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Welcome!

We're pleased to announce that Scott Anthony is kicking off The Management Roundtable's Innovation Leadership Gurus webinar series on September 16. Later sessions will be led by well-known innovation thought leaders such as Marc Meyer and Rita Gunter McGrath. I mention this now because there's a $500 discount on early sign-ups that ends today, July 15. So if you are interested, please sign up at the link below.

This issue's feature article offers an interview I did with another well-known innovator: Diane Hessan, CEO of Communispace. She talks about both how her business has innovated, as well as how it helps its clients innovate, and offers solid tips for those wishing to engage their customers in the type of conversation that will lead to innovation.

Comments and suggestions are welcome – send them to editor@strategyandinnovation.com.

—Renee Hopkins Callahan, Editor

For Innovation Leadership Gurus webinar series:
http://innovationgurus.com/

Innosight News and Events

The Landscape Transformed: What HR Leaders Need to Know to Survive and Thrive In the New Economy

Scott Anthony, will be a featured speaker at the Executive HR Network Summit. Held July 15 at the Harvard Club in Cambridge, MA.

http://www.innosight.com/news_events/event.html?id=769

Feature: Innovation by Community

Q&A with Diane Hessan, Communispace CEO

By Renee Hopkins Callahan

Diane Hessan is CEO and founder of Communispace, which builds private online communities for companies that want to engage and listen to their customers. She spoke recently with Strategy & Innovation *editor Renee Hopkins Callahan about the innovative way Communispace itself came to be and how listening to customers fosters innovation.*

RENEE: Please describe Communispace and how it got started.

DIANE: People always think that Communispace was my brilliant idea, but it wasn't. I got lucky. Communispace was started during the 2000 Internet boom: we wanted to provide the opportunity to apply online community to business by harnessing the collective wisdom of the organization itself, learning from each other, and sharing best practices. During a discussion with Hallmark about creating an internal online community for store managers, our client, Tom Brailsford, said, "40 percent of our growth over the next few years needs to come from products we don't have. What if we put consumers in the community instead?"

So in November 2000, we launched the Hallmark Idea Exchange for parents — a community of 150 moms who had agreed to come online and be part of an ongoing advisory board for Hallmark. The following day, Ken Murray, our head of IT, said 92 people had joined the discussion on the first day. In the first 24 hours Hallmark was saying, "People are telling us things that consumers have never said to us before." And the big deal with the Internet was that if Hallmark had more questions, the people in the community were still there to ask, unlike focus groups where they would be gone in an hour. So 24 hours later, both the client and the community members were thrilled.

Since then, we have been doing one very specific thing — building communities that help bring the voice of the customer to life for our clients.

RENEE: So Communispace pre-dates the current social media trend.

DIANE: Social media is not a new thing. Consider the Pillsbury Bake-Off, from the 1960s. If you view it through the lens that we have today, you'd see that the excitement wasn't about the contest itself, but about, "What if I got the chance to go to Orlando with 99 other bakers and share recipes and have a relationship with Pillsbury, who might take what I did and put it on their box of cake mix?" There's not a big difference between that and social media today. The Internet and new technology just make that connection easier.

RENEE: How can innovation result from customer communities?

DIANE: We're not really trying to do communities the way people usually think about them. We don't create communities where the metric is, "let's get 82 skillion people together online." What we're trying to do is to maximize the engagement, and the ultimate engagement for us is for consumers to be willing to open-up their lives, dreams, and frustrations so that we can get to game-changing insights. That's the holy grail of a Communispace community.

To do that, you need to create an environment in which people feel safe, special, and heard. If people think you're really listening and that you don't have an ulterior motive, it's unbelievable what they'll do for you.

In the economy now, there's not a lot that's rational about what's going on with customers. There's so much emotion and nuance and texture and contradiction in what people are doing. Why would a mom drive 50 miles to go to a Walmart to get clothes for herself and then drive two miles to Old Navy to get stuff for her kids? There's so much more to that than "no matter what, my kids are really important." Really probing and trying to understand what's going on there and probing the insight related to that can be profound.

