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Welcome!

Last issue Scott Anthony warned about the "Dangers of Data," saying that it's nearly impossible to come up with accurate forecasts for new-to-the-world products. In this issue Kevin Bolen and Krystin Stafford describe how one popular metric – the Net Promoter Score® – can keep innovators focused on the incremental innovation and obscure the path to disruption. Also, Scott Anthony writes about how Google may be finally beginning to mature as an innovator, and offers advice for the company as it grows.

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

—Renee Hopkins Callahan, Editor

Innosight News and Events

Webinar: "Your Playbook for Winning Through Innovation," a free 75-minute discussion featuring Scott Anthony and Vijay Govindarajan. 2 pm EST, Thurs., Aug 6.

http://www.greatmanager.com/events/august09.php

Feature: Opening the Performance Aperture

Why NPS and other Mega Metrics obscure innovation opportunities and mask disruptive threats

By Kevin Bolen and Krystin Stafford

"The superior man, when resting in safety, does not forget that danger may come. When in a state of security he does not forget the possibility of ruin. When all is orderly, he does not forget that disorder may come. Thus his person is not endangered, and his States and all their clans are preserved."

When Confucius offered this advice in 500 B.C., he could not have forecasted the economic swings of the past 18 months. Yet his words have never rung more true. When economic conditions are uncertain, undisciplined leaders often whipsaw their organizations back and forth between strategies in response to so-called "key indicators." While such metrics can be powerful allies in the path to growth and value creation, during periods of instability their limitations must be acknowledged and their influences balanced by broader perspectives.

In their book by the same name, George Day and Paul Shoemaker call these broader perspectives "Peripheral Vision" and suggest paying attention to the outliers for weak signals that may later become competitive challenges. Unfortunately for shareholders and employees alike, many leaders proactively adopt tunnel vision, overemphasizing a single metric in place of a broader dashboard. In this article we'll examine one popular metric in detail, the Net Promoter Score®, and see how a myopic view of market conditions and competitive positioning can mask weakness and blind leaders to true innovation and growth opportunities.

The emergence of a Mega Metric: NPS

Fighter pilots flying today's most technologically advanced jets will frequently turn off several of the alert systems. The pilots have found that so much input actually impedes their ability to perform, as minor disturbances compete with severe threats for the same level of attention. Corporate leaders face a similar challenge today. With IT and data systems reaching into every remote corner of the business, leaders have unprecedented access to minute performance data on demand. Like the fighter pilots, the challenge is to therefore identify the truly important anomalies from the daily "bumps" inherent in any corporate system.

When a *Harvard Business Review* article purported to have identified "The One Number You Need" (by Fredrick Reicheld in the December 2003 issue), it got CEOs and CMOs buzzing. A book followed in 2006, ensuring the buzz reached a fever pitch. The excitement was around one number that was supposed to be THE predictor of corporate growth, a key performance indicator that had so far eluded the corporate metric cognoscenti. The number? A company's Net Promoter Score (NPS®).

Put simply, the NPS measures a customer's response to one question: "How likely is it that you would recommend this business to a friend or colleague?" "Promoters" are those customers who respond with a score of 9 or 10 on the 0 to 10 scale. "Passives" are regular customers who are not enthusiastic about the business, and provide scores of 7 or 8. All other responses fall into the "Detractor" category and represent dissatisfied customers.

The Achilles Heel of Mega Metrics (including NPS): Causality

The appeal of this "one question" is apparent. It is elegantly simply, quantifiable and most importantly, people can be held accountable for its performance. If you accept that customer satisfaction truly *causes* growth and that the two data points are not merely *correlated* (or worse, simply *coincidental*), then it stands to reason that if the NPS is the best indicator of customer satisfaction then it is also the best predictor of growth. In the HBR article, Reicheld offers numerous examples of companies whose growth and profitability increased at the same time as they were experiencing improvements in customer satisfaction, thus providing enough plausibility for leaders to embrace the NPS, adjust performance incentives accordingly, and await the resulting uplift in their top-line.

The flaw here, as with many Mega Metrics, is the inherent assumption that because a metric works for some companies it will work for all companies in all circumstances. Often the context in which the desired performance was achieved is downplayed in favor ascribing full credit to the adoption of the promoted metric or management practice. Phil Rosenzweig does an excellent job detailing the risks associated with positive company performance effecting the perception of the strategy incorrectly in his book *The Halo Effect*.

Others have begun to notice such a "halo effect" around the NPS, most notably a group of academic researchers who explored the performance of NPS in a far more scientific study than Reicheld's observations (see "A Longitudinal Examination of Net Promoter and Firm Revenue Growth" by Keiningham, Cooli, Wallin, and Aksoy in *Journal of Marketing* vol. 71 July 2007 39-51 for a detailed analysis of the effectiveness of NPS as a predictor – reference link below).

