

CHAPTER 1



The Need for Innovation

Radical, category-breaking innovation is what is needed today. Some companies can do it consistently but most can't. Why not?

The Need for Innovation

Time was, all a company needed to do was improve. If it did it continuously (and that was hard enough), it could expect to be successful. Those days are long gone. The information explosion, the global economy—all the things you'd have to have been in a coma to have missed—have conspired to change the rules. In fact, *Harvard Business Review* concludes that “pursuing incremental improvement while rivals reinvent the industry is like fiddling while Rome burns”¹ and *Business Week* believes that “what’s likely to kill you in the new economy is not somebody doing something better, it’s somebody doing something different.”² Geoff Smith, VP of Business Development for Mitel, a manufacturer of telephone switching equipment, provides the perfect example. “Our competitors are not Lucent or Nortel,” he maintains. “Our competitors are companies like Cisco that see voice communication as just another data application that they can give away. They’re giving away our whole business.”

¹ Gary Hamel, “Strategy as Revolution,” *Harvard Business Review* (July/August 1996).

² Michael Bloomberg, “Winning at the Intersection of Fear and Opportunity,” *BusinessWeek* (January 11, 1999).

So what is the new imperative? The Society of Management Accountants calls “*innovation...fundamental to the quest for profitable, sustainable growth.*”³ Peter Drucker, probably the most insightful management guru ever, deems it *the* one business competence needed for the future. *Fortune* magazine’s advice to companies who want to be named to its Most Admired List? Innovate, innovate, innovate. Innovation currently accounts for more than half of all growth. And it is enormously profitable. A study done on the rate of return for 17 successful innovations showed a mean return of 56% compared with an average ROI of 16%.

Companies are catching on to this sea change. In an Ernst & Young study, European and North American companies called innovation the most important criterion for success in the future. Even technology firms who presumably are leading this charge consider “making innovation happen” the industry’s single biggest problem.

Jack Welch, CEO of GE and seen as the world’s greatest living manager, obsesses about his company’s ability to “break the glass”—that is, continue to innovate. He worries whether it has “the right gene pool—do people who join big companies want to break the glass? We’ve got to break this company to do this—there’s no discussion, we’ve just got to break it.”⁴

So organizations need to innovate to survive and they know it. But before we explore this issue further, let’s ask an important question.

What is Innovation Anyhow?

The commonly held view is that innovation is creativity—new ideas, knowledge creation. That’s why companies spend mega-bucks for courses where people play with brightly colored blocks to get their creative juices going. But it isn’t just that. It goes beyond idea generation to putting those ideas into action. Steve Wynn, CEO of Mirage Resorts—one of *Fortune*’s most admired corporations—points out that “the challenge is getting the steady stream of good ideas out of the labs and creativity campfires, through marketing and manufacturing and all the way to the customer.” In other words, while you need to keep the pump primed with lots of great ideas, it will be for naught if they don’t see the light of day. Management expert Rosabeth Moss Kanter has long maintained that “a good new idea means little—except risk—

³ The Society of Management Accountants of Canada, *Collaborative Innovation and the Knowledge Economy*, (Management Accounting Issues paper 17).

⁴ Thomas A. Stewart, “See Jack. See Jack Run,” *Fortune* (September 27, 1999), pp. 124–36.

without...excellence in execution.”⁵ So, if you have a lot of off-the-wall thoughts, you’re creative. If you can turn them into something of value, you’re innovative.

In addition, in today’s fast-moving, category-breaking business environment, building a better mousetrap may be effective, but it’s not innovation. Innovation is using supersonic waves to beam the mice back to their native habitat; it’s developing a whole new way to get rid of them. It is *not* about marginal improvement on a marginal product.

Accordingly, *Fortune* magazine maintains that only non-linear—that is non-obvious, non-incremental—innovation will produce long-term wealth creation. Radical innovation, the kind *inconsistent* with your present strategy, is no longer an option but an imperative. Geoff Yang, a Silicon Valley venture capitalist with one of best track records in the business (300% annual return on investment), agrees. “To come up with concepts for new products, CEOs have to encourage breakthrough thinking.”⁶

So, to be innovative, the idea has to be creative and implemented. To be competitive, it has to be a great leap forward. Otherwise, close but no cigar.

What Kind of Innovation Is Required?

We know that innovation has to be creative, implementable, and radical. But on what? Products and services are the obvious place but there are many other areas where we need to rethink our old habits. Guy Kawasaki, former marketing guru for Apple and author of *Rules for Revolution*, says that habits will kill business in the new economy. I’ve listed some of them below:

- *Our product is less terrible than yours.* Realistically, in the old economy and before the Internet, if consumers didn’t know they could get your products 20% cheaper on the other side of town, you automatically made 20% more profit. What they didn’t know fell directly to your bottom line. And if you were even marginally better than your home-town competitor, you were in gravy. Today, everyone can reach far and wide to get products that aren’t just less bad but actually work better.

