, had just corrected him using Cranium's own strategic language. And the supplier was absolutely right.

CHIFF is an acronym that stands for "Clever, High-quality, Innovative, Friendly, Fun." The CHIFF concept defines Cranium's strategic differentiation in the extremely competitive board-game market. CHIFF informs decisions across the organization, from branding to package design to the content of individual questions. The Chinese manufacturer had chastised Alexander for his kludgy idea for a game piece. Glued-together? That's not particularly "innovative" or "high-quality"; the feel of the piece would be all wrong. The manufacturer came back with novel, smooth design, not only improving the quality, but also making the game piece "Fun."

This is a board-game manufacturing success story. More importantly,

see 'Made to Stick' on page 6

Managing Teams

Structures must support, not thwart, teams tasked with creating new growth

BY SCOTT D. ANTHONY, MARK W. JOHNSON, & JOSEPH V. SINFIELD

Achieving meaningful growth through innovation requires companies to appropriately build, structure, and monitor teams that will be tasked with moving in entirely new directions. When undertaking such endeavors, senior managers have to ensure that internal structures and dynamics support, not thwart, their efforts to create new growth businesses. This requires challenging the prevailing mindsets that so often stand in the way of success.

The art of team formation and management is seemingly fraught

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Incubating Innovation
Is your company considering setting up an incubator to create new growth? Although efforts to create incubators often struggle, we find that taking a deliberate approach that follows three guiding principles can help maximize your chance of success. See page 14

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Voices of Disruption

BY CRAWFORD DEL PRETE

Each issue, we feature a person who is "in the trenches" of disruption. This issue, we speak with Crawford Del Prete, the senior vice president of communications, hardware, services, and software programs for International Data Corporation, a global provider of market intelligence, advisory services, and events for the information technology, telecommunications, and consumer technology markets.

How do you use the models of disruptive innovation in you work?

Every year there are literally hundreds of companies that come through our doors wondering how to invest in their future growth options. There a number of possibilities and potential strategies, but not clear paths.

The theories of disruption are extensible; they work across all types of businesses. If you know them well, they can be a clarifying force when dealing with some of these classic strategic struggles.

Pattern recognition is also an important element. The more familiar one is with the theories, the easier it becomes to see how an innovative new area is likely to develop. It's a very helpful way to distill through a set of strategies.

What are the challenges of bringing the theories to people who are unfamiliar with them?

Since I first began using the theories, one of the most common mistakes I see is people confusing a "disruptive technology" with the concept of disruptive innovation. *The Innovator's Solution* and later works were a turning point in explaining the differences.

With my analysts, I often use the example of Dell. From its direct-to-consumer origins, using direct mail and the telephone, Dell was a disruptor. But most people look back and see the evolution of the Internet and think, "Wow, Dell really succeeded through this disruptive technology called the Internet." In fact, the Internet was *sustaining* to Dell. It helped them to more cheaply and efficiently do what they were already doing.

It's a good example because it shows one thing: It's all about the business model. That's where true disruptions take place.

Do you encounter a lot of misapplication of the models?

Well, there are a lot of muddy areas between those who have spent time really studying the theories and those who assume they just "get" disruption.

In many ways, the concepts seem intuitive, but there's a lot of nuance that needs to be understood. The most dangerous people are the ones who have read the first half of *The Innovator's Dilemma* and then decided they understood all of the concepts and models.

For these people, everything becomes a low-end disruption and they'll go around calling things low-end disruptions even when there's not an existing market to

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unlocking new market growth

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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disrupt. Unfortunately, in that situation, the only tool you have to use is a hammer and, before you know it, every problem looks like a nail.

Do you have an example of how this has confused some people's thinking?

People get confused constantly, if they've not spent the time to learn about the models. Think of a classic "disruptive technology" like inkjet printers. I remember all sorts of people running around saying, "Inkjet just *is* disruptive to laser printers." They didn't want to hear anything else about it. In their mind, it just made sense: This is a low-end disruption.

Well, from an end-user's perspective, it was disruptive. But you have to go beyond that to think about why inkjet was brought to market and when it was brought to market.

From a purely technical point of view, inkjets might feel like a really disruptive technology, but what about from a business model and incumbent perspective? In that view, inkjet was sustaining to a leader like HP. And that's an important thing to be able to see clearly.

As another example, consider how the so-called "software as a service" market has developed. Back in 2000-2001, a lot of people were calling that a low-end disruption, as well. All sorts of people thought, "This is great. Everyone will buy this. It's cheaper; it a service."

But, in fact, all of these ASPs (application service providers) were actually rushing to modularize something that was still highly interdependent. At the time, there were no standards for data, so there was no guarantee a company would be able to use the data offline in the ways they would desire. And, the whole broadband adoption and availability was not in place to make it function really well.

In other words, the core supporting technologies were not in place. Had more people seen that and understood the implications, there might have been a much better view of how the market would develop.

How are the companies that you work with starting to confront these challenges?

We're often dealing with multiple, different parts of a business, which makes for an interesting situation. On the one hand, a company very much *wants* sustaining innovation. If you're speaking with a core business unit, these types of projects are highly valued.

On the other hand, though, a company *needs* disruptive innovations to fuel it's future growth. Without these innovations, the company's future will not be bright.

So, ultimately, these two forces—and sometimes groups within a company—are in competition with each other. From a CEO's perspective, these things need to be balanced and learning more about how to use the models is really helpful in starting to do this.

How have companies' approaches to innovation changed?

Primarily, I think that there's been a move away from the old IBM Yorktown labs or the AT&T and HP labs. This model—have all of our "innovative" people in white coats in one location—doesn't work. Companies are realizing it's about partnerships, community, customers, and a broader array of the workforce.

Are companies learning how to self-disrupt?

That's very hard. Companies can't just go mountaintop to mountaintop and never go through a valley. But shareholders are so demanding now that I worry that they just want to have a big hit, go on a long run, wait until the company is red hot, and then pull the pin. Sell and get out.

The problem with this is how does long term innovation happen? How do great ideas get the resources and context they need to succeed?

