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Welcome!

The digital edition of *Strategy & Innovation* launched in September 2008, and we now have four times as many subscribers as we had for our print edition. So in this last month before the anniversary of our digital launch, we're continuing to reach into our archives for some great stories that many of our readers will not have had a chance to see. This issue, that includes "A 'Culture of Innovation' — Separating Myths from Truths" by Steve Wunker and Natalie Painchaud, which debunks familiar myths about creating a culture of innovation. Our second story tackles the question of how a big company can continue to grow when its very size sets the bar for innovation initiatives impossibly high.

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

—Renee Hopkins, Editor

Feature: A 'Culture of Innovation' — Separating Myths from Truths

Establishing a replicable innovation process takes a lot more than redesigning your workplace and embracing flip-flops

By Steve Wunker and Natalie Painchaud

Time and again, firms pronounce their goal of creating a "Culture of Innovation." Many executives, it seems, feel that the ability to create sustainable growth is largely rooted in the attitudes and behaviors that govern a firm. They see snippets of how the culture of certain innovative firms can manifest itself — from kooky work environments to frequent, direct communication with the CEO — and hope these practices can engender a transformation of the organizations and business prospects.

Much of this conventional thinking about a culture of innovation is deeply misguided. Culture is fundamentally a lagging variable: It is the result of a set of decisions about strategy, structure, people, and processes. Starting a transformation by focusing on culture is like selling a failing car by changing the brand. A brand is the result — not the cause — of a set of correct design, strategy, marketing, and other organizational decisions.

This not to say that developing a culture of innovation does not matter. Culture anchors a company into a fixed way of behaving. Norms guide frontline employees when they make the hundreds of small, daily decisions that senior managers cannot address. Quite often, for instance, an innovative opportunity is spotted by someone deep in the ranks of an organization. The process of moving from first recognition to formal assessment and on to commercial execution can be deeply influenced by culture. Frequently, the person who spots the opportunity does not understand its full implications or their thinking may need reshaping. Culture guides the informal interactions of this process and impacts the biases managers bring when evaluating opportunities.

By debunking some widespread myths, this article lays out a viable route to building an innovative culture, a route that is quite distinct from common perceptions.

Myth: Creativity is key

Truth: Rigor, discipline, experimentation are keys

Don't get us wrong, creativity is good. But it's difficult to transform the same employees you had last year into a newly creative bunch of idea generators. Happily, there is seldom any need to "remake" people. Employees get creative ideas and spot innovative opportunities all the time. The trick is to give them a way to understand these insights and to provide a time-efficient assessment process that weeds out the flawed initiatives.

To enable employees to identify hidden opportunities, it can be helpful to outline the types of business models that should be sought and to compile examples of how even seemingly small insights can lead to large innovations. A Procter & Gamble (P&G) researcher, for instance, applied the "razor and blade" business model to the problems faced by people sweeping up small spills, thereby creating the $500 million Swiffer category of disposable cleaning supplies.

At P&G, brand managers are required to map out a complete list of possible brand extensions. Some of these may be outlandish, but the process forces overt recognitions of implicit ideas, which can then be evaluated in a way that limits the impact of long-held biases about the way a firm does business. For instance, once the Pampers brand could formally assess the idea of entering into children's clothing, Pampers Children's Wear became much less outlandish and the product line was launched in 2000.

Rigor and discipline are effective only if they are coupled with a process that encourages experimentation. Rather than the typical "get it right" attitude, firms should be comfortable with getting it wrong, at least in the first few iterations of an idea. Research by Amar Bhide at Harvard Business School shows that the average start-up changes its business model four times prior to finding success. Why should corporate managers expect to be so much smarter than entrepreneurs?

Myth: Act like a start-up

Truth: Act like a VC

Countless firms urge their employees to act like entrepreneurs. In truth, however, large businesses simply have too many constraints to behave like start-ups. Unless they have the capability and appetite to spin-out new companies — as Johnson $ Johnson (J&J) has done, creating 200-plus semi-autonomous business units — firms will saddle managers of innovative initiative with burdensome procedures, such as the need to consult too many internal stakeholders and to conduct exhaustive legal reviews.

A more effective route is to act like a venture capitalist (VC). Unlike most corporations, VCs approach innovation by partnering widely with outside firms, taking a highly staged approach to investment, and funding initiatives based more on their fit with a pattern of success than inevitably unreliable projections of financial returns.

A similar approach led to Apple's iPod, which was based on an idea proposed by an independent industrial designer. Apple partnered with a virtual team of specialist companies, concentrating its own efforts on the user interface and marketing, where it felt it could execute better than others. This approach took the iPod from idea to detailed specification within six months. An entrepreneur couldn't have assembled this team, but a venture capitalist certainly could.

