Making Innovation WORK

HOW TO MANAGE IT, MEASURE IT, AND PROFIT FROM IT, UPDATED EDITION

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Praise for *Making Innovation Work, First Edition*

"This is the book I wish I had read thirty years ago. *Making Innovation Work* is an important resource for leaders who are trying to improve innovation in their organizations. It's crammed with examples and practical ideas that can trigger improvements in innovation, starting tomorrow!"

—**Lew Platt**, Chairman of Boeing, former Chairman and CEO of HP, and former CEO of Kendall-Jackson Wine Estates

"Davila, Epstein, and Shelton remind us that even if the end product is rocket science, the process need not be. To the contrary, tried-and-true practices of management, process, metrics, and incentives are all that it takes to let innovation happen consistently."

—**Andrew Beebe**, President, EnergyInnovations

"*Making Innovation Work* is a fresh approach to systematically managing innovation. It integrates the innovation management literature in a way that is insightful, creative, as well as pragmatic. Davila, Epstein, and Shelton have particularly fresh insights on learning, culture, leadership, and executing change. This book will be of great help to those managers leading innovation and change."

—**Michael Tushman**, Paul R. Lawrence MBA Class of 1942 Professor of Business Administration, Graduate School of Business, Harvard University, and author of *Managing Strategic Innovation and Change* and *Winning through Innovation*

"This impressive book offers specific techniques for driving systematic, repeatable, and managed innovation at all levels in your company. It will help you build a balanced portfolio that integrates both incremental and radical innovations—so you can sustain growth indefinitely, instead of flaming out."

—**Guerrino de Luca**, President and CEO, Logitech waves through the leaders in the oil services industry, Halliburton and Schlumberger. They had to decide the right innovation strategy in the face of significant industry upheaval: Is it the right time to play to win?

While the two big players made decisions and second-guessed each other, the smaller players in the industry, such as Weatherford and BJ Services, had to make similar decisions: Is it the right time for the small players to play to win, and attempt to grow and take a leading position in the industry? These innovation strategy decisions made in 2005 will determine the shape of the oil services industry in the years ahead.

Utilities and oil service companies are not alone in this regard. Many other industries face similar challenges in deciding when to shift from PNTL strategies. For example, healthcare providers have been struggling for survival, and the entire industry has been locked in a PNTL innovation strategy. The major emphasis has been on cost reduction and incremental improvements to shore up revenues and profits. However, some players, such as Sutter Health, have shown significantly improved financial performance. With that change, some of the profitable companies may decide to shift to a PTW strategy because the timing looks good to create important competitive advantage. That shift to PTW by a few key players could change the competitive dynamics of the industry significantly.

A very interesting example of a company using a PNTL innovation strategy against a PTW strategy occurred in the so-called U.S. baby diaper wars of the 1980s and 1990s. Kimberly-Clark (KC), facing Procter & Gamble (P&G) and a host of smaller independent manufacturers, did not appear to have the positioning necessary to dominate the market, although it would have liked to. Darwin Smith, CEO of KC at that time, was an intense competitor who focused his company on creating value. However, P&G, one of the earliest participants into the diaper business arena, was fiercely defending its leading market share and profitability. P&G had dedicated significant resources and clearly signaled that it was not likely to be run out of the market. P&G was investing large amounts of resources on innovation.

Although it could not dominate the market with the resources at hand (it would have been very hard to outspend P&G), KC did not withdraw. KC challenged every one of P&G's innovation moves. In addition, sometimes the company took the initiative and introduced customer-preferred product features (such as training pants) first. Other times, it quickly and effectively countered P&G's innovations, responding with comparable or improved features and performance that mimicked the P&G innovation (such as boy and girl diapers). KC's PNTL innovation strategy combined preemptive and reactive innovations that kept P&G off balance and unable to dominate the market. The diaper war intensity seems to have abated, but it has not disappeared. Both KC and P&G are still slugging it out.

It is often the case that the external and internal forces do not dictate that a company adopt a pure PTW or PNTL strategy. They point to something in between the two extremes.

CEO Sanity Check

You need to clearly understand your current innovation strategy as it is being implemented, not as you have designed it. Here are some key questions to consider:

- Is the current innovation strategy:
    - Play to Win?
    - Play Not to Lose?
    - A mixture?
- Is the company investing for large or small amounts of innovation? Does your company need significant amounts of innovation or just small amounts at the right time?
- How is the current innovation portfolio balanced? How should the innovation portfolio be balanced in incremental, semiradical, and radical innovations?

- How well does the innovation strategy as implemented support your overall business strategy? How does it differ from the plan?
- Does the organization understand the innovation strategy? Can employees execute it faster, better, and cheaper than the competition?

Case Study: Shifting from a PTW to a PNTL Strategy—and Back Again[7, 8, 9]

Company: General Electric

GE is the birthplace of many of the modern concepts of R&D, starting with Charles Steinmetz more than 100 years ago. "Steinmetz did not want this lab to worry about next quarter's product," says Scott Donnelly, senior vice president for research. "He wanted it to work on the next big idea, even as GE's businesses were refining the last one." GE created one of the first PTW innovation strategies, with a balanced portfolio of radical, semiradical, and incremental innovation.

