Innovation under the Microscope

"…Unprecedented accomplishments are the product of a revolution in human cognitive abilities…"   Y. Harari

Business leaders are often awash in trendy concepts. Many attain cult status then promptly evaporate. Substantive ones like innovation stick because humans are hard wired to produce unprecedented accomplishments. We're the first to channel brainpower and will into world-altering, innovative activity.

Another reason for stickiness? A stellar performance-enhancing track record. Strong links between innovation, growth, and performance are well established across all forms of human organization: From Society to Country to Company to Individual. The equation: In Our Genes + Drives Growth is an enticing proposition.

Leaders naturally gravitate to and want to try it. Getting there, though, is another matter. Research by the Center for Creative Leadership is instructive. Here's the poll result of 500 executives asked about innovation practices in their companies…

94% Important

14% Effective

Despite importance, doing innovation remains challenging for most companies. Many larger companies have the resources to overcome missing the mark. If an innovation doesn't pan out (other research indicates more than 70% of new product initiatives fail) then they're on to the next one. This low hit rate option is off-the-table in the more resource limited world of smaller companies. So…

"How can leaders of middle market companies make innovation a viable option for growth?"

An Important Distinction

Innovation and invention complement each other but are different. Invention refers to scientific and technological breakthroughs. Big discoveries that later become building blocks for subsequent innovations. Think transistors enabling modern electronics.

Breakthroughs like this are resource and time intense. Invention strategies are extremely expensive, can take years to develop, involve large numbers of people, and often emerge without an apparent ready-made market. Imagine Tom Watson, IBM's founder not envisioning the social import of computers. In fact he didn't, at first.

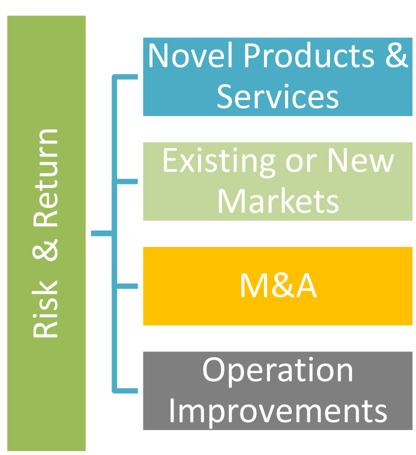
Most people associate innovation with new products. However, innovation as we define it: *Creating value-oriented novelty*, is broader and inclusive of all new strategic and operational activities intended to impact company value. Value here is defined as the result of two factors:

Altering strategic parts of a business model or how companies make money, can move the top-line needle. Things like creating new customer propositions, broadening products, M&A deals, or entering new markets. While continuous improvement activities focus on improving operating margins, productivity, and asset returns. Both are more accessible than invention yet still hard to pull off against the hum of everyday activity.

Consider Options

Innovation options vary by core activity and risk-reward profiles. Ensuring options align with strategy, company capabilities, and market knowledge reduce risk and increase chances of reward. For example, customer-centric companies well-versed in understanding customer needs are more likely to get new value propositions or products right. The same applies to veteran M&A deal makers who know what to expect from the ins and outs of the process.

For our purpose, consider these options first-time endeavors.



Novel Products and Services

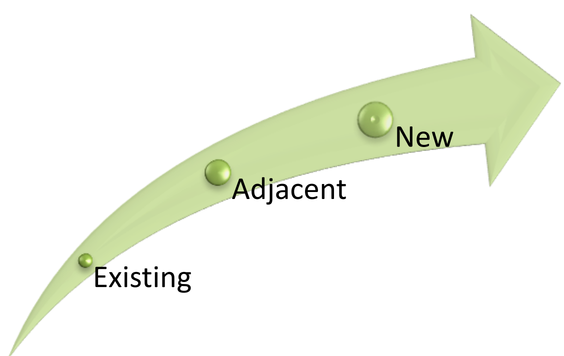
At the top of the list, novel products or services magnify risk and uncertainty. Externally, they require market and customer insight. Internally, it takes planning, execution capability and capital to make novelty happen. Market acceptance and/or returns is never guaranteed but having your ducks lined up reduces risk and increases potential top line growth and value.

A half-step down the same category, enhancing existing products is less risky at least in theory. The external and internal requirements above remain requisite. Again, the option puts a premium on understanding evolving customer needs <u>and</u> the ability to meet them, profitably. Greater certainty of returns, a more defined development path, and fewer dollars make this option compelling.

Bottom-line, when it comes to Novel Product and Service options, understanding evolving market trends, customer needs, and execution capability are king. Changing markets do alter needs and require companies to adapt. As the educational publishing industry shifted toward digital products in the mid 2000's, print-centric publishers needed digital content expertise. Print-centric content development partners able to quickly respond, retool, and provide digital product prototype services became much more attractive to publisher clients.

Existing or New Markets

Existing or New Market risk profiles vary to the extent companies venture outside their core market and product sets. It's as simple as that.



Further penetrating existing markets with current or even "tweaked" products is far less risky because market, brand, and product familiarity are already established. Developing entirely new markets with either current, tweaked, or new products carry more risk because new equals unfamiliarity which lengthens market acceptance time.

Adjacent Markets sit between the extremes. Conceptually, they seem like natural fits and slam dunks. But they can be tricky. Take a successful data science company operating in one part of the health care system thinking it can simply modify algorithms and readily enter a highly attractive emerging space. Two years later results are underwhelming. The lesson: Apparent similar-to-core markets may have decidedly different, more challenging features.