One of the surest ways to kill innovation is to flood an idea with money and people — something a good venture capitalist would not do. A large up-front investment creates pressure to quickly generate big revenues and often leads companies to cram an innovation into existing business processes. However, innovative offerings need the freedom to explore new business models that can result in — and sustain — widespread adoption.

Instead, create a small, dedicated, and reasonably empowered team that has a modest amount of initial funding& mdash; the VC approach. Instead of giving the team license to run fast, potentially in the wrong direction, limit resources to force the team to address the most important risks first. Senior management then can opt to invest more in the opportunity to take the next-most important risks off the table.

This staged-funding approach limits a company's exposure to potentially bad decisions and forces the team to quickly address the biggest concerns. Once ideas have become better developed and linkages to other parts of the organization increase, the team can grow and more resources can be deployed.

Myth: Be market-focused

Truth: Be customer-focused

While many companies purport to be market-focused, they are in fact often product-focused. Marketing may play an important role, but the group is often structured along product lines. There are sensible reasons for this, yet what gets lost is an understanding of the jobs customers want to get done.

Intuit, the maker of Quicken and other financial software, is an example of a firm that tries to look beyond these organizational blinders. While the company has traditional product marketing functions, it also engages in broader research to understand its customers' overarching needs. It then uses these insights to create entirely new product categories, such as its recent entry into software that helps organize doctors' bills.

At Ethicon, a J&J company that is a leader in surgical supplies, staff practically move into the hospital to shadow doctors and residents through their lives. J&J is trying to understand not just how the products are used, but the fundamental challenges that their customers face. A product-centric view would miss many opportunities for integrating solutions or generating totally new product categories.

Myth: Create cohesive teams

Truth: Form divergent teams

Hundreds of published studies have documented the psychological pressure to conform to group norms, even in the face of clear evidence that these norms are based on flawed thinking. Alas, "group-think" is a fundamental aspect of being human.

Many of these studies point out that groupthink can be avoided if there is even one voice of dissent. When this happens, individual thinking is able to blossom. The resulting clash of views can create discord, for sure, but it is also the likeliest way to generate fundamentally new ideas.

Few such ideas spring fully formed from the mind of a single creator; rather, they are iterated, built upon, and merged. Research has shown that some of the most novel ideas stem from the intersection of disparate disciplines. The Black-Scholes model of pricing options, for instance, emanated from a discussion the economist Fischer Black had with a fellow Massachusetts Institute of Technology professor about the Heat Transfer Theorem.

Clearly there is a cost to staffing teams in ways that might lead to dissent. Progress toward a particular goal may slow, and poorly handled discord may result in lower morale and employee turnover. It is not a suitable approach for every situation — especially ones where the expected outcome is fairly clear and time is a critical factor. It is not appropriate for launching a "New Cinnamon Flavor," but the approach does work if a firm is seeking real innovation.

This approach requires a leader who can draw the line between bickering and an honest exchange of divergent views within an atmosphere of mutual respect. Frequently, firms will make their high-flying, up-and-coming managers the leaders of teams tasked with creating major innovations. It is a dangerous approach.

These managers can be risk-averse and may bias a team toward safe and traditional thinking. The factors that have made them successful in the mainstream organization may be quite distinct from what a disruptive effort really needs.

Rather than seeking the "right stuff," executives should choose team leaders who have gone to the "right schools of experience." Someone who has managed a team with an unclear charter may be a better leader than someone who has run large, predictable projects.

Myth: Innovation bubbles up

Truth: Leaders drive innovation

Innovations are frequently spotted first by people near the frontline who understand customers and technologies better than senior executives. Unfortunately, they have little hope of bringing these opportunities to fruition without proper executive leadership.

Senior management needs to create a climate that allows the approaches outline above to bear fruit and to become ingrained in a firm's culture. They need to lead by consistent example, send the right messages, reward good innovation and initiative (even if it ultimately fails in its original goals), and share success stories.

Management should also set up supporting processes: surveys that monitor employees' perceptions of firm innovation; systems that track ideas even after they may be dismissed from active consideration; sessions where teams can "show and tell" their efforts to disparate parts of the firm; and venues that encourage staff mixing, idea exchange, and stories from subject-matter experts. Finally, they need to create a sense of urgency, pointing out the need for growth and challenging employees to develop "white space" ideas. Then bottom-up innovation can flourish.