Whether you agree with Reicheld or with his critics, what you cannot overlook is the inherit limitation of NPS and most Mega Metrics, which is that they are essentially point-in-time health checks. By its very nature, NPS fails to capture or even acknowledge the broader market forces that may be driving consumer demand for a particular good or service. It measures the current customer's response to whether they would recommend a particular business at this moment. What NPS fails to measure is *how frequently* those customers are asked by their friends and colleagues for a recommendation in that industry, or how changes in their broader lifestyle (say, rising unemployment and a plummeting 401k) may be influencing their recommendation at that moment.

To pose a hypothetical example, if the NPS had been around at the time, it might have been a great tool for assessing how well-satisfied a certain buggy whip manufacturer's customers were with its products. Following the NPS model, the one with the highest percentage of Promoters would grow so long as people kept asking one another "so, I am looking for a new buggy whip. Which one do you recommend?" As the car began to displace the buggy whip, however, the frequency with which this question was asked plummeted as buggies, horses, and whips were all relentlessly disrupted by the automobile. Instead of buggy whip recommendations, people began to ask, "So, how do you like your new Ford?

A buggy whip CEO ascribing to the "one number you need to know" management theory would be struggling to figure out why his sales were down. If they were to survey every customer who bought their product, they might consistently receive an NPS of 9 or 10. The data was saying there was no room to improve — and in fact, it was right. No amount of improvement to the product would have increased satisfaction or grown that business.

Looking out to the periphery, though, beyond his narrow industry, customers, and chief competitors, the buggy whip CEO would have seen the rise of the automobile. While not a direct competitor for buggy whips, it would be seen as a market influencer changing the demand for horses and buggies and thus impacting the buggy whip market.

Being the sole surviving, best supplier in a dying industry is not a recipe for long-term growth and success. Your business may decline slower than others, and for a period of time you may even reap the benefits of their successive failures as customers have no choice but to turn to you as one of the few remaining suppliers. But eventually, you too will succumb to the inexorable market disruption.

[NB: This notion of disruption has been well-covered in this publication, so we won't go into detail here. We would point those seeking additional context on the subject to Innosight's disruptive tools, while this Dick Foster interview on Create, Operate, Trade offers a deeper look into these industry cycles: Creative Destruction: Create, Operate and Trade – reference links below]

Finding innovation at the periphery

That isn't to say that the NPS is not a useful management tool; rather, that its application and those of other Mega Metrics need to be more narrowly defined and placed into the broader context of market dynamics. NPS might be used to help identify performance issues and customer dissatisfaction, or to reward high performers as part of an incentive structure. In any of these applications, it must be acknowledged that that NPS focuses on assessing the health of the core business.

Now, we are not advocating that companies ignore their core business. Companies must continue to focus on growing their core, as the core supplies the revenue and profits. However, companies cannot ignore the need to go outside the core business to develop products or services that can be a source of future revenues. For instance, if the majority of a company's revenues come from products or services that were devised, say, 5 years ago, this is a sign that their innovation pipeline has dried up or, at the very least, is stuck in a procedural bottleneck. An exclusive focus on a single Mega Metric fails to uncover this issue.

As much as they would love to confidently rely on the NPS as the "one number you need to know to grow," leaders are forced to adopt a more balanced and broader view of the market and their position within it. Such a view is critical to understanding the true health and potential of the company's entire portfolio in this context:

Balanced Portfolio View

Balanced Portfolio View

Considering your position from this perspective highlights the artificial limit to the market being measured by the NPS (upper left only). Failure to acknowledge this limited purview is the Achilles heel of the Net Promoter Score model. Rather than addressing this broader market dynamic, Reicheld actually advocates that you narrow your focus down to an even tighter cadre of core consumers and let someone else pick up your non-core consumers.

While this thinking might be beneficial for short-term maximization of current operations, such thinking could be big downfalls of otherwise-successful companies, since it effectively blinds leaders to the attack of disruptive forces. In the long term, if companies fail to simultaneously focus disciplined innovation efforts on exploring "step out" opportunities in the non-core quadrants, they will be inevitably overcome by competitors.

Seeking a balanced vantage-point extends beyond looking at the company's current portfolio and research pipeline to viewing the edges of your possible competition and the companies which may be disruptive to your business in the future.

Tips for finding the right balance for your organization

To explore your own Yin and Yang relationship between the core and the innovative exploration, we offer these quick tips:

- *Ask lots of questions.* Even the best management tools are only as good as the people who apply them. Encourage your teams to not only identify issues or opportunities but to dig further — find the source of the insights, or you risk overlooking something significant. Keep an eye out for causal relationships.

