STRATEGY & innovation

April 8, 2010

Volume 8, Number 3

Mastering Change for Innovation

Welcome!

Innovation brings change, and change offers opportunities for innovation. This issue of Strategy & Innovation includes my email conversation with Dan Heath, who with his brother Chip is the author of "Switch: How to Change Things When Change Is Hard." Also, continuing the conversation on business model innovation we've been having, we feature an excerpt from the epilogue of Innosight chairman Mark W. Johnson's book, "Seizing the White Space: Business Model Innovation for Growth and Renewal" — "Leading Through Business Model Innovation." Also, we have another piece that dives deeper into a concept from "Seizing the White Space" — "Where Do Your Profits Come From?"

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

— Renee Hopkins, Editor

Events

NAB Show – Andrew Waldeck will speak on "A Time for Change: Business Model Innovation for the Media Industry," April 11, Las Vegas

http://www.nabshow.com/2010/about/default.asp

The Front End of Innovation – Innosight will be exhibiting, May 3-5, Seaport Boston Hotel.

http://www.iirusa.com/feiusa/fei-home.xml

Future of Business Roundtables – Mark Johnson will speak, May 19.

http://www.conference-board.org/conferences/conference.cfm?id=2114

World Innovation Forum 2010 – Renee Hopkins will be tweeting and blogging coverage from the event, June 8-9, New York.
http://us.hsmglobal.com/contenidos/wifhome2010.html

Feature: *'Switch' – How Change Happens*

Ways innovators can master the change process at the heart of all innovation.

By Renee Hopkins

Change is at the heart of innovation – no innovation happens without change, and innovation changes the status quo. Understanding how to make change happen, then, is of critical interest to innovators.

Made to Stick authors Chip Heath and Dan Heath have tackled the question of how to make change happen in their new book, *Switch: How to Change Things When Change Is Hard*. At the heart of *Switch* is this framework that sets out three ways change happens:

1. **Direct the Rider** (the conscious mind), eliminating what looks like resistance but is more often a lack of clarity by providing crystal-clear direction.
2. **Motivate the Elephant** (the subconscious), eliminating what looks like laziness but is more often exhaustion by engaging emotions to get them on the same path as you.
3. **Shape the Path** (the situation), eliminating what looks like a people problem but is more often a situation problem, by making the environment more conducive to the change you seek.

With this framework in mind, *Switch* co-author Dan Heath answered questions I sent him about how *Switch* works from the perspective of an innovator:

Q. What are Switch*'s main takeaways for innovators?*

A. *Switch* discusses a simple framework for changing behavior. Innovators will need this skill more than most people, since they need to convince their colleagues to adopt new practices and their customers to embrace new products. One core principle of behavior change, which is particularly relevant to innovators, is that people rarely change because they are provided with information. Change comes from feeling, and the feeling provides us the motivation we need to overcome the nuisance of making changes.

So if you're leading change, you should ask yourself, "What can I get my colleagues or customers to *feel*?" As an example, consider Robyn Waters, who helped transform Target into the design powerhouse it is today. In convincing Target's merchants to take a chance on new designs or new colors, she'd constantly *show* them things. *See, look how using the bright blue Polo shirt makes your display "pop."* And they'd get inspired by what they saw and give her a chance. She never could have convinced them with a memo or a PowerPoint.

Q. What are the ways the relatively simple behavioral change of using checklists can drive more creative and innovative behavior (or outcomes)?

A. Checklists are basically insurance against overconfidence. A checklist will never generate an innovation — that's not the point. What checklists can do is train your innovative mind on the right issues. Let me give you an example. There's a classic study in psychology that asked students to come up with a solution for their university's chronic parking problem. Ideas ranged from raising parking fees to creating more "Compact Only" parking spaces. After the ideas were collected, a panel of experts assessed them — eliminating wacky or impractical options — and identified a set of "best solutions". The average individual brainstormer came up with 30 percent of the best solutions, which is pretty good for a solo effort. Here's what's not so good: The brainstormers confidently predicted that they'd identified 75 percent of the best ideas. Whoops.

So imagine if we'd provided those students with a checklist of "solution categories" to guide their thinking about the parking solution. We'd remind them to think about things like "solutions that raise the cost of parking" and "solutions that help more cars park in the same amount of space" and so on. It would have sparked their thinking and kept them from forgetting key areas of consideration.

Q. If a company's goal is to help its employees become more innovative, which is the best approach? Direct the Rider, Motivate the Elephant, or Shape the Path? Is there a desired combination for increasing more creative, innovative behavior? Or would the solution be very situation-specific?

