INNOVAT

BEYOND BOUNDARIES

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BUSINESS
ION

THE PHRASE "BUSINESS INNOVATION" CONJURES SPECIFIC TYPES OF IMAGES FOR THOSE OF US PAST A CERTAIN AGE. WE IMAGINE THE COCA-COLA COMPANY'S SECRET RECIPE LOCKED AWAY IN A VAULT, GOOGLE'S MIND-BOGGLING SEARCH ALGORITHMS SCRIBBLED ON A WHITE BOARD OR BRILLIANT IBM AND P&G SCIENTISTS TINKERING IN THEIR RESEARCH & DEVELOPMENT (R&D) LAIRS.

THOSE OF US PAST A CERTAIN AGE NEED TO LOOK AGAIN.

During the past decade, innovation has morphed before our very eyes—breaking loose from the R&D department, extending beyond products and services into internal business processes, and spilling outside the four walls of individual companies.

"Innovation has become more collaborative, inclusive and interdisciplinary," reports Tim Brown, CEO of design-consulting firm IDEO and author of *Change by Design: How Design Thinking Transforms Organizations and Inspires Innovation* (Harper Business, 2009). "It's no longer the guys in the white coats up on top of a hill doing the geeky stuff."

The lingering "Great Recession" may be accelerating the discipline's evolution—at least for organizations that embrace and practice leading-edge innovation. These companies have happily discovered that innovation can:

- Reduce costs and enhance customer experiences, in addition to fueling revenue growth;
- Greatly improve nursing-shift changes, airlines check-in, corporate budgeting and other internal processes in addition to hatching must-have products and services; and
- Involve just about everybody in the company (as well as partners outside the organization and, in some cases, customers), not just the traditional R&D team.

"I think companies make a mistake in how they define innovation," says Ric Merrifield, Microsoft's architect of business and the author of *Rethink: A Business Manifesto for Cutting Costs and Boosting Innovation* (FT Press, 2009). "Many companies don't view innovation as a day-to-day option for solving problems and addressing opportunities."

Organizations in which innovation represents a daily priority tend to embrace an expansive definition of the term (as the following discussions show); they also tend to execute innovation through intensive collaboration, a heavy dose of outside thinking and a clear yet simple underlying mission.

Beyond Boom Times: Recessionary Innovation

Companies invest in innovation during boom times and batten down the spending hatches in economic downturns, right? Not successful companies. Studies of corporate R&D spending during recessions by McKinsey and Bain indicate that enterprises that invested in innovation and marketing during recent downturns tend to out-perform companies that spent less in these areas.

During the Great Depression, Kellogg doubled its advertising budget while its competitor, Post, trimmed nearly all expenses, *New Yorker* business columnist James Surowiecki points out. "By 1933," Surowiecki continues, "even as the economy cratered, Kellogg's profits had risen almost 30 percent and it had become what it remains today: the industry's dominant player."

Rita Gunther McGrath, an associate professor at Columbia Business School, studies organizational innovation. "Recessions shake up old habits and old ways of doing things, eliminate less efficient competitors, free up top talent and otherwise offer resources to innovators and investors that aren't available during good times," notes McGrath, co-author of *Discovery Driven Growth: A Breakthrough Process to Reduce Risk and Seize Opportunity* (Harvard Business School Press, 2009).

Indeed, Apple, Microsoft, HP and other companies are known for innovation during economic downturns.

"Now is not a time for corporations to rest on their laurels," says Rich Friedrich, director, HP Labs Strategy and Innovation Office. "It's a time to get creative and seek out new ways to drive continued innovation growth. Innovation is vital in charting the course for future investment and company growth."

Many companies commit two common errors with regard to managing innovation during recessions, Merrifield notes. First, they cut costs across the board—a move that neglects the fact that some activities generate more value than others. "The second mistake is that they think innovation and cost-cutting are mutually exclusive," Merrifield asserts. "The reality is that you can combine innovation and cost-cutting and get much more dramatic returns on those cost-cutting efforts."