RENEE: So you're saying that having this deep kind of customer insight is critical to be able to truly innovate.

DIANE: Yes, and not just for product innovation, but for business model innovation, too. You have to look at what do your customers need. How does that play out? And then you can build a business model from that.

The breakthrough of the web for us is not "fast and cheap." The breakthrough of the web is that you can continuously have that conversation with customers. With the web, you don't have to lean on the idea that innovation has to start with the customer, because the customer can be there in the beginning, middle, and end. I've heard more CMOs in the last year say, "We are so customer-focused and innovative. We got all this consumer data in January and then we spent the whole rest of the year responding to what we learned from those consumers in January." That is a CMO who literally says innovation starts with the customer. The problem is that by March, the customer is in a different place.

RENEE: It sounds like an ongoing community helps businesses test assumptions, and utilize an emergent strategy. The way you have to do to use emergent strategy.

DIANE: We're our own example of that. When we were building Communispace, the world kept changing. About seven or eight years ago I asked one of our advisory board members, Bob Stringer, the author of the book Strategy Traps, for advice. I told him, "Here I am, I'm a Harvard MBA, I'm supposed to know how to do the grand plan, the strategy, set the priorities, and I can't do it in our business because I worry that my strategy in January is going to fall apart and that all of these goals will become obsolete." He asked, "What are you doing?" I said, "Our management team has a weekly meeting where we look at the numbers, and we look at what we're hearing from customers, and we evaluate what's going on with the business, and then we kind of change and reallocate everything. That's kind of embarrassing to say, but that's how we're doing it."

I thought he was going to beat me up, but instead he said, "That's emergent strategy. There's not only a term for it, but it's totally consistent with the type of business you're in." That was a total breakthrough for me, and it changed the way I lead. I realized that it was not only OK to create strategy as you go, but it might even be key to our success.

And at that time, the world wasn't changing as fast. Now that everything is changing so fast, especially with customers, that I think companies have to use emergent strategy. Saying, "I don't know what's next because it really depends" isn't sloppy because it's how you deal if you're trying to be externally focused.

RENEE: Does the fact that you fostered an innovative idea yourself help when you are essentially in the business of helping your customers to innovate?

DIANE: I always say to clients, "Just keep your head up." If your head is down all of the time, you don't get a chance to benefit from the serendipity. And you've got to find the serendipity. The contradiction in innovation is that there's so much discipline around it, but sometimes the discipline needs some serendipity. There's an idea that comes from left field. There's a day when something just clicks. There's something that you're struggling with and something from a totally different arena comes in and it all comes together. If your head is down, you miss some of that. And a lot of companies these days have their heads down.

Sidebar: Community Lessons

Here's what Diane Hessan and Communispace have learned about how to get people to come online and engage with companies:

"If you're thinking about using social media in your business, you must first figure out what you're trying to accomplish. We agree with the Framework put forward in Forrester's *Groundswell* book, which says there are five possible things for which you could use social media in your business: listening, talking, supporting, energizing (offering customers opportunities to spread the word amongst themselves), and embracing (co-creation and harnessing ideas and inspiration)."

1. **Provide social "glue"** – It's important to filter, so you can get people in the community who have things in common to talk about.

2. **Have a purpose** – You have to have a compelling purpose and make it clear to the people in the community.

3. **Be authentic** – Being genuine and even transparent really works online. For that reason, branded communities are much more effective than non-branded communities.

4. **Connect with customers** – You can have the best tools in the world but they won't help you if you can't connect and make conversation.

5. **Size matters** – The smaller the group, the more engaged people are.

6. **Give feedback** – We spend a lot of time thinking of ways to tell people, "Here's what we heard from you and here's what we're going to do about it."