The solutions will be situation-specific, but the strategy won't be. If you want your employees to be more innovative and creative, think in terms of a three-front campaign:

1. **Provide crystal-clear direction.** In a change effort, what looks like resistance is often a lack of clarity. For instance, what does it mean to be more "creative" or "innovative"? Different organizations would interpret those terms very differently. Do you want people to submit ideas for new products or processes? Do you want them to spend more hours in the field shadowing customers? Do you want them to build prototypes of their designs more rapidly? A leader needs to translate aspirations into actions — so think in terms of the behaviors that you want to encourage.

2. **Find the motivation.** As mentioned earlier, change comes from feeling. Why should people bother to act differently? After all, they've been practicing the "old ways" of behaving for months or years. It will take enormous effort for them to retrain themselves. Why should they bother? The motivation might come from the desire to correct mistakes — imagine screening a video of a customer who experienced a lot of hassle because of your team's failure. Or you could imagine appealing to their desire to be the best — painting a picture of an innovation that, if executed correctly, would blow people's minds.

3. **Clear the path**. If you want your team to be more creative and innovative, how many obstacles can you clear from their path? Can you create better IT systems to automate some of the bureaucratic duties that crowd out their creative time? Will you create PDA-free "quiet hours" so they can focus? Will you pay for offsite meetings so they can collaborate more easily? If you reflect on your own experiences, you'll surely realize that there were some environments in which you found it easy to be creative and others where it was impossible. How can you create an environment that makes it easy on your team?

Q. Driving innovation within a company often requires people to embrace contradiction – think analytically yet also think metaphorically; focus on the near-term result yet also think out to the future; drive incremental innovation to keep the near-term bottom line growing yet also drive breakthrough innovation to keep the company growing into the future. Obviously it's important to know when to switch focus. But how do you change into someone who has this capacity, when hardly anyone has it naturally? What do you change about yourself to be able to do this?

I see these more as balancing acts rather than contradictions. E.g., you need a balance of short-term focus and long-term focus. And I disagree with you — I think we all have this capacity to balance. But sometimes we'll end up out of balance — say, too focused on short-term results — and then we'll need to correct the situation. And that's when the strategy discussed above — clear direction, emotional motivation, and a clear path — can be employed.

People tend to moan and groan about change, but the fact is, we're all pretty good at it. People get married, they have kids, they switch jobs, they move cities, they embrace new technologies, they eat new foods and wear new clothes. Of course, that doesn't mean your change at work will be easy, but it does mean there's no one on your team who lacks the capacity for change.

Related references

Made to Stick:
http://www.amazon.com/Made-Stick-Ideas-Survive-Others/dp/1400064287/ref=pd_sim_b_1

Switch:
http://www.amazon.com/gp/product/0385528752/?SubscriptionId=1JCQD9WSPP6113SZ5DG2

Heath Brothers website:
http://heathbrothers.com/

Feature: Leading Through Business Model Innovation

How you can build a business with the capability to transform itself if need be.

By Mark W. Johnson

The world is moving so fast nowadays that the man who says it can't be done is generally interrupted by someone doing it. — attributed to Elbert Hubbard

Peter Drucker once said, "Every organization . . . has a theory of the business . . . Some theories of the business are so powerful that they last for a long time. But . . . they don't last forever, and, indeed, today they rarely last for very long at all. Eventually every theory of the business becomes obsolete and then invalid." The average life span of those theories grows shorter every day. Building a great business and operating it well no longer guarantees you'll be around in 100 years, or even 20. In 1958, the average length of time a company remained on the S&P 500 was 57 years; by 1983, it had dropped to 30 years; in 2008, it was just 18.

I believe investing for the long term in the twenty-first century means continually building and rebuilding your organization. Shorter business life cycles require a new sort of management discipline capable of leading an organization through an ongoing process of transformation and renewal. To thrive in today's marketplace, to be built to last, every business now must be built to*transform*.

A lot has been written about Internet pioneer Amazon as it emerged from the dot-com bubble as one of the few winners and continued to blaze a trail of impressive growth (from about $4 billion in 2002 to nearly $20 billion in 2008). But one of the most unexamined facets of its high-profile success is its unabashed embrace of transformational growth in its white space. Amazon survived the dot-com bust initially because, unlike many of its contemporaries, it had a viable and innovative business model built around a market-changing customer value proposition and a radical profit formula, which upended the staid book industry. Then it quickly expanded beyond books to include all sorts of easily shippable consumer goods, growing from its core into near adjacencies. But Amazon didn't stop there.

A few years later, the company seized its white space when it devised a new value proposition, offering a commission-based brokerage service to buyers and sellers of used books. Then it moved into its white space again by developing a model to serve an entirely different customer: third-party sellers. By opening up its storefront to other retailers that were essentially competitors, Amazon transformed its business from direct sales to a sales-and-service model, aggregating many sellers under one virtual roof and receiving commissions from the other companies' sales.