- *Think about not only core, but also about non-core activities.* It makes sense that you focus efforts on your core, since that's where you currently recognize revenues. However, what might your core look like in 5 years? 10 years? Keep an eye out for changing market dynamics and how you can develop an innovation pipeline outside of the core.

- *Don't let metrics and methods give you tunnel vision.* Even if a particular management tool is extraordinarily helpful in understanding or improving one activity or part of your business, recognize that it likely is not covering all of your bases. Take a more balanced view, force yourself to look expansively, and bring in a variety of perspectives from customers, to partners, to competitors.

Related references
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Innovators' Insight: Google Grows Up

Advice for Google's management as it seeks to continue to build its innovation capabilities

By Scott D. Anthony

Over the past decade, Google has inspired envy in trench-dwelling managers around the world. It's not just the unparalleled benefits. It's the way Google approaches innovation. Engineers are encouraged to dream up pet projects in their spare time. Teams self-form around the best ideas. Market-based principles ensure that the best ideas receive funding.

It sounds chaotic, democratic … and intoxicating.

"Why can't we do that?" countless managers wonder. "Instead, we have to deal with crushing bureaucracy that favors our leaders' personal whims over the most game-changing ideas."

Management guru Gary Hamel praised Google in his book *The Future of Management* (see related reference), positing that more and more companies would adopt the company's market-based system.

There is indeed much to admire about Google's approach, and much to learn from it. The system ensures that interesting ideas — even those that aren't obvious fits for Google's capabilities or core business model — receive some degree of attention.

However, Google's approach hasn't demonstrated that it can actually, you know, create successful businesses. Despite the hype, more than 95 percent of Google's revenues trace back to Web-based search advertising. Further, as the company's explosive growth has slowed, innovative employees have left to form new ventures. For example, Twitter was formed by former Google employees.

In a blog post last year (see related reference), I said this recession would be Google's "moment of truth." Either it would figure out how to bring appropriate discipline to innovation process to realize its latent potential, or it would end up looking like every other company.

The company has at long last recognized that discipline is not a dirty word. A June article in the *Wall Street Journal* (see related reference) described how Google plans to build a process to make sure that high-priority ideas received the right resources.

Specifically, it is creating "innovation reviews" where department heads share promising ideas with Google's top leadership, helping executives focus attention and resources on promising ideas early. As CEO Eric Schmidt said, "We were concerned that some of the biggest ideas were getting squashed."

It doesn't seem like Google is walking away from its ideals. Rather, it's trying to couple its world-class approach to the "front end" of the innovation process with the world-class discipline exhibited by companies like Procter & Gamble. It might yet struggle to bring these two approaches together. But success could allow the company to create an innovation capability that actually lives up to the hype.

Google's much-hyped Chrome operating system will be a great test of its new approach. There appears to be clear room for a disruptive player in the OS market, and Google's focus on designing an OS specifically for the needs of the netbook market makes good strategic sense. Market leader Microsoft designs its OS primarily for more demanding personal and laptop computers, and has less motivation to fight fiercely for the smaller and less profitable netbook market.

It won't be an easy battle, however, because Microsoft has made clear that it won't abandon the netbook market. In fact, the company has plans to introduce a netbook-specific version of its upcoming Windows 7 operating system. Further, Intel is emerging as an interesting competitor in the operating system space through its efforts in the "Moblin" coalition.

Winning this battle will require more than inventiveness and high IQ. It will require the exact kind of discipline Google is trying to instill. Chrome will be a great opportunity for Google to mature as an innovator, and a great opportunity for outside observers to see how the company manages the maturation process.

Of course, building a true innovation champion goes beyond winning a single battle. It involves developing the capability to create new growth business after new growth business.

I have three unsolicited pieces of advice for Google's management as it seeks to continue to build its innovation capabilities:

- First, set and communicate clear criteria for how you make funding decisions. Make sure those criteria include quantitative elements (how big could the market be) and qualitative elements (how passionate are we about this).

- Second, create an "ideal" innovation portfolio that blends core improvements and new growth businesses.

- Finally, consciously seek ideas that provide "unique" diversification by using a new channel, reaching a new customer, or creating a new revenue stream.

There's a general lesson in Google's maturation: constraints are good. People think that constraints are innovation inhibitors, but they aren't. Unconstrained efforts are often undisciplined efforts that lead to immaterial results. The right constraints in the right places can be innovation accelerators. Constraints can focus creativity where it is most needed. Constraints can help ensure investment flows to where it provides the highest returns.

Growing up isn't always a bad thing. We'll see how well Google handles it.