It will be very interesting to watch how this evolves. A number of companies—IBM, HP, Xerox—are starting to take different approaches to figuring out how to have both sustaining and disruptive efforts. Can you self-disrupt and never have a blip in the topline? You probably can't.

But not going after disruption doesn't work. Some companies just keep doing what they're doing and end up getting thrashed. Some rot from the inside, as all innovative ideas wither up.

A few companies, like Seagate in the 1990s, have taken what I'd call the Brave Model. Seeing significant structural problems in their ability to innovate while public, they end up going private. Then they can make the hard choices that one can't make when managing for the next 12 weeks.◆

Reprint # 050502A

Innovators' Update: Skype Out?

In 2005, we praised eBay's $2.6 billion purchase of Skype. What has happened since?

Each issue, we'll take a look back at a past Innovators' Insight to see how our analysis has held up. In this issue, we look at Insight #45, "Let Disruption Ring." The insight suggested that eBay had made a wise move in acquiring Skype. Here, we revisit the assumptions we made when we praised eBay's purchase.

When eBay acquired Skype for $2.6 billion in 2005, we praised the acquisition. We pointed to the fundamental disruptive potential of Skype's Internet-based telephony solution, how eBay users might embrace using Skype instead of email to communicate, and the potential for eBay to use Skype to move into new businesses like lead generation.

We did raise one cautionary note: With a $2.6 billion price tag, eBay was paying a pretty penny for Skype's disruptive potential. As we noted, "eBay's acquisition might have been even sweeter if it had acted last year when Skype's price presumably would have been sharply lower."

In early October, eBay announced it was taking a $1.4 billion charge related to the acquisition. $500 million of this was a payment to some of Skype's shareholders and management team, including founder and CEO Niklas Zennstrom, who has stepped down as CEO but will remain involved as Skype's executive chairman.

The other $900 million was an "impairment charge"—eBay admitting it simply paid too much for Skype. Even Zennstrom admitted that eBay might have "overshot in terms of monetization."

The write-down didn't affect eBay's stock—most analysts had already assumed the acquisition was overpriced—but analysts used the news as an opportunity to castigate eBay's failure to find new growth as its core auction model slowed (eBay's stock has been essentially flat for the past four years).

Skype has had some successes over the past 24 months. Analysts estimate that revenues have grown from about $60 million in 2005 to north of $300 million this year. Skype has more than 200 million registered users (though analysts estimate that only about 50 million actually *use* Skype). Despite the positive developments, Skype's performance hasn't been enough for eBay to justify its price tag.

What went wrong? Three key developments we expected have not occurred.

First, Skype has not created as compelling a stand-alone business model as eBay had hoped. While users continue to revel in Skype's simple, cheap, convenient service, the company hasn't yet figured out a breakthrough business model to monetize that user interest. Skype calls between computers are free, so the majority of Skype's revenues come from charging users modest fees to call landline phones, a relatively low-margin offering.

Secondly, eBay's users have not embraced Skype as they embraced Paypal, another eBay acquisition. When eBay paid $1.5 billion for the payments provider in 2002, it was the de facto payment mechanism for eBay purchase. It seems eBay's users were largely satisfied with the ability to communicate by email.

Finally, eBay has been unable to move into lead generation. Two years ago, one rationale for the merger was eBay's potential to use Skype to help broker connections between consumers and local service providers, such as handymen and plumbers. Emerging providers like Angie's List and ServiceMagic have begun to generate traction in this space, but eBay has made no obvious headway—yet.

It is also possible that Skype didn't have the right management team to address these issues. Zennstrom is a restless explorer who pioneered music sharing site KaZaA and emerging video provider Joost. Often, *exploiting* an opportunity requires a team that has different skills from the team that *created* the opportunity.

Not every acquisition or innovation turns out to be successful. While PayPal and StubHub (a ticket broker recently purchased by eBay for $310 million dollars) appear to be successes, Skype looks like a disappointment.

But do not close the door on Skype just yet. Many disruptive businesses go through several iterations before they discover a compelling business model. If eBay allows Skype to continue to experiment (some suggest social networking or advertising), the winning model might well emerge.◆

Reprint # 050504A

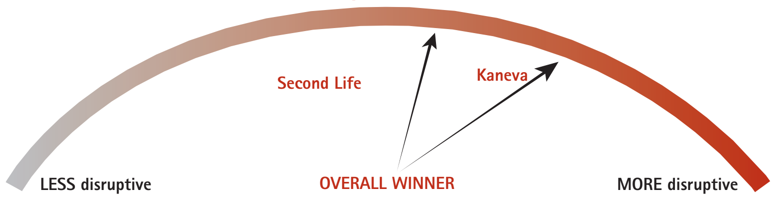
Disrupt-O-Meter

Tale of the Disruptive Tape: Second Life vs. Kaneva

"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 solutions in the nascent virtual worlds industry.

Virtual worlds are stand-alone computer applications in which users create fantasy creatures or avatars—animated 3-D versions of themselves—who move about the "world" interacting with others. Business activities in virtual worlds include everything from corporate training to e-commerce. Industry watchers project big growth: By the end of 2011, 80 percent of active Internet users (and Fortune 500 enterprises) may participate in virtual worlds. Second Life, a well-established world, and the newer Kaneva are taking differing approaches. Which is more disruptive?