Then Amazon did it yet again. After it expanded its IT resources in early 2000, it identified a new area of potential growth by finding another new customer — the IT community. Serving this new customer's needs required different processes, different resources, and a different profit formula — in short, another new business model. In 2002, after a careful period of incubation, Amazon launched a Web services platform that offered low-cost, reliable, and easy-to-use online services for other Web sites, as well as client-side applications for Web developers. It may have seemed risky for a young company that had only reached profitability in that same year to invest its innovation resources in new business models rather than stick to its core, but within five years the site used by those services had grown into the seventh-largest in the world. And Amazon kept going. In late 2007, it hired palmOne's former VP of hardware engineering Gregg Zehr and set up Lab126. Its first product, the Kindle e-book reader, came to market wrapped in a business model not only foreign to Amazon's DNA but also potentially disruptive to the entire publishing industry.

To launch a high-margin, product-based offering, Amazon had to become an original equipment manufacturer (OEM). It wrapped this technology in a seamlessly integrated iTunes-type digital media platform that combined both transaction-based content delivery and a subscription model for periodical content. It partnered with content producers in new and innovative ways and created an open back-end that allowed independent publishers to generate new content specifically for the Kindle platform. In its first year, Kindle sold an estimated 500,000 units and earned high customer satisfaction ratings. Amazon has greatly expanded the market for e-books and has positioned itself for success not only in this now suddenly viable market but in newspaper and periodical distribution as well.

Amazon at its roots is built to transform. When it finds opportunities to serve new customers, or existing customers in new ways, it conceives and builds new business models to exploit them. Amazon has the unique ability to create and operate at the same time — to invest for the long term by launching and running entirely new types of businesses while simultaneously extracting value from existing businesses. It demonstrates that becoming can become a part of being for any organization willing to invest the time, discipline, and effort. Whatever its future holds, Amazon's journey will likely be marked by a series of transformations, as it continues to pursue its vision unafraid of white space, business model innovation, or renewal.

To be built to transform requires the courage to focus on delivering value for the customer first. Identifying value begins by thinking of an important unserved or underserved job that customers want done and then coming up with a well-defined value proposition to address that job, however foreign to your current offerings that may be. "If you want to continuously revitalize the service that you offer to your customers, you cannot stop at what you are good at," says CEO Jeff Bezos. "You have to ask what your customers need and want, and then, no matter how hard it is, you better get good at those things." With a well-defined customer value proposition serving a focused, well-articulated job, business leaders and project teams can work together to design the appropriate profit formulas, key resources, and key processes the company needs to thrive.

To do this, business leaders need to become business model thinkers, to understand that both the current model underpinning their existing business and any new models they may devise are complex systems with interdependent elements that must work together to deliver real value. To build these systems, they must think like architects or engineers, to begin with blueprints, build prototypes, and develop working structures that can deliver on new areas of opportunity. Although they can't devise all the answers up front, they can ask the right questions. Then they must pursue those answers like an artist would, exploring with a process of structured creativity that allows everyone involved to freely imagine the possible, not just the easily done.

Business model innovation efforts should be focused on the pursuit of something grand — changing the game in an existing market, creating a whole new market, transforming an entire industry. If leaders can't succinctly articulate how a new business model will capture an opportunity for significant corporate growth (or in the face of tectonic shifts become a powerful engine of company renewal), then white-space efforts or fundamental business model change is unjustified. Business model innovators should be hunters of big game and leave the harvesting of core assets to others.

But while thinking big is an essential precondition for seizing the white space, it is equally imperative to start small. Slowly incubating the new venture using foothold markets will protect it as it grows and matures, giving it the time and space needed to test assumptions, make adjustments, and develop the key resources and processes that will deliver the greatest value.

Ultimately, companies need to learn how to get out of their own way. To many, this will seem like the hardest challenge, but I believe that much of the frustration leaders, managers, and employees encounter in trying to do something new stems from an insufficient understanding of the old. Too many companies don't actually know what business models they're currently operating under, going along day to day using rules of thumb, incentives, and the odd success story to guide them. But organizations that have an explicit understanding of the elements that make up their current business models are in a far better position to judge how well equipped they are to capitalize on new opportunities or meet coming threats.

Business model innovation thrives in cultures of inquiry, environments in which new value propositions and ideas for new business models are met with interest and encouragement. In built-to-transform companies, managers recognize that a nascent business opportunity, no matter how far from their core it is, might be the key to the Next Big Thing. "Controlling innovation is an oxymoron," says Netflix CEO Reed Hastings. "You inspire innovation. You support innovation. Unlike the quality process, where the goal is to reduce variability, innovations require you to look for ways to increase variability. And business model innovation is scary because it is the toughest to take on."

