

How to get serious about innovation if you do not fully know where to start

by **Laszlo Bax**, Founding Partner at Bax&Company



These days any company that wants to survive needs to be able to innovate. As a result, senior management of companies that have prospered for decades running business as usual suddenly find themselves confronted with a challenge: how to become a successful innovator?

Even companies that have enjoyed solid 30-50% profit margins in conventional sectors once dominated by personal networks, trust and the virtue of simply being a reliable business partner are being disrupted by much more agile new entrants enabled by Internet 2.0, Artificial Intelligence, online service ratings and mobile e-commerce.

As the horse business in the late 1800's, today travel, insurance, transport, manufacturing, hospitality, real estate, recruitment and almost any other sector is being forced to innovate, and to make the innovations that they deliver really count.

Innovation is generally understood to be the sourcing, development and meaningful scale implementation of new ideas that bring sustainable value to existing and/or potential customers. Which sounds simple enough, but turns out to be very difficult to get right consistently. Innovation as a concept has been on the corporate agenda since the 1980's. Back then, the emphasis was on processes to manage innovation, especially those adopted in industrial companies. 3M was the champion everybody looked up to.

In the nineties, the focus shifted to strategy, which meant that the processes should not just produce a wild portfolio of attractive

novel business activities, but should rather contribute to holistic strategic objectives defined by the board. Over the last decade, emphasis has shifted again, first towards the importance of Openness in innovation management (allowing projects to flow in and flow out of the company's innovation funnel) and then focussing on innovation culture, skills, DNA and mindsets.

Three Aspects to Cover

As we at Bax & Company see it, the innovation capability of a company resides in getting three things right:

1. **Strategy** in terms of purpose and strategic fit of innovation initiatives;
2. Well defined **processes** involving Stage Gate milestone decision making applying fixed criteria and clearing projects from one stage to the next only;
3. **Team** capabilities, attitude, incentives and culture that provoke and reward innovation contributions made by people and departments inside the company.

These three building blocks together represent the 'innovation machine' that can **deliver innovation impact in tangible and quantifiable ways.**

Typical innovation champions such as P&G, Apple or 3M all cover these three areas with equal rigor and structured, goal-oriented focus. When a company like P&G invites its employees (or students, suppliers, scientists) to come up with ideas, they very clearly indicate where they are seeking new solutions that break the mould, and what impact magnitude they expect. They clearly 'set the stage' in terms of what that they expect can be improved for their customers, and only then unleash the creativity of people to come up with well targeted ideas and solutions to the problems they identified.

When 3M manages its large portfolio of innovation initiatives, it uses explicit advanced methods and quite sophisticated online portals to make sure that each one is identified, resourced, monitored and reviewed.

When Philips sought more innovative behaviour of its somewhat static employees, it did not stop at changing the logo, organising a couple of brain-storming sessions, re-painting the offices and adding some white boards to their coffee corners. Philips hired experts that first taught the skills and attitude required for innovative behaviour to a small group of opinion leaders, who subsequently transmitted their knowledge to the entire team.

Let's briefly delve into each of these three building blocks and analyse what is needed.

Innovation Strategy

As well argued in the HBR article 'You need an innovation strategy'¹, a company that tries to innovate without first having defined

To be innovative you need a strong innovation strategy, processes to manage it and a team with the proper skills and attitude

an innovation strategy runs a very large risk of ending up with a portfolio of innovation initiatives that do not contribute to the key strategic objectives that the company has set for itself. Occasionally a project may well hit a certain area of interest, but the risk is high that this is more a coincidence than a deliberate impact of a focussed effort.

Innovation is not about 'letting thousand flowers bloom'; it's about unleashing the ideas and creativity of people inside and outside the organisation to overcome challenges, grab new opportunities and increase competitiveness of the company for the better.

Innovation strategy is strongly connected to the general company strategy, and as a result also with strategies defined for any specific aspect of the business: operations, IT, sales & marketing, HR strategies to name a few.

Innovation Strategy Setting

Without clear strategic purpose, innovation efforts are not targeted, impossible to assess for their potential added value, and in general not aligned among each other. **Innovation is never an objective itself;** it is a function directed at gradual and/or radical improvement of existing business

WHAT IS INNOVATION?