Novartis, for instance, recently built a biomedical research facility whose architecture encourages a mixing of staff from widely different disciplines. IBM has created ThinkPlace, and online forum where individuals can post their ideas and find like-minded employees globally to build on their musing with their diverse expertise and perspectives. Jerry Junkins, the former CEO of Texas Instruments, called consistently for staff to "find business in the white spaces between our existing business units."

Executives must recognize that innovating is harder than sitting still. Employees won't go through the extra work needed to innovate — or take on the potential career risks of a failed project — if they don't believe that innovation is important to the firm.

Changing strategy, structure, people, and processes can create the climate for innovation, but leadership makes these moves broadly recognized and quickly acted upon. As always, leadership must motivate.

How to create a culture of innovation and vet new ideas

The process of creating an innovation strategy — including a healthy dose of disruptive innovation — can proceed in parallel with the process of finding and vetting unusual ideas. This need not be a massive undertaking: The road is signposted by three concepts.

1. Develop a New Ventures Board

To evaluate innovative projects, form a "New Ventures Board" composed of senior management from across the company that can review nascent ideas for 15 minutes, without financials. If the board sees potential, a small amount is invested in risk assessment and market sizing. The financials of innovative efforts will often be mainly guesswork, so the board should look instead for fit with a pattern of success.

Although ultimately only a small percentage of opportunities will get commercialized, the board will gain exposure to many more ideas than it would have through a traditional "button-down your business case" procedure. The structure also enables incorporation of diverse views, reduces bureaucratic haggling, facilitates cross-functional dialogue, and protects projects from losing a single senior champion who may transfer to a new role.

Along with the board, create an associated innovation-vetting process that gives serious, if brief, management attention to out-of-the-ordinary ideas. One company has even developed a charter, stipulating how it will suspend usual assumptions about its business and will encourage pattern-based, low-cost assessment of ideas.

2. Look to the VC model

When judging a potentially interesting idea, think, "What would a VC do?" In many endeavors, it pays to decisive. However, when looking at innovation it is usually wise to be humble about what is and is not known, and to make small investment to take risks off the table in a prioritized fashion.

By all means, shelve flawed ideas. But even then, try to develop insights and catalogue them; you never know when new conditions will make them plausible. Recognize that very few business success stories have followed the initial business model and hit all of the financial targets. A VC doesn't invest in a business plan; but instead backs a good team with an interesting idea, and manageable risk profile, and the capability to iterate to success.

3. Lead your innovation efforts

Create the supporting infrastructure for innovation, send the right messages, and lead by consistent example. Innovation breaks the old rules of doing things. Employees will not bother with this trouble if they don't sense organizational imperative and conviction.

Together, these changes can help innovation to flourish and culture to coalesce in ways that alter how a company acts. Building a culture of innovation isn't about having ping-pong tables on every floor, but a proper and balanced approach can make culture a powerful enabler of business success.

Innovators' Insight: Too Big to Grow?

Large companies often set large growth targets for their innovation efforts, yet seeking large targets can make innovation exceedingly difficult

By Scott D. Anthony

If you work in a large company and you want to become humble quickly, check out the Stall Points Initiative, a fascinating stream of research by the Corporate Executive Board. The research shows that almost all companies hit a point where historical growth rates decelerate. Once the corporate growth engine stalls, it is very hard to restart.

The study involved close to 500 companies that have appeared on the Fortune 100 or international equivalents over the past 50 years. Close to 90 percent of those companies experienced a stall, or “secular reversals in company growth fortunes.” Only 50 percent of companies that stalled were able to grow even moderately over the next decade.

The Corporate Executive Board highlights four primary reasons why companies stall:

- Premium-position captivity, when companies get “stuck” in the high end of their industry
- Innovation management breakdown, a “chronic problem in managing the internal business processes for updating existing products and services and creating new ones”
- Premature core abandonment, when a company falls to capture all of the growth opportunities in and around its core business
- Talent bench shortfall, or a lack of leaders who have the capabilities to execute strategy

One thing that’s not directly on the list, but perhaps should be, is “inappropriate hurdles for innovation efforts.” As a company grows, the hurdle rate for new initiatives becomes so high that many potential game-changing initiatives never see the light of day.

The problem plays out in two ways. First, companies set the bar for the ultimate size of new initiatives so high that it becomes very hard to find attractive opportunities.

For example, a few weeks ago I was with a group of senior executives at a Fortune 100 company. We were talking about the strategic objectives of that company’s innovation efforts. One executive said that $1 billion felt like a reasonable target for a generic new growth initiative. Another said, "A billion is nice, but at our size we really need to set the target at $10 billion."