Disrupt-O-Meter



SECOND LIFE		KANEVA	
Users with a high level of technical proficiency and a do-it-yourself mentality	CUSTOMER	Less tech-savy consumers desiring easier-to-use online social networking tools	WINNER
Open-source application requires users to manage and create their own online properties	SOLUTION	Simpler, pre-packaged environment helps users interact and sell virtual goods online	WINNER
Revenue comes from memberships, real estate, ads, and "Linden" currency exchange (TIE)	BUSINESS MODEL	Users can purchase online real estate; companies can create plug-and-play partnerships	TIE
Complexity of the offering may limit the size of the ultimate user-base	COMPETITIVE LANDSCAPE	Application's straightforward, structured nature more likely to attract partners and consumers	WINNER

More Disruptive: Kaneva. Both virtual worlds compete with TV and 2-D Internet for consumers' time and attention to advertising messages. Kaneva's solution is more disruptive because its simpler approach will enable consumption by a larger group of consumers looking for a straightforward means of networking and interacting online. Also, its business model complements existing developments: the largest virtual worlds today—controlled environments like Club Penguin and Webkinz—are aimed at kids, who are more likely to "graduate" to Kaneva than to Second Life. Currently, a big barrier to widespread adoption of virtual worlds is the need to download new software and create a new avatar for each world. Those that open their interfaces and enable more of a plug-and-play approach, as Kaneva does, will likely be the winners. ◆

Reprint # 050505A

EMERGING TECHNOLOGY WATCH

Here Comes the Sun

A number of companies are beginning to make progress commercializing organic photovoltaics—solar cells made from plastic as opposed to silicon. These light, flexible cells are efficient across a much broader spectrum of light than the silicon cells used in rooftop panels, drawing power both from the sun and from indoor light sources. Cambridge, Mass.-based Konarka Technologies recently announced a partnership with Air Products to make windows that generate solar electricity. Iowa-based PowerFilm has been supplying flexible solar-panel shelters and tents to the US Army for several years. It also supplied the solar panels for the Eclipse Fusion Solar messenger bag, which won the innovations award at the 2006 Consumer Electronics Show. Texas-based Eclipse also offers other solar-powered bags, including backpacks and laptop cases.

Straight from the Heart

Radar technology developed by Honolulu-based Kai Sensors can detect and monitor multiple subjects, even through walls, based on their heart rate. The emerging technology has been picked up by the Army to use in searches and interrogations. The same technology, LifeReader, could be used to remotely monitor patients' heart and respiration activity wirelessly—potentially easing the diagnosis and monitoring of a variety of health conditions. The technology could be used in cars, as well. For example, medical information about passengers involved in an accident could be sent to emergency responders or an on-board system could detect a driver showing signs of fatigue.

Water, Water Everywhere

The AltelaRain system, developed by New Mexico-based Altela, can produce clear, drinking-quality water from a briney stream using a thermal distillation process. Altela has come up with a way to make this process energy efficient and modular. An entire unit that produces 250 gallons of drinkable water per day fits into a 20- by 40-foot shipping container. By placing multiple units together, a water treatment system can be created, allowing companies to build in areas that have little or no water or to get off the water "grid." The system can also be used to clean heavily polluted water. With water shortages looming worldwide, Altela is one of a handful of companies working on water technologies. Others include NanoH20, of Los Angeles, CA, and Israel-based Atlantium.

Reprint # 050505B

though, it is a *strategy* success story, because the executives of Cranium developed a way to communicate a crucial element of the company's strategy—its differentiation—in a useful, comprehensible way. "CHIFF" is simply a very clear, very actionable statement of strategic differentiation. Cranium employees, suppliers, and channel partners all use CHIFF to make hundreds of on-the-ground decisions that defend Cranium's competitive differentiation.

Let's face it—there is no clearer proof that a strategy has been communicated properly than when a manufacturing supplier, in another country, with a different native language, uses it to correct (rightly) the founder of the company.

What makes CHIFF work? The secret isn't the acronym. And it isn't a solution that's unique to the board-game industry. The secret is that it respects the principles that make ideas "sticky"—understandable, memorable, and effective in changing thought or behavior.

These principles can be used to transform the way strategy is communicated within a firm. When pursuing disruptive innovation, in particular, a company's strategic intent is likely to be vastly different from previous modes of thinking, making clear communication that much more important.

Talking strategy effectively

A strategy comes to life through its ability to influence thousands of decisions, both big and small, made by employees throughout an organization. A strategy is, at its core, a guide to behavior. A good strategy drives actions that differentiate the company and produce financial success. A bad strategy drives actions that lead to a less competitive, less differentiated position.

A lot of strategies, however, are simply inert. Whether they are good or bad is impossible to determine, because they do not drive action. They may exist in pristine form in a PowerPoint document, but if they don't manifest themselves in action, they are irrelevant.

To understand the problems that can render a strategy inert, it's useful to review how the process of strategic communication is supposed to work. The leaders of the organization, those at the top of the pyramid, so to speak, have the best macro view of the organization and where it's headed. They are in the best position to pick a strategic direction.

Next, the people who populate the base of the pyramid must understand the strategy and make decisions that put it into practice.

Finally, the frontline people, who will always have more recent and accurate information about what competitors are doing and how customers are responding, must be able to have a conversation with the leaders about the company's strategy.

There are three nasty barriers, however, to successful communication of this kind. The first is called the "curse of knowledge," and it plagues leaders' attempts to share the strategy with the frontlines in a useful manner.

The second barrier, a result of insufficiently clear strategy statements, is called decision paralysis, and it causes delays and confusion on the frontlines.

The final barrier is the lack of a common strategic language—in other words, the frontline people are gathering useful information, and the top leaders are keen to hear it, but the two parties don't communicate effectively because they're using incompatible vocabularies.

Fortunately, there are ways to overcome these three barriers, solutions that may seem a bit counterintuitive at first, but that are quite easy to implement once they are understood.

The 'curse of knowledge'

The "curse of knowledge" is best illustrated by a psychology experiment conducted in 1990 by a Ph.D. candidate named Elizabeth Newton at Stanford University. Newton designed a simple game in which she assigned people to one of two roles: "tappers" or "listeners." Tappers received a list of 25 well-known songs, such as "Happy Birthday to You." Each tapper was asked to pick a song and tap out the rhythm to a listener. The listener's job was to guess the song based on the rhythm being tapped.

Over the course of Newton's experiment, 120 songs were tapped out. Listeners guessed only 3 songs out of 120, a success ratio of 2.5 percent.

But, here's what made the result worthy of a dissertation in psychology. Before the listeners guessed the name of the song, Newton asked the tappers to predict the probability that the listeners would guess correctly. They predicted that the probability was 50 percent.

The tappers got their message across one time in 40, but they thought they were getting their message across one time in two. Why?