⁵ Rosabeth Moss Kanter, “Follow-up and Follow-through,” *Harvard Business Review* (March/April 1990), p. 8.

⁶ Lori Ioannou, “Make Your Company an Idea Factory,” *Fortune* (June 12, 2000), pp. F264N–F264R.

- *Budget is paramount.* If it's not in the budget, it doesn't exist, no matter how worthwhile. And budgets, the last time I looked, are not instruments of risk. By putting them above innovation, companies avoid those high-risk, high-payoff opportunities that are the essence of innovation.
- *Outsourcing saves money.* In the short-term, it does but it kills you in the longer term. In outsourcing the work, you also outsource your talent, your core competencies, and your capacity to innovate.
- *The best product wins.* I wish, I wish, I wish that were true. Then we'd all be working on Apples and playing our (rapidly disappearing) videotapes in Beta format. First to market seems to be the way to win. This means software with lots of bugs that will be fixed, later, honest. It is forcing us to rethink the value and the profitability of quality.

These habits are no longer useful and in fact will get us into trouble. We need to come up with new ways to address new challenges. We need to innovate our way out of old habits.

Some Organizations Are Great at Innovation

Some organizations have a marvelous history of innovation; not just the breakthrough that put them on the map, but a continuing stream. 3-M produces 30% of its revenue from products that didn't exist four years ago. Enron is a pipeline operator that has reinvented itself into a new economy trading powerhouse. In an e-business world still trying to figure out how to make things work, EnronOnline, its business-to-business site, traded \$100 billion in its first year of operation. Its EVP, Steve Kean, knows "innovation is at the heart of sustaining a company's competitive advantage."⁷

Companies that innovate successfully understand the need to be radical. Hewlett-Packard makes both laser and ink jet printers, products that naturally compete. However, rather than try to avoid the competition, H-P encouraged the two divisions to cannibalize each other's markets. The result? It is the leader in *both* laser and ink jet printers.

Similarly, Jack Welch's success is at least partially attributable to his radical innovation. When he became CEO of GE in 1980, he figuratively blew up what was at the time the most successful company in

⁷ Nicholas Stein, "The World's Most Admired Companies," *Fortune* (October 2, 2000), p. 183.

the United States. He demanded every GE business be first or second in its field. With that strategy, GE today is consistently one of the most admired companies in the world (i.e., most profitable, given this is *Fortune* magazine doing the admiring). But Welch has now realized that the innovation imperative requires a new mindset. GE no longer wants its member companies to be first in their field. To be more open to innovation everywhere, it expects them to be players—not even necessarily the dominant one—in many markets.

Some companies can innovate successfully and are rewarded handsomely for it. But it is a fragile thing. Compare *Fortune's* picks for most innovative companies in 1999 and 2000. In 1999, it was Home Depot, Intel, and Fortune Brands in that order. A year later, it was Enron, Nokia, and Home Depot. Only Home Depot stayed within the top three and it dropped from first to third. Needless to say, none of these companies stopped innovating but it is clear that staying on top of the innovation game is as hard as getting there in the first place.

Some Are Crummy

So some organizations seem to have the magic bullet. But most don't and they know it. The American Management Association conducted a survey of 500 chief executives. These executives, like the companies in the Ernst & Young study cited earlier, named innovation as the top answer to "what must one do to survive in the 21st century?" But only 6% thought they were doing the great job necessary for today's economy. There have been many failures.

Xerox's Palo Alto Research Center (PARC) is famous for innovations that Xerox did *not* exploit—like fax machines, laser printers, and graphical user interface (GUI). The problem continues to exist. PARC's strategy-integration manager Mark Bernstein reports that a number of projects with money-making potential are orphaned, even though industry analysts have urged Xerox to focus on PARC's new technologies to pull itself out of its present slump. But they are also skeptical Xerox will do so, saying that a "central irony of Xerox's predicament is that it may ultimately be undone by its inability to adapt to the computer-driven, networked world its own lab helped to create."⁸

Procter & Gamble has a similar problem. It has a long history and is credited with revolutionizing business with its use of brand marketing. But its last major breakthrough was Pampers in 1961. The company went from innovation to merely improving—Tide has had over 60 "new

⁸ Jeremy Kahn, "The Paper Jam from Hell," *Fortune* (November 13, 2000), pp. 141–46.

and improved.” The company has fallen seriously behind its competitors. It had become known as “the land of the Proctoids—a place that squelches entrepreneurs, creative types, freethinkers—where ‘troublemakers don’t belong.’” In 1999, the new CEO, Durk Jager, promised to act aggressively to fix this problem. He said, “The core business is innovation. If we innovate well, we will ultimately win. If we innovate poorly, we won’t win.”⁹ Seventeen months later, he was out of a job, the industry consensus being that he had pushed change too fast for the Proctoids.