Mathematically, of course, the executive is right. But only 250 public U.S. companies have $10 billion in revenues. How many high-flying start-up companies from the last decade reached $10 billion in revenue in 10 years? Well, Google hit $10 billion in its eighth year (2006) and … that's it.

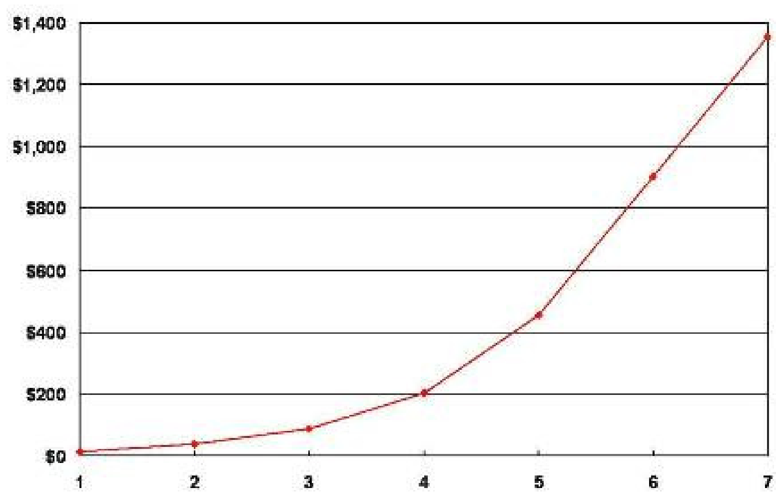
The problem is there aren't very many $10-billion businesses sitting around. If you are going to go after such a large bogey, you'll be pulled towards large, existing markets, which can be inhospitable homes for new growth businesses.

Then comes the second problem. If a company is going to get to a high steady-state target, of course first-year revenues have to be at least $100 million. Anything less than that indicates a market that's too small to matter.

Unfortunately, massive businesses don't always look like massive businesses in their early days. We did a quick analysis of revenue by year of close to 20 recent disruptors. The list included Google, eBay, Amazon.com, First Solar, Enernoc, Baidu, and several others.

As the chart below shows, the average first year revenue of the collection of companies was less than $40 million, with many companies having revenues of less than $1 million. It took until year 3 for the average of the sample to get close to $100 million, and year 7 for the average of the sample to exceed $1 billion.

Average Annual Revenue of Portfolio of Recent Disruptors



($MM)

That is astronomically fast growth, but would be not fast enough for a company seeking a $100-million pop in the first year. The only reliable way to create top-line growth of that magnitude is through relatively large acquisitions, which tend to be at best value-neutral.

So what’s a behemoth to do? One key to success: individual units responsible for growth should be kept small enough so they can prioritize opportunities that start relatively modestly. For a long time Hewlett-Packard had a practice of splitting up any division that reached a certain size, to minimize bureaucracy and leave the smaller unit free to prioritize relatively small opportunities.

Another key is to set reasonable screens for new growth opportunities. For example, one of Innosight’s colleagues was helping a pharmaceutical company set screens for its innovation efforts. The goal was to increase the reliability with which the company created blockbuster drugs that hit $1 billion or more in annual revenue.

Our colleague asked the company to run its current blockbuster drugs through the screen. Not a single one would have made it through. Again, the company set the bar so high it would have make it close to impossible to succeed.

By all means make sure there is a story for why a given opportunity could be a blockbuster success. But leave room for exploration, iteration, and small starts, or it will just be a matter of time before you hit your own stall point.

For more information
A summary of the Stall Points research is here: http://stallpoints.executiveboard.com/

“There Is Good Money and There Is Bad Money,” Chapter 9 of The Innovator’s Solution: Creating and Sustaining Successful Growth, by Clayton M. Christensen and Michael E. Raynor. Harvard Business School Press, 2003.

From the InnoBlog

Emerging Technology Watch: 3M Debuts Bluetooth Stethoscope

By Renee Hopkins

On August 19, 3M introduced the first electronic stethoscope with Bluetooth functionality (see related reference). Adding Bluetooth solves a problem that has plagued electronic stethoscopes -- they can capture sounds that are hard for the ear to hear using an analog stethoscope, but taking those sounds off the devices for analysis has proved difficult. The new stethoscope can send its data to a Bluetooth-enabled computer, and comes with software to allow doctors to interpret the data. The sounds can also be sent as an audio file to other doctors for second opinions. The goal is to give physicians better information with which to make diagnoses and potentially cut down on the use of unnecessary referrals to specialists in some cases. While the stethoscopes now are only compatible with Windows XP and Vista, reportedly there will be Blackberry support in the future, which could make the electronic stethoscopes attractive for physicians who use PDAs.