Related references
http://www.amazon.com/Future-Management-Bill-Breen/dp/1422102505
http://blogs.harvardbusiness.org/anthony/2008/12/googles_moment_of_truth.html
http://online.wsj.com/article/SB124528387214225641.html

From the InnoBlog

'Silver Lining' Virtual Book Tour Ends - Update

By Renee Hopkins Callahan

This week's virtual book tour for Scott Anthony's book *The Silver Lining: An Innovation Playbook for Uncertain Times* has wrapped up. Thanks to all the bloggers who participated. Here's the final list of links to all the reviews and interviews:

Monday, July 20: Chris Flanagan, BIF Speak
http://www.businessinnovationfactory.com/weblog/silver_lining_review

Tuesday, July 21: Jeff De Cagna, Principled Innovation
http://www.principledinnovation.com/blog/2009/07/21/pi-podcast-interview-with-scott-anthony

Wednesday, July 22: Josh Kutticherry, futurethinktank
http://futurethinktank.com/2009/07/22/finding-the-silver-lining/#more-595

Thursday, July 23: Jim McGee, FastForward Blog and McGee's Musings
Review: http://www.fastforwardblog.com/2009/07/22/the-silver-lining-an-innovation-playbook-for-uncertain-times/
Interview: http://www.fastforwardblog.com/2009/07/23/innovating-innovation-an-interview-with-scott-anthony-of-innosight/

Friday, July 24: Boris Pluskowski, The Complete Innovator
http://completeinnovator.com/2009/07/24/a-look-beneath-the-silver-lining/

Bonus: Review and interview with Scott published today by Braden Kelley at Blogging Innovation
Review: http://www.business-strategy-innovation.com/2009/07/book-review-silver-lining-by-scott.html
Interview: http://www.business-strategy-innovation.com/2009/07/innovation-conversations-with-scott.html

No Disruption in the Galápagos: Innovation in Japan's Bizarre Cell Phone Market

By Andrew Laing

Japan has a well-deserved reputation as a country full of gadget lovers. The Japanese consumer electronics market consistently produces devices in some combination of useful, highly advanced, and downright cute, from Hello Kitty SMS devices to disturbingly detailed squid-shaped USB drives to the toilet in that Simpsons episode that gave Homer restaurant recommendations (see related references). Japan's cell phone market is probably the most technologically advanced in the world – so why, as the *New York Times* asked on Sunday (see related reference), haven't their eye-popping innovations reached the rest of us yet?

Japan's cell phone market is flooded with incredibly sophisticated devices – *Wired* characterized it as five years ahead of our own (3G networks, for instance, which have only recently begun unreliably spreading across the United States, showed up in Japan in 2001 – see related references), and more than twice as many people use so-called smartphones in Japan than in the United States (see related reference), despite a population less than half as large. While these characteristics make many in the U.S. envious, however, they put both Japanese manufacturers seeking to expand abroad and foreign manufacturers (like Nokia and Apple) seeking to penetrate Japan's market at a disadvantage, and have led Japanese observers to coin the phrase "Galápagos syndrome" to characterize their woes: their market is just too different.

One useful way to think about these fascinating market dynamics is through the lens of disruption. One might expect that a market so saturated with high-end devices filled to bursting with features like TV tuners and videoconference-capable cameras would be ripe for disruption, but one high-profile device that would arguably look disruptive in Japan while being sustaining almost everywhere else – Apple's iPhone – has had tremendous difficulty finding eager consumers. Compared to many other devices on the market in Japan, the iPhone has few features, an extremely low-resolution camera, a conservative design, and a low price, but its reception has been lukewarm at best (see related reference). This appears to be because Japan's consumers aren't ready for disruption at all: they aren't being overshot! The devices they can choose from may be fiendishly complicated (one Japanese engineer even mused that pushing buttons on his phone and discovering new features is "good for killing time"), but for the most part they demand and make use of those features – so much so that many Japanese citizens rely entirely on their phones (see related reference) and eschew PCs entirely.

The rapid technological evolution in this Galápagos of cell phones provides an excellent case study in disruption (or lack thereof) and serves as a reminder that disruptive innovations can only succeed when they're "good enough" against what consumers consider to be important performance metrics. Perhaps over time Japan's evolution will converge with some of the rest of the world's, but then again, in consumer electronics a five-year gap is an evolutionary eternity.

Related references

http://www.cookieskids.com/Product.aspx?l=00210055009100000000&p=TOY01346&a=nextag&mr:referralID=825fd11c-753b-11de-a19a-000423c27407
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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:

July 24: http://www.innosight.com/blog/407-innovation-links-for-july-24.html

July 17: http://www.innosight.com/blog/406-innovation-links-for-july-17.html

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