When a tapper taps, she is *hearing the song in her head*. It is impossible for the tappers to avoid hearing the tune playing along to their taps. Meanwhile, the listeners can't hear that tune—all they can hear are a bunch of disconnected taps.

In the experiment, tappers are flabbergasted at how hard the listeners seem to be working to pick up the tune. *Isn't the song obvious?*

The problem is that the tappers have been given knowledge (the song title) that makes it impossible for them to imagine what it is like to *lack* that knowledge. The curse of knowledge makes it difficult for us to share our knowledge with others, because we can't readily re-create the state of mind of our listeners.

'The 'curse of knowledge' afflicts many executives trying to communicate their strategy

The curse of knowledge afflicts many executives trying to communicate strategy: They speak as if they themselves are the audience, and they tend to formulate the strategy in language that is sweeping, high-level, and abstract. *The most efficient manufacturer of semiconductors! The lowest-cost provider of stereo equipment! World-class customer service!*

Top executives find abstractions almost irresistible. When a CEO discusses "unlocking shareholder value," there is a tune playing in her head that the employees can't hear. What does "unlocking shareholder value" mean for how I treat this particular customer? What does being the "highest-quality producer" mean for my negotiation with this difficult vendor?

Executives can't unlearn what they know, but they can thwart the curse of knowledge by "translating" their strategies into concrete language. Stories work particularly well in dodging the curse, because they force us to use concrete language—there aren't many stories drowning in abstractions.

A good strategy should guide behavior, and a story can work better in this role than the standard boilerplate mission-speak. At Costco, as described in the book, *Around the Corporate Campfire*, by Evelyn Clark, people talk about "salmon stories." In 1996, Costco was selling nearly $200,000 of salmon a week at $5.99 per pound. Then, according to Costco co-founder Jim Sinegal, buyers "improved the product [by removing belly fat, back fins and collarbones] and lowered the price" to $5.29.

But the buyers weren't finished. They subsequently negotiated for salmon that had the pin bones and skin removed, and lowered the price of this higher-quality salmon to $4.99 a pound. With the lower prices driving sales, Costco began to place big orders directly with salmon farms, taking the price down to $4.79.

The point? Costco stands for the relentless pursuit of ever-increasing quality at ever-decreasing prices. "Salmon stories" provide a brilliant way to communicate the company's competitive advantage.

As a matter of fact, Sinegal says, "We've used that story so much as a teaching tool that I've had other buyers in the company, such as a clothing buyer in Canada, come up to me and say, 'I've got a salmon story to tell you.'"

Two paragraphs back, you came across the sentence, "Costco stands for the relentless pursuit of ever-increasing quality at ever-decreasing prices." Note that the sentence works as a summary of the salmon story. But here's the counterintuitive part: it doesn't stand alone very well without the story. The abstract statement is powerful and profound only to an executive *who has internalized years of salmon stories*; It is dry and vague to someone who doesn't have access to those same experiences. (Decreasing prices over what time scale? What if you can't decrease the prices and maintain the same level of profitability?)

Stories that speak to an organization's strategy have two parts: the story itself, and the moral. It's nice to have both, but if you have to choose between the two, choose the story. Because the moral is implicit in the story, but *the story is not implicit in the moral.* And the story—with its concrete language, specific protagonists, and real-world setting—is more likely to guide behavior.

Both stories and concrete language help leaders dodge the curse of knowledge, and everyone in the organization benefits from a shared understanding of the strategy.

Decision paralysis

Most people in an organization aren't in charge of formulating strategy, they just have to understand the strategy, internalize it, and use it to make decisions. But many strategies are not concrete enough to resolve a well-established psychological bias called Decision Paralysis.

Psychologists have uncovered situations where the mere existence of choice, even choice between several good options, seems to paralyze us in making decisions. A study, conducted by Eldar Shafir, a psychologist, and Donald Redelmeier, a physician, in the *Journal of the American Medical Association*, shows that even experienced decision makers can be paralyzed by choice.

Shafir and Redelmeier presented doctors with a medical history describing the condition of a 67-year-old man. He was experiencing chronic hip pain because of arthritis. Doctors had tried several drugs to treat the pain, but had stopped because the drugs either didn't work or produced serious side effects. An alternative to prescribing drugs would be to refer the patient for hip replacement surgery, which could solve the problem permanently. On the other hand, hip replacement is a difficult surgery that often involves three or more months of recovery.

Before the doctors could opt for the referral for hip replacement surgery—which seemed the sole remaining hope—they discovered that there was one other medication that had not yet been tried. The doctors in the experiment were asked: Would you write the referral or try the additional medication? Forty-seven percent chose to try the medication before surgery.

Another group of physicians saw the same patient history, but they discovered *two* additional medications that hadn't yet been tried. Given two options, only 28 percent chose to try either one. Seeing *more* good options made trained physicians *less* likely to choose any of them—something about the presence of multiple options seemed to make doctors freeze rather than act. Why? When decision options multiply, they leave people numb and inactive.

When people are able to talk effectively about strategy, they're more likely to set priorities appropriately

Every organization is forced to make choices among attractive options: customer service versus cost minimization; revenue growth versus maximizing profitability; quality versus speed to market. Fold together many of these tensions—an atmosphere full of potential opportunities and risks and uncertainties and incomplete information—and you've got a recipe for paralysis.

How can strategy liberate employees from decision paralysis? When people are able to *talk effectively* about strategy, they're more likely to set priorities appropriately than when strategy only exists as a set of rules. Frontline employees want to do the right thing, and most of them find it quite easy to decide between the right thing and the wrong thing. The problem is deciding between the right thing and the right thing.

The hardest decisions, after all, are the ones where we must decide between two good options. Consider the Costco salmon story. If you're selling scads of salmon at $5.99 per pound, and subsequently you secure a supply of higher-quality salmon at a lower price, what do you do? You know that there's enough demand for the salmon to exhaust your supply at the $5.99 price point. So do you maintain the price (or even raise it) to deliver a better bottom line for shareholders? Or do you cut the price to maintain your focus on value for customers? This is a choice between two good options.