For example, by transforming the flight check-in from a labor-intensive process to a much more automated and self-service experience, airlines increased customer satisfaction and reduced labor costs. These types of innovative and valuable process-improvement opportunities exist for the vast majority of companies following nearly two decades of unprecedented economic growth.

"Many innovation discussions during good times tend to be more opportunistic," Merrifield says. "The attitude is one of, 'Hey, why not? Let's swing for the fences and if we miss, we miss.'" Innovation during recessions should target specific growth—and cost-reduction—opportunities.

Beyond Products and Services: Process Innovation

Some of the innovations that most delight Merrifield and other innovation gurus might sound mundane to the uninitiated on first blush. Merrifield grins knowingly at the notion of "mundane innovation"—and the partner companies that Microsoft helps "rethink" traditional processes probably do cartwheels in response to the term; a manufacturing company in Merrifield's book reaped $40 million in savings within three weeks from this type of ho-hum innovation. The opportunity to apply innovation to traditional business processes is so ripe, Merrifield believes, because many organizations fall into the "how trap." That is, they focus much more on *how* they do things rather than on *why* they do things. For example, ask a colleague what she's doing at the fax machine, and she'll likely respond, "I'm sending a fax, Einstein." Well, not exactly—sending the fax is actually *how* she's fulfilling a business requirement. "Communicating status" is the *why* or *what*.

Consider the flight check-in process of a decade ago: the *how* involved standing in long lines. The outcomes, or *whats*, included confirming a reservation, conducting a security survey and checking in luggage when necessary. The airlines realized that the confirmation could be conducted by customers online before they arrived at the airport, and the baggage check could be transformed into a self-service activity (alas, we remain hungry for security line innovations).

"What the airlines realized is that it doesn't matter who does the work, where it happens or what the process is, as long as those three outcomes are achieved," Merrifield asserts.

The airlines are hardly alone. Dell rose to prominence not by producing innovative PCs, but by innovating how the components of each PC were purchased, assembled and paid for. Similarly, Netflix did not unearth a new form of entertainment; rather, its founder realized he could never compete with the retail space Blockbuster already occupied so he leveraged Internet connectivity, the U.S. Postal Service and some nifty heuristics to deliver (and recommend) DVDs to customers in a new way.

"Innovation is about being creative, but it is also about creative destruction—and not enough people realize that," says Steve Player, North American program director of the Beyond Budgeting Round Table. The organization is dedicated to improving upon traditional corporate budgeting, forecasting and planning processes—primarily by eliminating the expensive, time-consuming, headache-inducing, and often worthless annual budgeting process.

Twenty-eight percent of North American corporate finance executives report that their 2009 budgets were invalid before the year started, according to a 2009 *Business Finance* magazine survey, and more than two-thirds of these respondents expected their 2009 budgets to be irrelevant by mid-year.

Player, a former Big 4 auditor, also points out that linking incentive compensation to traditional budget targets unwittingly encourages unethical behaviors. Managers tend to negotiate lower numbers during the budgeting process to help ensure that they can "earn" their incentive payment. "Innovating can involve getting rid of something that is troublesome and finding a better way to tackle the challenge," adds Player, author of the forthcoming *Future Ready: How to Master Business Forecasting* (Wiley & Sons, 2010). "The elimination of the budget is an example of this type of innovation."

Innovation "is being applied to many, many things beyond the products the company makes," Brown agrees. "More companies are now thinking about innovation as it applies to our own organizations and processes."

Beyond R&D: Innovation is Everyone's Job

The shift Brown mentions has pulled innovation out of the confines of traditional R&D function and made it everyone's responsibility.

"Innovation needs to be on your to-do list when you look at work," says Merrifield. "You can look at every problem and opportunity as a candidate for innovation."

Brown has spent more then two decades exploring and harnessing innovation for clients and his own company, and he reports that A) more people are involved in the discipline; and B) people who practice innovation for a living possess a much broader set of background experience and expertise.

"In organizations there is a growing idea that innovation is a cross-disciplinary activity," he says. "It's not just for engineers or people who trained at art schools. It includes potentially everyone in organizations." Even traditional R&D departments, or a consulting firm that specializes in innovative services, for example, now hire a broader array of experts. "If you come to our organization, you'll see dozens and dozens of different disciplines and backgrounds represented," Brown says.