A question that always comes up: what is the definition of innovation? Here's what Wikipedia offers: 'Innovation is: production or adoption, assimilation, and exploitation of a value-added novelty in economic and social spheres; renewal and enlargement of products, services, and markets; development of new methods of production; and establishment of new management systems. It is both a process and an outcome.'

Therefore, key ingredients are 'novelty', 'value-added', 'economic and social spheres'. Novelty can be 'new to the world', 'new to the industry', 'new to the company' or 'new to me'. Value-added means that an innovation must serve a purpose of value, not just its own merit of being new. And finally, it must affect either an economic or societal 'sphere', which rules out novelties that only affect our own thinking, our private activities or non-societal actions or thoughts.

¹ Pisano, G. P. (2015). You need an innovation strategy. Harvard Business Review, 93(6), 44-54.

activities as well as the creation of new ones. In most businesses, the actual area within which ideas can be considered is limited; the company often has defined a playing field that it considers within its scope. A key task in setting this scope will be diplomatic dialogue with management levels above your own, if those exist. Your headquarters in London, Singapore or Madrid need to endorse the innovation initiatives in your Business Unit, or at least do not oppose them.

Within this playing field, the strategic purpose of the innovation function must be defined in several terms: financial, **KPI improvements**, reduction of risks, access to new profitability opportunities, HR objectives such as **team happiness, retention and productivity**. Other possible strategic purposes of innovation include an increased uniqueness of the company's **value proposition** in the market (making it less a cost-based competition), **strategic blockage** of competitors, **positioning** of the company in terms of being an attractive employer.

Not only does the strategic purpose of innovation need to be defined; **it also needs to be quantified** both in terms of timeline as well as in terms of quantifiable impact: how many millions of euros of new profitable business, what increase in months of average employee retention, what increase in perceived uniqueness as scored by clients on objective scorecards, numbers and quality of candidates applying for job openings. Once the company has defined to some extent the things it wants to achieve with the help of innovation, the

LANTMÄNNEN EXAMPLE

Lantmännen, a big Nordic agricultural cooperative, was challenged by flat organic growth and directionless innovation. Top executives created an aspirational vision and strategic plan linked to financial targets: 6 percent growth in the core business and 2 percent growth in new organic ventures. To encourage innovation projects, these quantitative targets were cascaded down to business units and, ultimately, to product groups. During the development of each innovation project, it had to show how it was helping to achieve the growth targets for its category and markets. As a result, Lantmännen went from 4 percent to 13 percent annual growth, underpinned by the successful launch of several new brands. Indeed, it became the market leader in premade food only four years after entry and created a new premium segment in this market.

Such performance parameters can seem painful to managers more accustomed to the traditional approach. In our experience, though, CEOs are likely just going through the motions if they don't use evaluations and remuneration to assess and recognize the contribution that all top managers make to innovation. (Source: McKinsey & Company)

next step is to translate these business/organisational objectives into more specific innovation objectives and other key innovation portfolio characteristics: sought balance between radical and incremental innovation, balance between process optimising innovation and new opportunity innovation, etc.

Together will allow you to specifically define what your company expects to achieve through innovation, and what mix of innovation goals/types/approaches balance inside the innovation project portfolio is

optimal to deliver on these expectations. Explicit specification of the kind of innovations is required along several axes, differentiating between incremental or radical innovation, sales & marketing or product innovation, channel innovation or internal process innovation, process or product innovation, just to name a few.

Defining all these aspects of the innovation strategy of the company of course tightly interacts with general strategy development, and thus must be driven by senior management of the company. The key point

REALITY CHECK WITH EXISTING PROJECTS: WHAT IS INNOVATION?

Once the ideal portfolio mix is preliminarily established, the logical next step is to make an inventory of present initiatives/projects that may be considered innovation. This step automatically raises the question: 'what is innovation for my company?' Answering this question is another key step in the journey towards having a clear grasp of what your company wants to get out of innovation. Some companies adopt a top-down approach: using abstract concepts, such as degree of novelty or levels of value-added, they determine which projects / initiatives should be considered innovation and which should not. Others adopt a bottom up approach: taking examples of projects / initiatives in the company and labelling each one of them as innovation or not, based on perhaps unspoken or otherwise not explicit criteria for classification. Agile companies combine the two approaches mentioned to check if they both lead to a similar outcome.