To make such a choice, you need an index of priorities, and the salmon story provides it. The salmon story is a statement of competitive advantage that drives home the message that Costco's priority is the customer over the shareholder. (Or, to be more precise, long-term customer value over short-term shareholder profits.)

Lack of a common language

According to the classic 1950s models of communication, a "sender" communicates with a "receiver." The metaphor suggests that the message that is passed is a kind of package, wrapped up on one side and unwrapped on the other. Should strategic communication work this way?

Absolutely not. Good strategic communication facilitates discussion among people who have different native "languages." Employees rely on leaders to define the organization's game plan. Leaders rely on employees to tell them how the game is going. For this dialogue to work, both sides must be able to understand each other. This is easier said than done.

Strategy is often articulated in a way that makes it hard for employees to talk back to leaders. For instance, imagine if Cranium's stated strategy had been "To be the #1 provider of engaging tabletop entertainment." On what grounds could the Chinese manufacturer state an objection? The strategy is so high-level, so abstract, that it would make you feel foolish to talk back. What could the manufacturer say? "Using this glued-together piece will threaten our #1 provider position"? Doubtful.

One interesting case study in creating a common language comes from British Petroleum (BP). In 1991, BP set out to reduce exploration costs dramatically. Traditionally, the costs of unsuccessful drilling—or "dry holes," in industry parlance—were thought of as the inevitable costs of doing business. It was a mindset akin to that of venture capitalist: invest in ten companies in the hopes that one or two of them will be mega-successes that provide a nice return on the fund as a whole. But the costs of drilling were high. A small well might cost $4 million to drill, a large one $40 million.

Then, Ian Vann, the head of exploration at BP at the time, hit upon a way to articulate a new vision for exploration: "No dry holes." Instead of a dry hole being a normal, acceptable part of doing business, a cost that was expected in the majority of expeditions, a dry hole should be considered a sign of failure.

This new statement of strategy, "no dry holes," had a notable effect on the behavior of both the explorers and top management at BP. The former balked initially, because explorers liked to *explore*. But as they learned about "no dry holes," they started taking off their explorer hats and putting on their geologist hats: Was the right substrate available to form oil? Was there a basin to contain the oil if it formed? Could subsequent events have degraded the oil?

The conversation around "no dry holes" prompted explorers to become more systematic about aggregating their information. They began to color-code maps—green for features that might support an oil field, amber for areas where information was missing, and red for clear counter-indications. They overlaid the maps and drilled only in regions that were green on every conceivable dimension.

The language used by management in discussions also shifted. Before "no dry holes," BP tended to rely on Expected Monetary Value (EMV) to talk about decisions. As an analytical model, EMV is flawless, but the assumptions feeding the were subject to manipulation. "No dry holes" created common ground that brought more people into the conversation, shifting the strategic conversation from numerical risks to geological risks.

"No dry holes" is a great example of strategic communication. It was formulated in order to create a competitive advantage for BP against other energy companies. And it was communicated in a way that made it effective as a guide to behavior. Notice the concreteness of the phrase and the way it easily overcomes the curse of knowledge.

But "no dry holes" also had a more subtle effect—it established a shared strategic vocabulary that allowed employees to talk back to leaders effectively. The strategy had changed in a way that gave them an equally credible voice in the decision. It's easier for frontline employees to object to management decisions, and vice versa, when everyone can use the same language to communicate.

"No dry holes" allowed BP employees to share a common, concrete purpose. The strategy paid off: By 2000, BP's hit rate was an astonishing two in three. This created a formidable strategic advantage for the company against its competitors, and the savings in the cost of exploration went straight to the bottom line.

Three keys to sticky strategies

The trick to talking strategy successfully is to make your ideas sticky. Our research indicates that you can ensure effective—and sticky—communication about strategy by following three straight forward principles: use concrete language, highlight the elements of a strategy that are *not* intuitive, and tell stories.

A strategy that is built into the way an organization talks *cannot be inert*. If your frontline employees can talk about your strategy, can tell stories about it, can talk back to their managers and feel credible doing so, then the strategy is doing precisely what it was intended to do—guide behavior.◆

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with even more unpredictability than even the knottiest technological problems. Six Sigma principles suggest, for example, that a company should tolerate an error rate of less than one percent in its manufacturing processes. Yet, most managers will admit that one in four hiring decisions ends up being a mistake.

In short, forming and managing teams is a critical invisible barrier that makes it difficult for even the best-run incumbents to realize their innovation potential.

How, then can senior managers make the right decisions about how to set the right objectives for a team, staff it for success, and interact with the team in the most positive and productive way?

Setting a team up for success

Chapter 10 of *The Innovator's Solution* describes the importance of "initial conditions." If you start a project team in the right set of initial conditions, the right answers are readily apparent to the team. If you start a project team in the wrong set of initial conditions, the right answers can be hard to see. The wrong initial conditions can lead to a dysfunctional team that finds it difficult to make progress.

Unfortunately, most organizations don't have a standard way of creating and chartering project teams that move in disruptive directions. Our experience suggests that senior leaders seeking to set a team up for success should create a team charter that spells out objectives and degrees of freedom, then staff the team with managers who have the appropriate "schools of experience."

Establishing objectives and defining degrees of freedom

Teams chartered with creating new-growth strategies desperately need guidance about their objectives and degrees of freedom. Left to their own devices, teams often assume they can do things that they can't, layering on risks that the company is not willing to consider. Worse still, they can assume they can't do things they can.

Teams that fall into this trap end up creating unexciting growth strategies that are too close to the core. A lack of clarity about objectives and degrees of freedom can leave teams paralyzed, or cause them to spend valuable time analyzing an unimportant issue.

To address this, we suggest creating a team charter: a simple, one-page document that helps the team set off in the right direction.

Start that charter with the team's objectives. You might not know what the ultimate successful growth strategy will be—in fact, the odds are high that your first strategy is wrong in some meaningful way, but you should have a good sense of your overall strategic objectives.

Perhaps you are trying to develop a new growth opportunity in an identified adjacent market. Maybe you are seeking to find a way to leverage a particular technology in a new way. Regardless of the objective, we have found it helpful to summarize the team's strategic objective in a simple sentence.