It doesn't have to be. Throughout my book, *Seizing the White Space: Business Model Innovation for Growth and Renewal*, I have detailed a structured approach to the essentially unstructured process of creating something new. I have shown that while forays into your white space carry a high degree of uncertainty, they needn't carry a high level of risk. An organization can make business model innovation a management discipline — a repeatable process that can be well understood. Seizing your white space begins with a simple four-box business model framework, but it leads to far-reaching implications for all organizations navigating the turbulent waters of twenty-first-century global business. Business model innovation can help companies meet many of the big challenges they face, be they growth gaps, market shifts, revolutionary technologies, or uncontrollable social forces. It can help companies devise profitable, market-based solutions to the needs of consumers and societies around the world that will make people's lives better and economies more prosperous. To create new growth, spur transformational change, and renew our companies, we must learn to seize the white space through business model innovation.

This article is an excerpt from Seizing the White Space: Business Model Innovation for Growth and Renewal *by Mark W. Johnson (Harvard Business Press, February 2010).*

Feature: Where Will Your Next Profits Come From?

The story's not always just in the margins.

By Mark W. Johnson

How does your company make its money? I'll wager it's not in the way that you think. Not entirely, at any rate.

I typed the term "profit formula" into Google the other day, and the first entry I got was entitled "Calculating Gross Profit Margin."

That's not really surprising, since most companies measure profits in terms of margins, whether gross or net. What could be more rational? After all, at its most basic level, a company's profit formula has two parts — revenue and costs. Sell something for more than it cost you to make it and you turn a profit. How much higher revenue is than cost for each transaction is the margin. So it seems logical that focusing on margins is a good way to keep track of your profits.

And it is. But it's also a good way to close your organization off to the possibility of making future profits.

To understand why, let me lay out what I believe is a more useful way to think of profits — a formulation I've broken out into four parts to make it easier to view profit generation strategically. In this framework, the factors you need to consider when determining how your company will turn a profit for a given offering are:

- Revenue model (price x quantity)
- Cost structure (direct costs, overhead, economies of scale and scope)
- Margin model (how much each transaction must net to reach the desired profit level)

- Resource velocity (how quickly resources are turned into offerings — leadtimes, throughput, inventory turns, asset utilization).

Companies that habitually use margins to judge how well their current model is working often make the mistake of using them to judge how feasible a new opportunity would be, too. That leads them to reject out of hand any new business that might involve lower margins.

But as you can see from this framework, your current company's margin requirements are a function of many other factors: the price you've set, the quantities you sell, your fixed costs, your economies of scale or scope, the speed with which you can get paid. Change any of these factors and the margins required to turn a profit change as well.

Granted, changing fixed costs, overhead, or the way in which customers pay you is hard for incumbents. But the very fact that it's hard to think about profit generation in other terms is what creates opportunities — if not for you, then for focused start-ups unencumbered with your fixed costs or your need to sell at a certain price to maintain margin.

Dell Computer, for example, became extraordinarily profitable not just because it found a lower-cost way to make personal computers than its competitors, but because it found a way to get its customers to pay for the computers before Dell had to make them — thus assuring that it made only the computers that would be sold. With that advantage, Dell could be profitable at far lower margins than Compaq or IBM could ever accept.

That's why Dell's model was not only effective but sustainable for so long. Its model was not only new, it fundamentally conflicted with the models of its competitors.

IBM, the wily business model innovator that it is, recognized the threat that Dell's lower margins represented and further understood that to compete it needed not to copy Dell but to reengineer its own profit formula, which it did by offering up a business model innovation of its own — focusing more on higher-margin services. But the transition was painful — involving the layoff of some 200,000 people. Referring to how traumatic the memory of this was in an interview over a decade later, CEO Sam Palmisano put it like this: "Over the course of several years, we wiped out the equivalent of a medium-sized northeastern city — say, Providence, Rhode Island."

Executives focus intently on margins for a reason — they're the first indicator of risks to the business. I won't argue with that. But too great a focus on margins carries risks of its own. How vulnerable would your company be to a competitor that has thought up a novel way to turn a profit in your market? You won't begin to be able to answer that question unless you understand your entire profit formula, not just its margin requirements, and ask yourself how it might otherwise work.

This article was originally published on Harvard Business Review's 'The Conversation' blog (see related reference).

Related references

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http://blogs.harvardbusiness.org/cs/2009/11/is_your_company_courageous_eno.html

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