7. **Make it interesting** – Give people projects; don't just give them surveys to fill out.

8. **Keep it legal** – Don't ignore the lawyers. In some verticals, such as pharma and financial services, what you do on social media could put you out of business.

9. **Identify an objective before starting** – Use the Forrester Framework (discussed in the book *Groundswell* by Charlene Li and Josh Bernoff) to learn more about the possible objectives.

10. **Be gracious** – The same rules apply here as in the rest of the world. Say "thank you" and even give member appreciation gifts.

Related references
http://www.communispace.com/

Innovators' Insight: The Dangers of Data

Companies that are moving into new markets face a fundamental challenge: Markets that don't exist can't be reliably measured and analyzed.

By Scott D. Anthony

In August 2007, star Morgan Stanley analyst Mary Meeker estimated that the "overlay" advertising model introduced by video-sharing site YouTube would immediately add $720 million in net revenue to parent Google's pockets. Unfortunately, former Merrill Lynch analyst Henry Blodget pointed out (see related reference) in a blog post that Meeker had made a mathematical error (see related reference): Her estimate actually should have been $720,000.

Meeker acknowledged the error, sharpened her pencil, and came up with new estimates ranging from $76 million to $189 million in revenue next year. What a whirlwind week for overlay ads!

This isn't to pick on Meeker. Trying to come up with accurate forecasts for new-to-the-world innovations is incredibly difficult. In fact, the only thing we could reasonably predict in this scenario is that all of Meeker's estimates would have been wrong.

You see, there's a pesky thing about how the world works. Reliable data only exists about the past. And sometimes only the distant past. For example, market research reports summarize the results of decisions made months, if not years earlier.

Making decisions based on a single forecast with a seemingly precise point-estimate often leads incumbents to pass on investing in disruptive opportunities because they just seem too small. Alternatively, they throw money on a "sure thing" that proves to not pan out. The scars from these experiences lead to organizational risk aversion.

Some of these errors are legendary. In the 1950s, IBM hired Arthur D. Little to estimate the potential market for photocopiers. The consulting company added up everything that constituted the market for copying documents at the time — carbon paper, dittography, and hectography — and concluded the market was too small to warrant investment. Of course, as Xerox and other companies made photocopying simple, cheap, and convenient, new applications emerged and the market exploded.

Companies and investors that make critical decisions based solely on a single internal or external forecast run a high risk of making similarly major investment mistakes. As Blodget wrote in his blog about Meeker's mistaken projections, "the episode clearly reveals the risk of blindly accepting what appear to be carefully developed assumptions, not to mention the estimates derived from them."

There are three things that can be done to make better decisions about highly uncertain markets. The first is to let patterns inform decisions. By our count, disruption has affected more than 60 different industries, including high-tech industries, low-tech industries, product industries, and service industries. Remember, a simple pattern connects these seemingly disparate developments:

- There is an important problem that can't be adequately solved by current solutions
- An innovator develops a different way to solve the problem that focuses on simplicity, accessibility, affordability, or customizability
- The innovator adopts an approach that powerful competitors would find unattractive, uninteresting, or difficult to mimic in the near term
- The solutions is commercialized with a business model that creatively maximizes revenue potential while minimizing fixed costs
- Of course, patterns of success in different industries and different contexts can be more complicated, but when you see forecasts of blockbuster growth for a new offering that runs counter to the pattern — or you see meager forecasts for an innovation that is a spot-on — be wary of making decisions based purely on the forecasted numbers.

Secondly, it is critical to remember the importance of focusing on assumptions, not answers. See if there are analogs or benchmarks that can provide insight into whether there are reasons to believe that major assumptions might bear some kind of semblance to reality. Always be on the lookout for simple ways to turn assumptions into knowledge.

Running multiple scenarios can be a useful way to unearth assumptions and understand the range of potential outcomes. For example, Blodget ran different scenarios showing how YouTube's new model in five years could add revenues ranging from $200 million to $13 billion.