From this exercise, you will be able to define quite clearly what your company considers innovation and what it considers to be 'business as usual'. Some firms ultimately reach the conclusion that their 'business as usual' project portfolio management approach should be the same as their innovation portfolio management approach, side-stepping this debate.

The nine steps to build an Innovation Machine

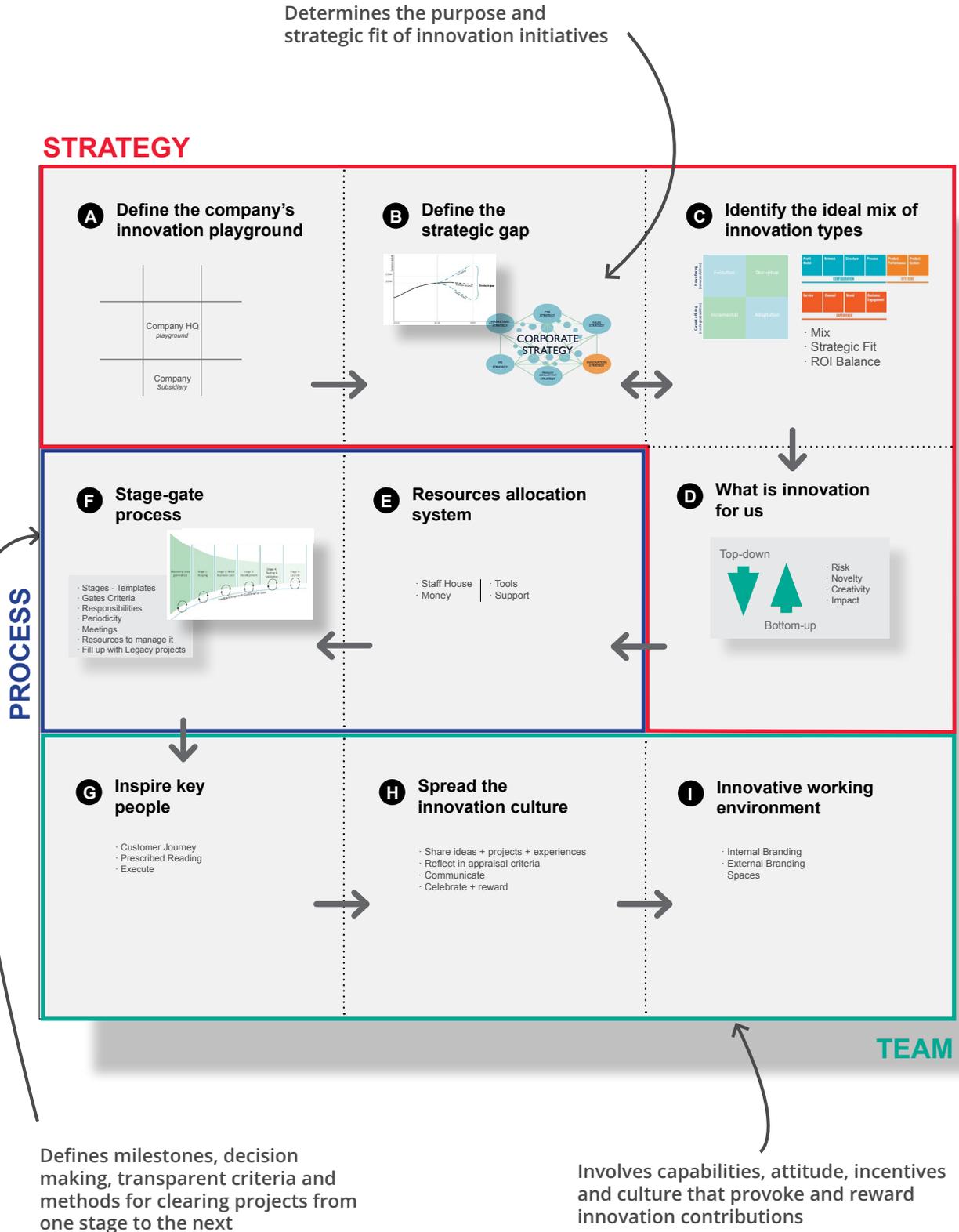


Figure A - The 9 steps to build an Innovation Machine. Step 0 -the initial Innovation Capability diagnosis- is not shown here.

to adopt across the board is that innovation is needed to meet strategic objectives.