Other companies struggle with innovation. Motorola resisted going from analog to digital and lost its commanding lead in cellular phones. McDonald’s stuck to its successful formula too long, resulting in creative inertia and a string of innovation flops like McPizza, McLean Burger, and the “adult” Arch Deluxe. Levi Strauss stopped innovating and destroyed its brand name to such an extent that its estimated market value has gone from \$14 billion to \$8 billion while The Gap has gone from \$7 billion to \$40 billion in the same time period.

Pretty depressing. Much as organizations want innovation, they’re not great at it. In fact, a study of 46 leading-edge companies in the United States, Canada, Europe, and the Middle East found that companies unintentionally kill it. They hire creative people and then prevent them from using their skills. The *Financial Post* calls this inability to innovate “the single most dangerous gap in business today.”¹⁰

So here we are, knowing that innovation is the next competitive edge and also that generating and sustaining it has daunted many a talented and determined manager. Why? Well, that’s what this book is about. Not only why companies can’t sustain innovation but also what they can do to change.

About This Book

The first section of this book, Chapters 2 to 4, helps us understand how we got into this pickle and how the encouragement of dissent can play a central role in fostering a more innovative culture.

There are four main things managers need to do to encourage dissent and therefore innovation in their organizations. The first is to avoid inadvertently suppressing open dissent that naturally occurs. This topic will be covered in Chapters 5 and 6.

⁹ Katrina Brooker, “Can Procter & Gamble Change Its Culture, Protect Its Market Share and Find the Next Tide?” *Fortune* (April 26, 1999), p. 150.

¹⁰ *Financial Post*, “The Creativity Deficit is Described as the Single Most Dangerous Gap in Business Today,” (October 25, 2000), p. c9.

Chapters 7 to 9 help managers work with people who have taken on the role of a dissenter. That is, they typically dissent no matter what. While they can be pains in the neck, they can also be very helpful in creating an innovative culture. These chapters will help managers identify them, coach them, and act as their political handlers in getting their ideas accepted in the company.

Much as dealing with open dissent is a challenge, it is even more difficult if it goes underground. Chapter 10 will help you identify if your dissent has gone underground and Chapters 11 and 12 help you to bring it to the surface again.

A culture that sustains innovation needs to incorporate ways to encourage continuing dissent. Chapter 13 will cover how to kickstart the move to an innovation culture, Chapter 14 deals with processes and mechanisms that support innovation, and Chapter 15 shows individual managers how they can help the culture change.

Chapter 16 deals with dissenters who are destructive and must be let go. The final chapter provides some thoughts on where to go from here in the evolving role of manager as promoter of innovation.

Summary

Even though having a great idea is, in and of itself, an accomplishment, the true test for any organization is getting it to market. The more we rely on innovation for success, the more we understand how tough that road is. The next chapter will explore how we have set up organizations that are inadvertently unfriendly to innovation.

Main Points

- Innovation is the key to long-term, sustained growth.
- It must be radical not incremental innovation.
- Some companies can do it but the majority can't.

References for This Chapter

- Brooker, Katrina, "Plugging the Leaks at P&G," *Fortune* (February 21, 2000), pp. 44–48.
- Colvin, Geoffrey, "America's Most Admired Companies," *Fortune* (February 21, 2000), p. 110.
- Colvin, Geoffrey, "The Ultimate Manager," *Fortune* (November 22, 1999), pp. 185–187.
- Hamel, Gary, "Driving Grassroots Growth," *Fortune* (September 4, 2000), p. 186.

- Hamel, Gary, "Reinvent Your Company," *Fortune* (June 12, 2000), pp. 99–118.
- Kahn, Jeremy, "The World's Most Admired Companies," *Fortune* (October 11, 1999), pp. 267–70.
- Kawasaki, Guy, *Rules for Revolutionaries* (New York: HarperCollins Publishers, Inc., 1999), as quoted in *Fortune* (May 24, 1999), p. 296(d).
- Kupfer, Andrew, "Xerox Jam is too Much for Thoman," *Fortune* (May 29, 2000), pp. 42–4.
- Munk, Nina, "How Levi's Trashed a Great American Brand," *Fortune* (April 12, 1999).
- Rose, Ian, "Valuing Intellectual Capital: Summary Report," IBR Consulting Services Limited (August 1997), p. 24.
- Roth, David, "From Poster Boy to Whipping Boy: Burying Motorola," *Fortune* (July 6, 1998), p. 28.
- Sellers, Patricia, "Big, Hairy, Audacious Goals Don't Work—Just Ask P&G," *Fortune* (April 3, 2000), pp. 39–41.
- Sellers, Patricia, "Reinventing the Arch: McDonald's Starts Over," *Fortune* (June 22, 1998), p. 34.
- Stein, Nicholas, "The World's Most Admired Companies," *Fortune* (October 2, 2000), p. 183.
- Stewart, Thomas A., "3-M Fights Back," *Fortune* (February 5, 1996), p. 99.
- The Society of Management Accountants of Canada, *Collaborative Innovation and the Knowledge Economy* (Management Accounting Issues paper 17) p. 40.
- Valery, Nicholas, "A Survey of Innovation in Industry," *The Economist* (February 20, 1999), p. 7.