Following that sentence should be a description of what the team can unquestionably do, what it can consider doing, and what is off the table. It can be helpful to consider the following dimensions:

Which customer group can we target? If we are a consumer-focused company, can we consider business customers? If we are a business-focused company, could we consider targeting consumers? If we target large companies, could we target small ones?

Which distribution channel can we use? If we typically use a retail channel, could we consider going direct? If we typically use mass channels, could we consider using niche ones?

What revenues do we have to reach at steady state? Is it $100 million? $50 million? When is steady state?

What is the offering we will provide? If we typically sell products, could we sell services? If we typically sell services, could we sell products?

Which brand will we use? Can we consider creating a new brand?

How will we make revenues? Can we consider new revenue streams? Which types of revenue streams are on and off the table?

Which suppliers and partners will we use? Can we consider using new suppliers? Can we consider outsourcing things we normally do ourselves? Can we consider doing things we would normally outsource?

What tactics will we use? Can we consider acquisitions and partnerships?

What go-to-market approach will we use? Can we consider test markets with preliminary prototypes that aren't perfect?

There are other dimensions that might matter in particular industries. Pharmaceutical companies might want to incorporate perspectives on medical efficacy claims, for example, ranging from perceived benefit to clinical proof. Chemical industries might consider allowable environmental impact, while media organizations may wish to consider advertising reach.

Regardless, the key is identifying what is desirable (what you want), what is discussable (what you will consider), and what is unthinkable (what is out of bounds). Making these parameters very clear up front—and being willing to consider changing them as new information comes in—can help ensure that teams focus on the right activities.

Team managers must be comfortable following novel approaches to understanding consumer needs.

Staffing for success

Beyond creating a clear charter, senior managers need to staff the team appropriately. The challenge in getting the team right should be familiar to anyone inside a large organization. Sometimes, companies try to assemble the "best and the brightest." But these are typically vital cogs of the core engine that powers the company.

While there might be good bench strength and significant processes to ensure the core keeps humming, losing a key line manager can cause the core to stumble in a damaging way. Additionally, the people who are best at running the core business can be the worst at running new ventures.

Alternately, some companies staff new growth initiatives with the "diamonds in the rough." Innovation requires doing things differently, the argument goes, so we're going to get people who think differently. But assembling together a band of misfit toys is unlikely to be the vehicle that drives growth either. These teams can lack the required discipline to move ideas forward. They can also lack the appropriate organizational gravitas to influence internal resources.

Disruptive pursuits almost always involve very different experiences than those that a manager has in the core business. When pursuing disruptive innovations, it is best to select team members who have attended "schools of experience" where they have wrestled with challenges that you can predict the team will encounter.

Although these kinds of challenges are often idiosyncratic, there are certain schools of experience that provide ideal training for managers staffed on disruptive projects. Ideally, managers building a team that is chartered with creating new growth should look for individuals who have:

Dealt with ambiguity. Ambiguity typifies disruptive projects. Managers well-trained to remove ambiguity ruthlessly can be ill-suited for disruptive circumstances.

Confidently made decisions based on pattern recognition and judgment. Many roles require managers to dispassionately make decisions based on the numbers, or fixed rules. Disruption requires intuition, judgment, and the ability to recognize patterns.

Experimented and found unanticipated customers for a product or service. In some companies, identification of market opportunities requires meticulous planning and research. Approaches that appropriately hone in on core opportunities can completely miss disruptive opportunities. Managers must be comfortable following novel approaches to understanding consumer needs.

Utilized a deep network to overcome a barrier or solve a problem. In some organizations, success requires playing by organizational rules: sticking to the chain of command or seeking answers internally. Solving disruptive challenges requires networking to overcome barriers, bending rules in a smart way, and looking outside the company for a possible answer.

Operated in "constrained" environments. Managers who have operated in resource-rich environments have the luxury of patiently following a pre-determined course and carefully analyzing unknowns. In constrained environments, managers must scramble to find success. There are more ways to obtain this experience than working at a cash-strapped startup company, however. For example, managers who have experience in developing economies often have experience in finding creative ways to solve problems.

Demonstrated a bias for action. Many managers carefully and cautiously analyze important decisions and seek to build deep consensus before taking action. This approach is very valuable for critical decisions that affect core operations, but it can paralyze disruptive ideas. Remember, the first strategy is almost always going to be wrong. Seek managers who moved forward even if adjustment was later required.

Identifying critical schools of experience gaps on the team can help inform internal staffing decisions. Additionally, it can highlight the need to pull in outsiders who have had a greater chance of addressing an issue than the internal manager.

To utilize the schools of experience model, ask three simple questions: What problems do we know we will encounter? Who in the organization has encountered this problem? What skills might we need to teach the team?

Seek to match up the problems with managers who have had those experiences. Then look to see who in the organization has addressed those challenges. It is quite likely that the managers who have addressed these challenges are not the typical names that bubble up for high-profile ventures.

The role of senior leaders

It should come as no surprise that senior management has an important role to play when it comes to disruption. For example, an engineer inside a large high technology company that successfully launched a disruptive growth business appeared at a conference with Clayton Christensen a few years ago. The engineer described how that company's CEO was intimately involved in the creation of the startup, working closely with the team and making key decisions.

An audience member piped in, asking: "I am about to launch a disruptive project within my company. I'm not sure if my CEO really gets it. What should I do?"

The response: "I'd leave."

Managers ought to break out of an 'us-versus-them' mindset and use strategic thinking skills to help their team solve problems

While a bit flippant, the response was directionally correct. Without CEO support, the audience member's chances of ultimate success would be quite low. The team would propose things that wouldn't make "sense" to the company. They would run into intractable roadblocks, and ultimately end in failure. Senior managers bent on disruption need to ensure that teams don't fall prey to a host of corporate antibodies.

As more and more companies have adopted stage-gate processes to manage innovation, an us-against-them mentality has emerged. Teams present to senior managers, who then act as gatekeepers, either opening the gate to let projects through or locking it until the team comes back with better numbers or more proof. Such an approach can inhibit an organization's disruptive potential.