Only when that is the case, can we trust that the whole company will wholeheartedly embrace innovation as part of their core jobs, because without it, they would not be able to reach core business performance objectives. Once that has been achieved, all the company will seek and engage with the processes that are offered to manage innovation in an efficient way.

Managing Innovation as a process

With a clear definition of the areas, objectives, novelties and strategic contributions sought, the company can now turn towards creating an efficient management approach of its innovation activities.

Almost inevitably this involves a Stage Gate process: cultivating initiatives from initial rough ideas to fully defined and resourced projects that just need to be implemented. Initiatives that move through the Stage Gate 'funnel' step by step are forced to add detail and remove residual risk of failure.

If companies would have unlimited resources to dedicate to innovation, then they could just staff and budget any initia-

tive right up to its final delivery or failure. This utopian situation never exists. The resources that can be dedicated to innovation are limited, and thus an optimal approach to their allocation is needed to avoid waste, and optimize the chances that good ideas make it into fruition.

Since the 1980's, this is pursued applying Robert Cooper's Stage Gate model, which basically cuts the development pathway from initial idea down to final complete implementation into several discrete steps, each of which is closed off with a clear milestone assessment of a fixed set of well-defined criteria.

The company needs to define in detail the complete process that enables the flow of ideas through a 'funnel' that gradually sifts out the less attractive ones, to allow concentrating resources in later stages of the funnel to the best ideas. This includes the definition of the stages, the level of detail required in each of them, the decision-making procedures and responsibilities. The criteria used in each phase of the Stage Gate process normally can be broken down into various categories:

1. The **residual risk** of failure remaining in an initiative after completion of the

relevant Stage,

2. The increased understanding of the **added value** of the initiative in case it would be successfully implemented in the company to its full extent; and
3. The better understanding of the **resources required** to complete all the next steps towards full implementation.
4. The **fit** of the initiative with the company's **strategy**.

Each key factor is normally broken down into subsections and each subsection can have a specific weight factor.

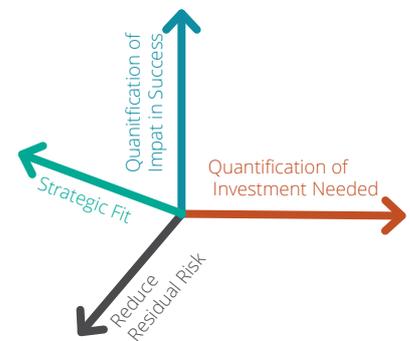


Figure B - The knowledge regarding the idea/project uncertainty should grow along the three axes thanks to the research and testing activities.

SCOPING YOUR INNOVATION BUDGET

Next step is that the previously mentioned analysis of existing projects (allocating them as innovation or not innovation) is expanded to define for each of them objectives, resources, defined phases and decision-making milestones. Again, this represents half of the approach, the bottom up part, which gives us a feeling for the kind of objectives we consider for our present innovation initiatives, the kind of milestones we use to judge if projects can go from one phase to the next, etc.

The complementary top down approach in this specific area is to reason from a logical framework which objectives we can consider for innovation initiatives, which phasing, which resources, which staffing, which main risk management issues, etc. Top down considerations can be relatively straight-forward following traditional phases as known from experience, or they may be quite advanced, including the use of Real Option theories for project value assessment or other advanced approaches. Most companies should initially adopt a straightforward definition of the aspects by which an innovation initiative is defined. In the end, this exploration of the elements that the company wants to see defined for any innovation initiative translate into several project / initiative templates that structure them into a document.