Under Jack Welch, the CEO in the 1980s and 1990s, the labs shifted toward a PNTL mentality, serving the largely incremental needs of the business units. Welch made the business units pay for research. He was largely successful with a PNTL strategy in the battle to stay ahead of competitors with preferable products. GE's business strategy made that innovation strategy preferable. The current CEO, Jeffrey Immelt, faces the challenge of shifting the innovation strategy to win the value added wars.

Immelt says that he "would be surprised if, a bunch of years down the road, we aren't into businesses that require new names (significantly different from the GE heritage and brand). GE is incubating service-heavy businesses in security, water treatment, oil and gas, hydrogen fuels, and other areas that cannot be bolted onto existing GE businesses."

The R&D numbers now reflect a shift toward increased technology investment in semiradical and radical innovations. Describing the R&D component of the PTW strategy, Immelt says, "Superior technology is the only route to consistent growth without declining margins." Of course, changing business models is also something GE does very well, so tagging technology as the *only* route seems wrong.

GE is also using major crosscutting initiatives, what we call innovation platforms (see Chapter 4, "Organizing for Innovation: How to Structure a Company for Innovation"), that will benefit several business units:

- Artificial intelligence
- Pulsed detonation
- Nanotechnology

Too Much of a Good Thing

Can you have too much innovation? We should not be misled by the frequently used expression "Innovate or die." Those who espouse this slogan firmly believe that massive doses of radical innovation are required to survive. Is radical innovation truly necessary for survival for all organizations at all times?

A lack of innovation, especially radical innovation, can lead to failure. However, investing in radical innovation at the wrong time or in the wrong amounts can be just as fatal. In other words, it is possible to "innovate and die" by taking the wrong kinds of risk and by playing the wrong kind of strategy.

There is another risk with taking the expression "Innovate or die" too much to heart. Too many innovative ideas out there for companies to process clouds their judgment on which ideas are truly great.[10] Clouded by the excess, the companies take on too much innovation and the wrong types of innovation, and waste their investments.

Case Study: Play to Win Innovation Strategy

Company: Starbucks

It is not enough to choose the right strategy once. You have to *keep* choosing the strategies to remain successful. This is the real challenge. Starbucks provides a good example.[11] Starbucks achieved a revolution in the coffee industry. Previously, coffee brands like Folgers and Nescafe had fairly pedestrian images, and brand loyalty was not a driving force for American consumers. However, by the late 1990s, if you asked an American to associate a brand with coffee, you would be highly likely to get Starbucks as the answer.

Starbucks began in 1987 and has remained successful for more than a decade. Why? Starbucks' strategy can be seen as continually changing its focus so that consumers do not grow bored. The company has also systematically built brand association with products other than coffee (for example, ice cream) to remain highly visible to consumers. Starbucks has continually adapted, experimented, and regenerated its image and its focus to maintain its edge in the industry.

Clearly Defined Innovation Strategy Drives Change

The following case study of Procter & Gamble shows that success in innovation requires a clearly defined innovation strategy that matches the current realities in the company. P&G had great difficulty transforming from its conservative and cautious organization into one that could embrace more aggressive doses of innovation. It also learned that attempting to change everything at once is not a formula for success.

Case Study: Innovation Strategy at Procter & Gamble[12]

It was no secret that, by the late twentieth century, P&G had lost its originality. In its heyday (roughly the 1960s through the 1980s), P&G was a market-leading innovator in technology and new products. It had led with competitively significant improvements across its flagship categories of detergents, dentifrices, and diapers—that is, Tide, Crest, and Pampers/Luvs. However, whereas the company had dominated many of its market categories in the mid-1990s, by the late 1990s, things had grown moribund. Senior P&G management admitted that the company had not had a breakthrough innovation since 1985, and its continued market dominance in the years ahead was in question.

P&G was still a formidable marketing machine, but the organization had become conservative and slow moving. It was dominated by what competitors called the proctoids—bureaucrats in suits.

In 1997, realizing these problems, a half-dozen senior executives held a "think-in." Their goal was to equip P&G to dominate the consumer goods industry in the twenty-first century, as it had in the twentieth.

During that meeting, they developed a Play to Win strategy. This strategy aimed at boldly reclaiming their industry leadership position. They planned to create a more nimble organization and to increase the speed and quality of innovation. They also focused on improving the speed of commercialization of new products. In addition, they wanted to move the company's focus to higher-growth, higher-margin businesses, such as healthcare and personal care.

Senior management knew they needed to overcome many obstacles to attain their goals. P&G's new product commercialization process was painfully slow. Fiefdoms had developed, and these had frustrated previous attempts at significant collaboration and change. Finally, the working relationship between the brand managers and the technology development managers was often strained and painful.