It's obviously hard to make serious planning decisions when numbers swing that wildly, but the point of the exercise is less about allocating today's resources and more about gleaning deeper insight into critical assumptions and highlighting early signals that provide greater certainty into the ultimate outcome.

Finally, companies can turn to emerging tools like prediction markets, where people buy and sell virtual shares based on their belief about the likelihood of certain events. Prediction markets take advantage of the "wisdom of crowds" phenomena noted by James Surowiecki (see related reference): The collective almost always does a better job at answering questions than any one individual.

Prediction markets such as the University of Iowa's Iowa Electronic Market have proven to provide accurate forecasts of presidential elections and Oscar nominations. Companies such as Hewlett Packard and Eli Lilly use prediction markets as a tool to help with business planning.

Companies need not be beholden to the tyranny of bad forecasts. By developing a competency around pattern-based analysis, shifting focus from meaningless answers to meaningful assumptions, and utilizing a wide range of approaches, companies can increase the confidence with which they move in new directions.

Related references
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http://en.wikipedia.org/wiki/The_Wisdom_of_Crowds

From the InnoBlog

Emerging Technology Watch: Understanding Glass

By Renee Hopkins Callahan

Recently, a couple of interesting articles (see related references) in the *New York Times* detailed new research into glass. The true physical nature of glass remains somewhat mysterious — one article points out that "although there has long been debate as to whether glass is a solid or liquid, it is now usually described as an amorphous solid (there is no evidence that it flows, extremely slowly, over time as a liquid)." Yet there is still disagreement among scientists about the exact nature of glass.

Scientists are still probing this question because answering it could lead to a number of breakthroughs: "Understanding glass would not just solve a longstanding fundamental (and arguably Nobel-worthy) problem and perhaps lead to better glasses. That knowledge might benefit drug makers, for instance. Certain drugs, if they could be made in a stable glass structure instead of a crystalline form, would dissolve more quickly, allowing them to be taken orally instead of being injected. The tools and techniques applied to glass might also provide headway on other problems, in material science, biology and other fields, that look at general properties that arise out of many disordered interactions. Scientists are also probing into the potential building uses of types of glass other than the typical soda lime glass most often used now. And they are experimenting with new materials and methods that could someday lead to glass structures that are unmarked by metal or other materials.

Related references
http://www.nytimes.com/2009/07/07/science/07glass.html?_r=2
http://www.nytimes.com/2008/07/29/science/29glass.html

Cost Reduction and Low-end Disruption: Two Sides of the Same Coin — Guest Post

By Juan Pablo Vázquez Sampere

The following is a guest post by Juan Pablo Vázquez Sampere.

"Your innovation strategy is great, kid, but is it going to give me growth in the next quarter?" Chances are your CEO has responded this way to your innovation initiatives. Here's a way to answer this question affirmatively. As Scott Anthony points out in his new book *The Silver Lining*, low-end disruption can bring growth (see related reference).

Our research in Europe has shown that a strategic cost-reduction initiative coupled with a low-end disruption helps meet two corporate goals with just one initiative. Low-end disruption and cost reduction are two sides of the same coin. They are two extremes of the same continuum, just as the same enzyme is used in the body to balance two biological processes.

When it comes to cost reduction, European managers try to apply one of these alternatives:

1. Rank the Income Statement cost and expenses account by size and determine a percentage of reduction for each.
2. Negotiate a layoff with the government (a step that would be unnecessary in the United States).
3. Kill the product features managers think the customer won't notice.

Instead of relying so much on your gut, we propose this methodology to deliver a high-growth product along with a significant cost reduction.

- **Step 1**: Understand that company insiders can almost never truly understand what features the customer actually values. The reason is that companies analyze the market in from the point of view of the way they make money. They never see the actual shape of the market.

It is next to impossible for a company to understand the job its customers are hiring it for, let alone try to improve its products based on that job. This is a well-proven reason to seek outside help in understanding the rugged landscape of customer jobs your company is making money from.