The actual analysis of existing projects in terms of dedicated resources and expected impacts also allows the company to get a feeling for what a reasonable balance between the two can be. To use some extreme examples; expecting to build a new multi-million-euro business within 3 years investing less than 500 person hours into an initiative seems an unlikely bet; just as well, investing €200.000 into a new IT system that may result in 10 new clients each generating €100.000 of additional business does not deliver a great ROI either. The actual balance needs to be established by senior company management, creating consensus in what a reasonable balance would be. As always, the acceptable risk of failure is a key factor here. A company that is comfortable with seeing innovation fail to deliver for several years can afford to dedicate little resources to the innovation function, in the hope that occasionally, an initiative will 'get lucky' and survive and grow against the odds. Another company that considers its fundamental existence to depend on innovation will probably manage most of its resources as if these were related to innovation initiatives. Whatever the resources earmarked for innovation are, the company needs to establish a system to allocate them; normally connected to the decision-making process on innovation ideas.

To ensure that each Stage Gate milestone (**'Kill / Go decision'**) can be taken correctly, each phase needs to deliver the key information in a **fixed template** that forces the team of an idea to clarify the information needed to allow the Stage Gate decision making unit to judge on the set criteria of that phase.

To summarize the process: each idea that enters into the Stage Gate funnel is step by step elaborated on three main axes:

1. The **potential impact** that successful implementation of the idea would have on the company's business;
2. The size, profile and controllability of the **risk of failure** of that idea and
3. The **resources required** to fully implement the idea on the scale that would deliver the full impact as defined under axis #1.

Those three axes are covered in the templates used to define initiatives in each phase; first in just a few main building

RELX Example

Innovation is inherently risky, to be sure, and getting the most from a portfolio of innovation initiatives is more about man-aging risk than eliminating it. Since no one knows exactly where valuable innovations will emerge, and searching everywhere is impractical, executives must create some boundary conditions for the opportunity spaces they want to explore. The process of identifying and bounding these spaces can run the gamut from intuitive visions of the future to carefully scrutinized strategic analyses. Thoughtfully prioritizing these spaces also allows companies to assess whether they have enough investment behind their most valuable opportunities.

During this process, companies should set in motion more projects than they will ultimately be able to finance, which makes it easier to kill those that prove less promising. RELX Group, for example, runs 10 to 15 experiments per major customer segment, each funded with a preliminary budget of around \$200,000, through its innovation pipeline every year, choosing subsequently to invest more significant funds in one or two of them, and dropping the rest. "One of the hard-est things to figure out is when to kill something," says Kumsal Bayazit, RELX Group's chief strategy officer. "It's a heck of a lot easier if you have a portfolio of ideas." (Source: McKinsey & Company)