Fortune magazine's annual rankings of the most desirable companies to recent business school graduates shows that future business leaders value innovative organizations. Google topped this year's rankings while, for the first time ever, IDEO—which, with 500 employees, is a fraction of the size of most corporations on the list—appeared on the list at number 15.

"YOU CAN LOOK AT EVERY PROBLEM AND OPPORTUNITY AS A CANDIDATE FOR INNOVATION."

Beyond Technology: Human-Centered Innovation

As innovation has moved beyond an exclusive focus on products and services, and beyond the exclusive responsibility of the "guys in lab coats," another element of its focus has shifted. Rather than dealing exclusively with technology, business innovation now tends to address human concerns in deeper and more meaningful ways.

Brown describes this as "design thinking," which he defines as "human-centered." This type of innovation, Brown notes in a 2008 *Harvard Business Review* article, "especially when it includes research based on direct observation, will capture unexpected insights and produce innovation that more precisely reflects what consumers want."

That sounds like it should have always been the focus of innovation. But it hasn't. Consider the experience would-be cyclists and mountain bikers confronted when they walked into a bike shop packed with bewilderingly technical and expensive bicycles and jargon-spewing staffers. IDEO and Shimano, the Japanese manufacturer of bike components (including those that let you shift gears), did just that with a team of engineers and marketers *as well as* designers and behavioral scientists. Rather than figuring out how to construct and sell another high-priced derailleur, the team set out to answer a human-centered question: *why don't 90 percent of American adults ride bikes?*

The team discovered that many would-be U.S. bikers felt too intimidated by the activity's technical wizardry to participate. In response, it created a simplified "experience"— easier-to-use coasting bikes that shift automatically; friendly, customized guidance on local bike trails; and in-store retailing processes designed to lessen, not increase, the intimidation factor—that aimed to reconnect adults with the biking experiences they recalled from their youth.

The "Coasting" campaign succeeded: eight different bicycle manufacturers signed on to participate shortly after the program appeared.

Product-related, technically grounded research & development is not going away, nor should it. Brown's point is that there are many forms of innovation; of those, the human-centered approach, deserves more widespread application.

Social Media as an Incubator

The development and use of social media technologies illustrate the expanding nature of organizational innovation.

"Many companies are taking advantage of new social networking and connection technologies to improve the way they incubate and hatch ideas," notes Gunther McGrath, pointing to InnoCentive—an online market for problems and solutions—as an example. "Eli Lilly has used these technologies to better connect its scientists and engineers internally as well. Companies are realizing that they can't out-innovate the world, so we are seeing far more creative exploitation of ideas that generated outside of proprietary R&D departments."

Social media technology is ideal for connecting with customers, establishing relationships with them and, in some cases, soliciting feedback that informs the design of future products and services. "Social

"DESIGN THINKING"

networking is going to generate a lot more referral business and give consumers more control," says Merrifield. "Look at the voting on 'American Idol' … No longer does the guy who runs the record company automatically choose which band we're going to hear next. We get to choose, and the record company executive can feel pretty confident that what we choose is going to sell."

Successfully integrating social media technology into business workflow ultimately requires trust, notes Peppers & Rogers Group founding partner Don Peppers, whose latest book, co-authored with Martha Rogers, is *Rules to Break and Laws to Follow* (Wiley, 2008). "You need to be transparently responsive," Peppers says of companies that embrace social media. "You need to be honest with consumers. You can't let the lawyers in the room where you prepare your blog posts. You have to do it from the heart. That may sound corny, but people respond to that."

One of the biggest hindrances to more open discussions between companies and their customers is an "overdeveloped sense of legal liability," Peppers adds. "But a more damaging scenario for your business than a lawsuit would be a general deterioration of the level of public trust in your brand. The most valuable asset you have in the social networks environment is your reputation for trustworthiness."

A Not-So-Secret Formula for Success

The reputation for trustworthiness Peppers describes also represents a crucial quality within organizations with successful innovation track records.