It can be useful, here, to think about the difference between how you interact with a television and how you interact with a computer. You "lean back" to watch television, but "lean forward" to interact with the computer. Similarly, senior management can lean back and review core improvements, but must lean forward and roll up their sleeves to work on initiatives for new growth.

If senior managers say they don't have time to do such activities, ask what possible activities could be more important than the creation of the new growth businesses that will power the company's success over the next decade.

Taking a "lean forward" approach ensures senior management involvement in disruptive ventures. Such involvement is crucial because the weight of historical evidence suggests that a great deal of organizational autonomy is necessary for companies to successfully create businesses that are disruptive to their core.

One oft-cited example of this phenomenon is in the retailing industry. Almost every established general merchandise retailer failed to make the transition to discount retailing. Dayton Hudson, based in Minneapolis, created a separate subsidiary called Target. Today people know the name of the subsidiary, not the parent. Other industry leaders, including Hewlett-Packard and IBM, have followed similar approaches to create disruptive businesses.

Of course, any manager knows it is not easy to simply create a separate venture. Why? The factors that make organizations capable of doing some things, makes them utterly incapable of doing others. Disruptive attackers triumph over market-leading incumbents because they hone in on an existing company's liabilities.

It can seem daunting to already-busy managers to allocate time to activities that they typically delegate. Many senior leaders tell us, "I just don't have time to work like this." We respond by asking what possible activities could be more important than the creation of the new growth businesses that will power the company's success over the next decade. After all, presumably senior management got to where they are because they have the most wisdom and strategic insight. There is no better place to apply that wisdom than in the pursuit of growth.

Now, of course senior management can't be deeply engaged in every project a company undertakes. If a project is in a well-known market, it's appropriate for senior management to act as a traditional gatekeeper. Nor should senior managers abdicate their role as decision makers who determine when a team has learned enough to continue moving forward. But if neither the management nor the team knows the answer, senior managers ought to break out of the us-versus-them mind-set and use their strategic thinking skills to help the team solve problems.

Suggestions for teams

Teams seeking to change the way in which they interact with senior management may be daunted by the challenge. There are a number of approaches that can at least begin to change the dialogue between teams and their management.

For example, a team tasked with commercializing a disruptive opportunity could begin by engaging senior management in an assumptions-generation session to illustrate how the team is carefully considering what it doesn't know.

Additionally, the team could invite executives to watch a focus group or customer observation so that senior management can experience the world as the customer does.

Teams can include executives in even some of the earliest stages by, for example, inviting leaders to an ideation or brainstorming sessions so they can feel greater ownership of emerging solutions.

As the team begins to move forward, continue the dialogue by sending short e-mails that provide focused updates on a regular basis. This will give senior management a window into real-time progress and challenges.

When formally meeting with executives, it can be helpful to intentionally limit the number of PowerPoint slides. The team should not let a presentation crowd out a more valuable strategic discussion.

Another approach is to proactively identify an innovation "champion" who can be an organizational advocate to help overcome inevitable hurdles standing in the way of success.

For example, one team in a Fortune 100 conglomerate was working on a game-changing innovation that required close coordination between business units in different countries and an outside technology supplier. The team developed special "hiring criteria," which suggest that the ideal candidate for an innovation "champion" possesses the following relevant skills and experiences:

- Is influential within the different business units
- Has clout with the company's senior team
- Is visionary and passionate about new products and innovation
- Is entrepreneurial, willing to take risks, and willing to do things differently
- Combines business understanding with technical expertise, and is comfortable with new technology
- Has experience working with external partners
- Is willing to dedicate at least one to two days per month (five to ten percent of their time) to the project
- Has accumulated political capital—and is willing to spend it

* * *

Structuring teams for success is a hidden challenge for companies seeking to create disruptive growth businesses. By setting the right parameters, staffing the team appropriately, and involving senior leaders in the right way, companies can dramatically increase their odds of success.◆

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Incubating Innovation: Three Guiding Principles for Success

Without a clear mandate, a defined set of rules, and solid senior management support, corporate incubators are doomed to fail

BY STEPHEN WUNKER

At some point, all companies realize that they need to grow faster to meet their shareholders' expectations and that the core business just isn't going to reach those goals. So, senior management begins to think of new ways to create growth outside the core organization. They may decide to set up an "incubator." What often happens next?

In reality, most incubators fail to live up to expectations. Indeed, a 2002 survey of 300 firms by Arthur D. Little found that only 47 percent of companies believe that their new ventures satisfy strategic objectives. Worse, only 24 percent meet financial objectives.

When done right, however, new growth businesses can in fact generate massive growth. IBM's Emerging Business Organization has produced businesses based on innovative technologies such as Linux, generating over $2 billion in annual revenues. HP has grown its printing business to be the dominant source of its profits.

How can companies avoid the most common pitfalls and make incubators work? Our experience leads us to recommend a planned, deliberate approach, which may surprise readers familiar with disruptive innovation. However, by starting by out defining an incubator's purpose, setting clear rules, and laying key building blocks, companies are more likely to succeed with incubators.

Define the purpose of the incubator to differentiate its opportunities

Failure to define a purpose will result in the incubator team facing many internal—and competing—pressures regarding where to focus efforts and limited resources. For this reason, the incubator needs to have a clear mission and the independence to pursue its goals without undue interference from the core.

Begin by establishing "goals and bounds" that clearly differentiate the types of opportunities the incubator should prioritize from those it should eschew. Surprisingly, putting such constraints on the incubator's innovation efforts can actually lead to superior results, because the team will have clear guide posts on what is within and what is outside of the scope of the company's goals. (To learn more about using a "Goals & Bounds Target," see "Constraining Innovation," *Strategy & Innovation* Nov/Dec 2006.)

Establish clear rules and find the right team leader

The incubator's mandate, and its rules, must be different from the core's, so that the incubator's disruptive ventures can start small and iterate to success.