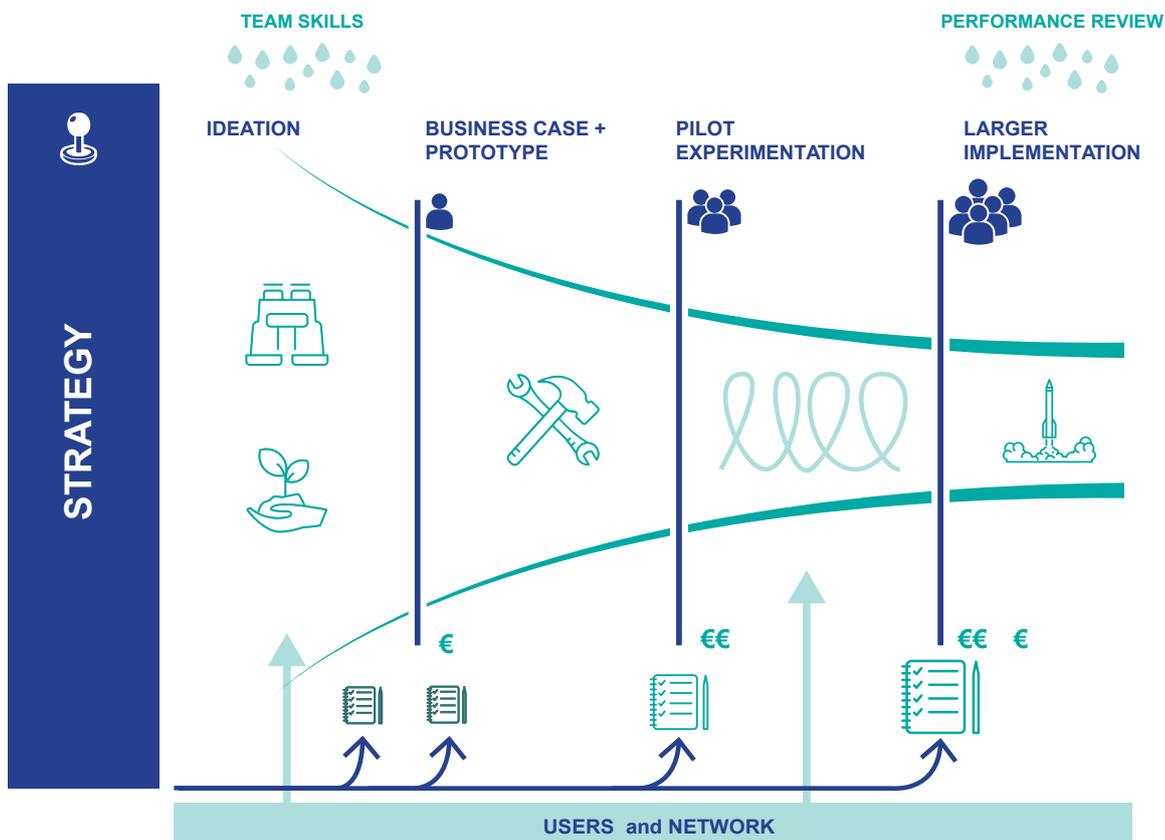


Figure C - A general view of the process that we are implementing at a recent insurance sector client.

blocks, and in later stages broken down in increasing detail. In each Stage Gate the decision-making unit and their decision-making process are clearly defined.

When the rough process is outlined and a first approach of selection criteria for each Stage Gate is defined, it is time to put some first preliminary numbers on budgets that the company expects to allocate to each phase in the Stage Gate process. As mentioned in the example box, RELX ended up with 10-15 x \$200.000 or \$2-3M to be dedicated to their Phase 2, and probably \$2-4M to their Phase 3. To come up with 10-15 Phase 2 'experiments' perhaps required them to elaborate some 20-30 concepts or ideas on paper in a fixed format. If every one of those takes 10 days to elaborate then that would represent a budget of perhaps 200-300 days x \$300 per day = \$60-90k. All of this probably with the expectation that the two projects that made it to Phase 3 would, over their first 5 years of life add some \$50-100M to their revenues, or a total of \$10-20M in margin.

Of course, for every company, this rough calculation can be completely different as phases can have very different average cost levels, margin contributions may not even be of the same order of magnitude, and the failure rates at each phase may be very different. However, the analysis must be performed, and a reasonable balance between phases, total portfolio investment, total margin/value creation expectations and failure rates is required.

Once we have a first rough estimate of the resources we'd like to allocate to innovation

Innovation is about unleashing ideas and creativity of people inside and outside the organisation in order to overcome challenges, grab new opportunities and increase competitiveness of the company

projects, we need to check these in two ways: by assessing the resources required (past, present and future) for the presently identified innovation projects, and by assessing the balance with the overall value creation expected as defined in our innovation strategy.

A possible Stage-Gate for your company

The general concept of Stage Gate innovation management is perhaps well explained in Robert Cooper's own articles, where he describes his idea-to-launch approach.^{2,3} For a recent client, we ended up creating a 4 phase Stage Gate process:

- 1. Ideation / capture / first shaping**
- 2. Business case & prototype**
- 3. Pilot experiment**
- 4. Larger implementation**

Let's take a closer look at each of these phases. In the ideation phase, we normally use a variety of more or less creative techniques combined with customer or process insight analysis to deliver a certain volume of more or less interesting ideas. It must be clear that Ideas are not just one-liners.

In the business case and prototype phase, the best ideas are elaborated to a level where senior experienced staff members can mentally picture what would happen if the idea was put into practice.

In the pilot experiment phase, the best business cases and prototypes are tested in a real life (but well fenced off) environment that is large enough to show merit of good initiatives, while still being small enough to not cause major damage of the experiment fails to deliver value.

HALLMARK Example

Hallmark made a significant decision to move to a consumer-focused innovation approach to create more relevant and differentiated products and services for its customers and needed a tool that would support the corporate vision and newly designed Stage-Gate® processes.