Even when companies embrace new elements of innovation, they still need to execute. Although organizational innovation practices vary greatly, experts continually return to three important success factors:

Collaboration

"At HP, we see open collaboration across companies, nations and industries as the most promising way to innovate out of the downturn," notes Friedrich. HP Labs' Innovation Research Program pairs scientists from universities around the world with researchers at HP Labs in an effort to derive scientific and economic benefits through collaboration. Collaboration, particularly between different organizations, appears to be increasing as a way to address increasingly large and complex problems. In the utility sector, for example, Xcel Energy's SmartGridCity project in Boulder relies on a partnership of seven different technology and services vendors working together to provide smart in-home devices that help manage energy use and environmental impact throughout the Colorado city.

Outside Thinking

New business challenges are inspiring problem-solvers to look outside their four walls for ideas from other domains, IDEO chief creative officer Paul Bennett says in a video interview posted on YouTube. In the coming months and years, Bennett says that successful organizations and business leaders will be "inspired by other business models, other cultures, by places that have been in recession for a really long time, by people who have already been on a journey you're going on." That explains why consultants at Accenture have studied Hollywood smash hits to glean insights that might help pharmaceutical companies bolster pipelines in dire need of new "blockbuster" drugs; why McKinsey consultant Michele Zanini in a recent paper compared the frequency and magnitude of Southern California earthquakes to the frequency and magnitude of worldwide banking crises; and why Beyond Budgeting's Player views the OODA ("Observe, Orient, Decide, and Act") Loop, devised by a U.S. Air Force military strategist as a way for U.S. pilots in slower planes to defeat better-equipped enemy fighters in the Korean War, as a model for improving corporate forecasting and planning processes.

Principled Performance

Funding and executive support have long been identified as the two most crucial elements of successful organizational innovation. These factors remain crucial, but another element may be an even more important ingredient of successful innovation over the long term. Look at Nike, GE, Apple, Whole Foods, P&G and other companies that have been capitalizing on innovative products, services and processes over time, and you will find an overarching organizational purpose, notes Brown. Nike, for example, makes sports and exercise relevant and accessible to people. "If you point out the companies that deliver successful innovation over a reasonably long period of time, I think you will find that sense of purpose there," Brown explains. "I think the purpose-driven enterprise is a way that companies can balance the need to be operational and innovative at the same time."

The sense of purpose can foster the trust necessary for employees to take risks by looking at a product, service or process and ask whether it can be designed differently to reduce costs, increase revenue or boost customer satisfaction.

This is not your father's business innovation; the table below highlights the recent evolution of organizational innovation:

INNOVATION EVOLVES

	THEN	NOW
Objective	Revenue and market growth	Revenue growth, cost reduction, recruiting and retention benefits
Key Requirements	Executive support, funding	Clearly defined organizational purpose, in addition to funding and executive buy-in
Focus	Products and services	Products, services and internal processes
Ownership	R&D function	Everyone in the organization
Execution	Closely guarded, within a company's four walls	Highly collaborative within companies and among external partners

BusinessWeek

50 MOST INNOVATIVE COMPANIES 2009

01. Apple
02. Google
03. Toyota
04. Microsoft
05. Nintendo
06. IBM
07. Hewlett-Packard
08. Research in Motion
09. Nokia
10. Wal-Mart
11. Amazon
12. Procter & Gamble
13. Tata
14. Sony
15. Reliance Industries
16. Samsung Electronics
17. General Electric
18. Volkswagen
19. McDonald's Corp.
20. BMW
21. Walt Disney
22. Honda Motor
23. AT&T
24. Coca-Cola
25. Vodafone
26. Infosys Technologies Ltd.
27. LG Electronics
28. Telefónica
29. Daimler
30. Verizon Communications
31. Ford Motor
32. Cisco Systems
33. Intel
34. Virgin Group
35. ArcelorMittal
36. HSBC Holdings
37. Exxon Mobil
38. Nestle
39. Iberdrola
40. Facebook
41. 3M
42. Banco Santander
43. Nike
44. Johnson & Johnson
45. Southwest Airlines
46. Lenovo
47. JPMorgan Chase & Co.
48. Fiat
49. Target
50. Royal Dutch Shell

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