Related reference
http://www.medcitynews.com/index.php/tag/littmann-3200/

Lessons for Innovators from the TV Show 'Shark Tank'

By Natalie Painchaud

When making a pitch for your idea be sure to describe how the business will become big and be specific in your ask.

Shark Tank is an adaption of the Japanese television show Dragon's Den, which gives entrepreneurs the chance to pitch their plans to venture capitalists ("the sharks") with the goal of securing investments to pursue their ideas.

The show provides useful lessons to not only aspiring entrepreneurs but to any innovator who needs to pitch a new product idea to their bosses for continued exploration.

When we conduct workshops at Innosight we have teams present their ideas in short pitches answering the following questions, much like on the show.

1. What problem are you solving for consumers?
2. What is your idea?
3. What is the business? How will you make money?
4. What specifically are you asking for?

People in our workshops and people on the show do quite well on the first two questions. They have personal stories of how they identified the needs (or JOBS™) in the marketplace and have creative and compelling presentations of their ideas (songs, prototypes, samples).

The area where we have seen the biggest room for improvement is in the third area, demonstrating how they will make money and make the business big. The "Sharks" (and your bosses) want to see that there is real interest from customers in the innovation and a clear path to develop a big business. Questions you should be prepared to answer are:

- Do you have sales? How many units have you sold?
- How do you know people are interested in this product?
- Who is the customer? How much do you expect them to pay?
- How many stores are you in? Have you shown this to a retailer who said "I like this, I want to sell this"
- How do you know people will buy that?

The other shortfall is not being specific enough in "the ask". People who ask for money to build the brand so they can then go to trade shows or retailers do not fare well. Whereas people who ask for money to fulfill production for orders they have in place already do well. Be specific. You need to show how what you're asking for will help build the business and help make them money.

As you pitch your innovation ideas be sure to describe why the business is compelling and make a specific “ask”. To see the process in action check out the show (Sundays on ABC at 9pm EDT).

Related reference
http://www.innosight.com/our_approach/JOBS.html
http://beta.abc.go.com/shows/shark-tank/

Losing a Standards War: If You Can’t Beat Them, Join Them?

By Krystin Stafford

The AP reported this week that Toshiba Corp. is joining the Blu-ray Disc Association (see related reference). Why is that such a big deal? Because until last year in the U.S., Toshiba Corp.’s HD-DVD was battling it out with Blu-ray in a standards war.

Across industries, standards wars often accompany the emergence of new technologies, as players pit their proprietary technologies against one another. We’ve all likely experienced this at some point and have had to make the decision of whether to buy now or to hold off until a standard is established. Think Betamax versus VHS or iTunes’ formerly DRM-protected music (see related reference) versus DRM music from other providers.

When there is a highly fragmented market without an established technology standard, consumers have to recognize that what they purchase may become obsolete in the short term if a different technology becomes the standard and the product stops being supported. When a victor is about to be declared in a standards war, an opposing company has a few options: 1) they can march on and fight what is likely a losing battle, 2) they can ally themselves with others (‘the enemy of my enemy is my friend’ mentality), or 3) they can cede to the competing technology. Depending on the situation, different paths should be taken.

If the company’s foothold is weak, marching on can lead to wasted resources that could be better used developing or acquiring other technologies. Allying with others can help to fight a strong market leader, but defeating the enemy will mean sharing the market with those allies. Ceding to the competing technology may be favorable if there are few players in the market and there is an upside that can be gained.

Thinking to the future, what kind of standards conflicts might we expect? How about eBook readers (see related reference) that have associated stores with proprietary formats preventing the use of those purchased books on other eBook readers (see related reference)? In the healthcare world, standards wars may play out in hospitals, as a fragmented marketplace offers electronic medical records (EMR) to a wider user base. Will there be a clear winner for EMR adoption? Alternatively, consider the auto industry. The U.S. government just granted billions of dollars (see related reference) for the development of batteries and parts for electric cars. Instead of engaging in a standards war over the charging plugs they use, companies have banded together to create a standard for charging electric cars (see related reference), which may help adoption of those vehicles.

The fight to become a standard and a leader is all around us. When you consider new or emerging technologies, the competition to establish dominancy is incredibly important. When you don't become the standard, your options are to join the competition or to come back, alone or with allies, with something bigger, stronger, faster, newer, etcetera. It will be interesting to see how all these technologies evolve — and who knows, these could be the B-school case studies of the future.

Related references

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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:

August 21: http://www.innosight.com/blog/423-innovation-links-for-august-21.html

August 14: http://www.innosight.com/blog/425-innovation-links-for-august-14.html

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