Unless a very senior executive is a strong advocate, or unless the incubator is created from the beginning with a mandate to be different from the core, the incubator may stumble on standard core rules—that new projects require a full P&L or an explicit internal rate of return, for instance. If these rules apply to the incubator, the company needs to say so up front. If not, the incubator needs to be free to follow a more fluid, iterative approach to exploring disruptive projects.

Defining the incubator's purpose and creating a mandate will focus the development of the proper "portfolio" of innovation projects that the incubator pursues. Without active management, an incubator's portfolio ends up consisting of highly incremental initiatives, with one or two big bets to show that grander purposes are in scope.

Disruptive innovations are uncertain, unpopular, and difficult. In a portfolio heavily weighted toward incremental improvements, disruptive projects invariably lose out, even though they tend to create by far the most shareholder value.

The most critical staffing decision is the selection of the incubator's leader. While it is tempting to choose a senior leader, this can in fact prove counter-productive. Senior leaders, or even younger rising stars, often cannot dedicate themselves wholly to the incubator. The unit then becomes an "other" bucket for the leader, who does not have the time to focus on the incubator's core mission.

Rather than seeking out people with resumes well-suited to core management positions, leaders should look for those who have encountered challenges similar to those they will find in the incubator. These experiences include the ability to manage unstructured situations, to test and learn rapidly, and to build external partnerships.

Senior executives also need to take responsibility for staffing a small full-time team to start the incubator. These people should volunteer for the job, as the right outlook is essential, and the types of employees whom the core can easily spare are usually not the sort needed in a fast-moving, relatively unstructured environment. If management views a rotation in the incubator as excellent grooming for broader responsibilities (as it frequently is), then staff will be more willing to sign up. There should be a clear plan for how additional people will be brought on board as initiatives grow.

Cement the building blocks that will keep the incubator healthy

The seemingly mundane details of how concepts are ideated, shaped, and evaluated frequently hold the keys to the success—or failure—of incubator efforts. Companies recognize the need for some sort of stage-gate process, yet simply copying the process from the core creates vast problems.

Because the core works in a world with greater certainties and bigger bets, its evaluation system tends to require buttoned-down business cases at an early stage.

Managers must define a wide range of business plan elements for the project to proceed to the next stage, and there is little capability for piloting initiatives and looping back as new learnings emerge. Incubators—if they are reaching for disruptive innovation—work in a world with far less clarity.

As a result, we find that incubators gain better traction if they employ a model based on one used by the world's experts in creating great new businesses—venture capitalists (for more, see "Mastering The Emergent Strategy Process," March-April 2006). This five-step model brings discipline to the ideation process; finding opportunities is not left to serendipity or management's passing notion.

1. **Generate ideas.** In the initial stage, members of the incubator should surface a wide range of new ideas. Ideas should not be limited to things that would fit naturally within the core; ideas for products, businesses, and non-product innovations should be sourced both internally and externally.
2. **Sort and prioritize.** In this stage, ideas are rapidly transformed into rough idea descriptions so that team members can identify the best ideas. Ideas that are not appropriate for the incubator can either be shelved or routed to the core business to commercialize. This stage should preclude the need for a traditional stage-gate formal hearing, thereby eliminating the "process before the process" that tends to stop many of the most radical ideas from being aired.
3. **Shape.** Using a standardized template, create short pitch decks to facilitate a further discussion on which ideas merit deep investigation. The team once again can shelve flawed ideas or route sustaining ideas to the core.
4. **Expand and discover.** Subsequently, there are fast-cycle iterations where key assumptions are addressed before the overall business plan is crafted. The approach is quick because it focuses effort, eliminates the need for perfection in the assessment, and consistently engages senior management in a way that short-circuits drawn-out debates.
5. **Develop and commercialize.** This final phase involves taking a disciplined test-and-learn approach. Techniques include operating and commercial test piloting ideas to progressively reduce risks and uncertainties and actually launching small new ventures (keeping in mind disruptive mantra that an new venture should be "patient for growth, impatient for profits").

One critical principle must be remembered: If you do not kill projects, you may die yourself. The work required by a project only increases over time. If the march of projects is to stay robust and fast-moving, the wounded must be cleared from the battlefield. Ventures need to "graduate" from the incubator as well, either routing back to the core or becoming standalone initiatives.

Along with this process, leaders should make iteration and risk part of the incubator's culture. This type of culture can be created by leaders who evaluate disruptive ideas with an open-minded approach, coaching and problem-solving in an involved manner. There will be time to evaluate more critically when a broad launch is proposed, but a disruptive opportunity needs nurturing to get to that point.

Leaders can create such a culture by influencing others to adopt similar frames of reference. For instance, leaders should ask about more risky alternatives that were rejected.

Leaders can also ask about how the project could be executed in half the time. The answer may not be feasible, but by asking the question they will force staff to consider the elements of the project plan that may add little value.

Another critical step in creating an iterative, risk-tolerant culture is establishing communication networks and colleague engagement. Successes need to be publicized (giving awards is a great way to raise the profile of a success and to disseminate more information about it), and failures need to have their learnings systematically recorded. Cross-functional forums can encourage ideation. Speakers can bring in outside perspectives—ideally, ones at odds with the internal orthodoxy. Newsletters, online dialogues, and "book clubs" can further foster knowledge dissemination, idea formulation, and staff commitment.

A deliberate, holistic approach is the key to an incubator's success

Incubating innovation is challenging. Countless firms launch incubators to great fanfare, only to scuttle their prospects over time. Success comes from a deliberate approach, a holistic view of what the incubator requires, alignment of a wide range of inter-dependent success factors, and consistent leadership and communication.

While management needs to give careful thought to how the incubator is established, it also needs to get moving quickly and to pay continuing attention to these norms in the incubator's early days.

These learnings also apply to revamping current incubator initiatives. Management should follow the same sequential process laid out above: re-evaluate purpose first, then rules, then building blocks for the incubator itself. It will take time to re-align an existing incubator, particularly given the vested interests in a corporate context, but change will nonetheless occur if it starts with high-level agreement on output and rules.

Done right, incubators can generate vast success. It is difficult, but if it were easy, the growth and profitability from disruptive innovation wouldn't be so great.◆

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