- **Step 2**: Create a Base of Competition/Product Matrix: Pick one of your products and create a spreadsheet for it. Insert a column for each and every one of its features. Also, insert five rows in the matrix with the following entries: “Functionality 1”, “Reliability 1”, “Convenience 1”, “Adaptation 1”, “Personalization 1”.

- **Step 3:** For each row, classify the features listed in each column as follows: If the feature listed describes a Functionality, then insert a mark in that row. Then create an additional row beneath “Functionality 1” with the name “Functionality 2”. Continue doing this with the rest of features and bases of competition until you have them all assigned.

- **Step 4:** Prepare a mini-survey with the content of the matrix. Interview no more than 25 customers. Using customer-friendly terms, ask them, essentially, “by what percentage is this feature overserved?” Tell them that if they answer 100 it will mean the feature is just good enough. If they answer less than 100 that will mean the feature is underserved, and if they answer more than 100 it will mean they are overserved. The amount over or under 100 will be the percentage by which customers are over- or under-served. Please don’t make this survey statistically significant — the sample very small deliberately, so the sample error can prevent you from reducing reinvestment in features that might still be slightly underserved.

- **Step 5:** Calculate the mean of the percentages from all rows exceeding 100 that refer to a functionality or a reliability. Then subtract to that mean 100. Now subtract the mean from all the percentages. Convert to a dollar amount using your current cost-allocation budget. Chances are this is a significant cost reduction.

- **Step 6:** The number in dollars you calculated from the previous step is your total cost reduction. Decide how much of that you want to keep, and use the rest to launch a low-end Disruption.

- **Step 7:** You have now a great starting point to launch a low-end disruption. Just pick the matrix of the product you just prepared and reinvest the desired amount of money in the rows that contain the words “convenience”, “adaptation” or “personalization.”

The next time your CEO asks you how to use innovation to deliver short-term growth, show your new low-end disruptive product concept and explain the rationale used. Our experience in Europe with this has been very positive. Results obtained with this methodology are usually counterintuitive for senior managers, and they normally consider that refreshing. We have used this methodology several times now during the current economic crisis and still haven’t found a CEO unwilling to give it a try.

In times of crisis, the objectives of cost reduction, growth for the next quarter, and making a successful, more convenient, and affordable product are not inversely related. They are actually regulated through the same enzyme — your company's values. You can't change them, and values are put to the test in times of crisis. If you can build a solid argument to launch a simplified, more personalized product to a customer who is now much less willing to pay, you will create a precedent that will prove really helpful for your company's future strategic positioning.

Juan Pablo Vázquez Sampere is a partner at Stratemic and an Associate Professor at IE Business School in Madrid, Spain (see related references).

Related references
http://www.silverliningplaybook.com
http://www.ie.edu/IE/php/en/claustro_detalle.php?id=686
http://www.stratemic.com/
http://www.ie.edu/business/

Coke's New Secret Formula

By Kevin Bolen

RFID, SAP data center, dedicated Verizon network, Windows CE with touch screen interface…for flavored water? The cola wars have come a long way from blind taste tests in the local shopping center!

With the limited release this summer of the new Coca-Cola Freestyle machines (pictured at left), Coke is essentially introducing a new business model into the fountain drink industry, one with serious disruptive potential. The system is about the size of a small Coke machine you would see on the street but features a large touch screen interface and single dispensing position. The consumer simply navigates through 100 varieties of beverages and then the machine uses micro-doses of flavor from canisters stored inside to precisely mix up the selection. Profiled in this recent *InformationWeek* article (see related references), the Freestyle is a consumer and customer service tool, a network node, an inventory and supply chain manager, quality control, and business intelligence agent all in one. The integration of these various functions and their associated data streams offers Coke the rare opportunity to improve their performance on the sustaining curve while simultaneously introducing a disruptive play into the market (for more on these curves, see The Disruptive Innovation Primer in related references).