M&A

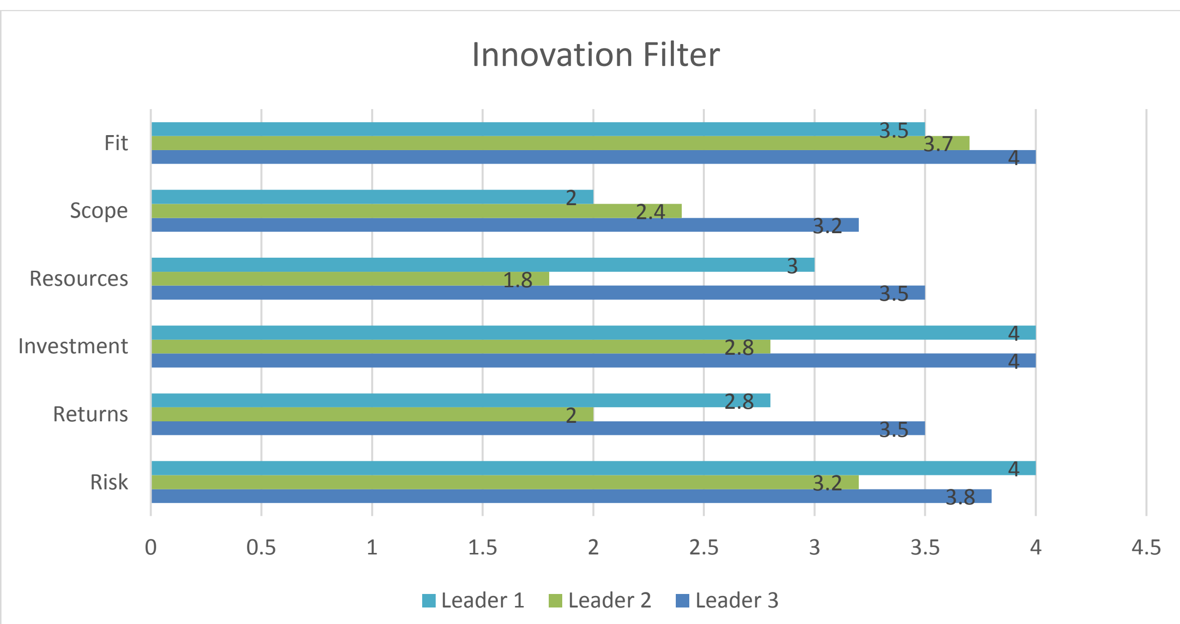
With failure rates well above 50%, the track record of M&A deals indicates high risk and variable returns. The literature teems with reasons why deals fails. Yet success or failure rests on largely controllable and surprisingly basic factors. Once again it boils down to leadership and organization practices. Deals succeed because of the effectiveness of strategy, pre-deal due diligence, price negotiation, and post-deal integration.

Operation Improvements

Finally, innovation options can introduce new ways of operating to improve revenue growth, efficiencies, and returns. Process or structural changes, adopting new marketing and distribution methods, or better leveraging technologies are familiar examples of this form of innovation. Improvements of this type are highly dependent on organization factors that either welcome or sabotage change efforts. Success hinges on leaders providing clear direction and commitment as well as empowering cultural flexibility.

Validate Options

Assume there's no shortage of innovative options for your company. Some of which have passed through the intuitive, gut feel gate and seem promising. Still not ready to pull the trigger? Time to hit the *more analysis* button…



Our Innovation Filter is a multi-rater survey tool with low-high scales. The analytic framework ecourages probing the viability of possible options. Leaders want to pass them through all the gates before giving the green light.

1. **Fit** refers to alignment with strategic direction and the overarching purpose of value creation. Will the iniative increase growth and/or improve returns? Will it build on or potentially disrupt the current business model? Either or both of which may be feasible.
2. **Scope** is the complexity and size of the undertaking. It naturally provides context for defining internal resource needs. But it can also extend to pegging the market. Is the market ready for the innovation as conceived? Timing on or off? Will the new product's design or service overshoot functionality needs of a majority of customers?
3. **Resource** discussions are code for can we do it and what's needed to make it happen. The answers dovetail with execution. Do we have enough talent, project structure, and discipline to succeed? Will we need outside help in the form of new hires or third-party partners?
4. **Investment** is the glue or budgetary element in the equation. How much might the option cost, initially and throughout the forecast period? Uncertainly aside, the goal is to put a hard numbers on the table.
5. **Returns** is shorthand for how much value is created by the innovation. More to the point, how much additional cash from operations is generated by the initiaitve due to a change in revenue minus investment costs.
6. **Risk** takes the discussion into uncomfortable psychological territory. Seemingly great ideas with momentum die hard. Yet, it remains undeniably beneficial to put them under the microscope and identify all that can go wrong before launch.

Getting the Ball Rolling

Doing innovation challenges companies to be on their game. Leaders can start by articulating their strategic intent or, in lay terms, what they want to achieve. We think the endgame is always about value. Linking innovation to Growth and/or Returns helps leaders formulate and better execute the right options for their companies.

The Filter adds discipline to the complexities of innovation. Inserting discipline earlier in the planning process reduces uncertainty and risk. Gaining stakeholder alignment on things like scope, budget, and returns then increases chances for successful execution.

Try out these quick macro-questions with your team and trusted advisors.

1. How will innovation increase our value?
2. Which innovation option is best?

3. Are resources in place or available to make it happen?
4. What are the risk/reward tradeoffs?

Answers enable leaders to better leverage innovation and create value.

Contact us to sharpen your innovation efforts