On the sustaining front, Coke is offering its consumers a wider array of drink choices at the point of consumption. They hope this greater array of choices will delight many consumers who leave the fountain disappointed that their preferred beverage was not offered. They also hope the increased number of options will capture a significant portion of the non-consuming market who have traditionally selected water or no beverage at all as the options traditionally available at the fountain were not to their liking. Both of these are significant competitive advantages that will move Coke further up the sustaining curve. However, increasing the number of flavors alone will not yield transformative growth.

The real disruptive potential here lies in the data, not the drinks. By mixing flavors on site in the machine and capturing purchase behavior real time, Coke is better able to test new offerings and immediately respond to market insights around existing and emerging consumption patterns at a hyper-local level. Each point of purchase becomes a kiosk through which Coke can interact with its consumers and test their reactions to new formulas and new messaging. It is no longer dependent on limited and lagging sell through data from its restaurant customers, rather, it can decide which beverages to present to the consumers based on time of day and recent consumption patterns. Much like Zara has done in the apparel industry, Coke is virtually eliminating the time lag between trend identification and capitalization.

Coke also made sure to address the "jobs" of their channel partners, namely the restaurants selling the beverages. By opening up the data to these outlets, Coke is expecting them to play an active and informed role in increasing beverage revenues while the RFID-controlled, networked inventory and supply chain control system promises to address long-standing frustrations.

As the benefits of this smart system are realized, we expect to see other restaurant chains shifting from competing fountain suppliers to Coke.

Related references
http://www.informationweek.com/news/mobility/RFID/showArticle.jhtml?articleID=217701971
http://www.innosight.com/innovation_resources/diagnostic_tools.html

Selling Convenience

By Rebecca Waber

After returning from a recent trip to Tokyo, friends were eager to hear about any culinary adventures I might have had. "Did you eat a lot of sushi?" They wanted to know. "Well, some," I'd respond, "Mostly from 7-Eleven."

That response tended to make people pause. The thing is, Japanese convenience stores ("*combini*") are pretty fantastic (see related reference). Although they are recognizably similar to their American counterparts, with snacks, drinks, and toiletries, there is a critical difference in the high-level job-to-be-done that the stores address.

In the United States, convenience stores seem to see themselves as solving a fundamental job-to-be-done like "Provide access to a mini-grocery store when the real grocery store is far away." Under this rubric, convenience stores offer products like chips, tuna, and milk.

The overarching meta-job of a *combini*, however, is more like “Make inconvenient tasks more convenient.” Under this theme, *combinis* sell delicious and cheap ready-to-go bento meals and mini-meals. They’re also the place to go to pay utility bills, buy concert tickets, or drop off luggage to be taken to the airport.

This strategy has proved extremely successful. 7-Eleven is actually Japan’s No. 1 food retailer (see related reference) and most profitable retailer overall, and the Japanese branch now owns its American parent.

A lesson here is that even companies that appear superficially similar to each other may be aimed at fundamentally different jobs targets, which dictate the strategic choices they make. The “make the inconvenient convenient” job has a lot of headroom to grow; plenty of things in life are inconvenient. This meta-job provides a platform for all manner of profitable offerings that would seem out of place in an American convenience store.

On the other hand, the American meta-job of providing small grocery stores has pigeonholed the industry in a modern environment where access barriers to larger grocery stores are fairly low. Hopefully, American convenience store retailers can learn the lessons from their Japanese equivalents quickly — I could really go for some *yakisoba*.

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Innovation Links Posts

We've started posting once or twice a week annotated links to various news and blog items of interest in the innovation world. Since the last *Strategy & Innovation* was published, these links have been posted:

June 26: http://www.innosight.com/blog/391-innovation-links-for-june-26.html

July 10: http://www.innosight.com/blog/398-innovation-links-for-july-10.html

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