The combination of the process and the software tool which supported their Innovation management, managed to improve the alignment of ideas with corporate strategies and priorities, a greater understanding into which products are being launched each quarter and their projected revenue for accurate planning and reduced risk.

Specially through a software solution guiding hand-by-hand the well-designed Stage-Gate processes, workflows, and metrics are easily refined as business needs change and as the company and its processes mature.

² Cooper, R.G. *Perspective: The Stage-Gates Idea-to-Launch Process - Update, What's New, and NexGen Systems*. *J. Prod. Innov. Manag.* 25, 213-232 (2008)

³ Cooper, R. G. *From Experience: The Invisible Success Factors in Product Innovation*. *J. Prod. Innov. Manag.* 16, 115-133 (1999).

Only the best pilot experiment projects make it to wider implementation. In that phase, substantial resources are invested to roll out the innovation that proved valuable in the pilot experiment phase.

Managing your Stage Gate process

The process must be managed. Clear roles must be assigned to persons that have authority to kill or spare projects in each Stage Gate, applying rigorously the criteria defined for each Gate. Overall portfolio management is a specific job that must be assigned to a senior person; someone who can question the metrics, the budgets, the Gate decisions without fear for career consequences.

Team Skills, Attitudes & Culture

With a clear Stage Gate Process defined, clear templates to fill out in each phase, and a clear and tangible innovation strategy from which even more tangible challenges can be derived, it becomes a pleasure to invite and inspire team members to contribute to Innovation.

Which does not mean that the entire organisation should now embark on massive and highly unstructured brainstorming. In fact, the technique known as brainstorming is often used incorrectly, and is only effective when well facilitated by experienced professionals. Even more importantly, the production of a high amount of ideas is just one of the many jobs that needs to be performed inside the innovation process. Those that feel less comfortable with divergent 'everything goes' explosions of creativity can contribute in many other ways and in each of the later phases: when developing business cases, when prototyping solutions, when experimenting concepts etc.

Having established that, some specific attitudes can be useful to spread across the organisation⁴. Companies that can put themselves into the shoes of their clients tend to come up with value propositions that appeal more to those clients. Companies that can cope with uncertainty and have developed mechanisms to manage high risks of failure, will be better at experimenting and failing quickly, to increase chances of success in their second iteration.

EMIRATES AIRLINES Example

In 2013, Emirates took off as one of the world's fastest-growing airlines of the decade. This rapid growth created operational challenges resulted in disjointed, sometimes disappointed customers, and a decrease of quality and innovativeness brand perception. To solve this, Emirates' started by analysing their customer journeys to plan customer experience improvements and training their employees to deliver a homogeneous service to improve their brand perception.

Customer journey as an initiation

Bax & Company recommends to start innovation skills training by performing an intense program to analyse the customer journey of (some of) your customers. Customer Journey analysis obliges participants to put themselves in the skin of a customer. This is done by looking at all company-customer touch-points from the customer's perspective.

By careful mapping of the customer journey and asking specifically what they like or dislike in every step of the way, you identify specific areas where you can improve, simplify or enhance the positive experience that you want your clients to have when engaging with your company and your products.

Reflecting innovation performance in the annual performance review (and salary growth)

A company that values truly the contributions to innovation that team members make, must also reflect those contributions in the annual performance reviews, and must reward with higher salary and/or other secondary compensation elements those that contribute more consistently.

In the end, innovation activities should not be taken up just for the sake of doing something around innovation as a fashionable topic. Similarly, recognition for contributions that individuals or teams make to innovation must not be linked to superficial indicators. It's not just coming up with ideas that should be recognised; it's as much about evaluating them, testing them, or

even criticising them in a constructive way. In the end, performance assessment is difficult even when considering more tangible criteria like sales, client wins, in-time delivery on projects and such. In innovation, in absence of actual monetary value being delivered at the moment the review takes place, managers need to take a step back and review the contributions made to the overall health and value of the innovation initiative portfolio. Just start by putting innovation on the checklist and discuss it with each employee. Elaborate an inspiring incentive framework later.

Conductive environment

To make innovative behaviour possible to maintain, companies need to create physical and ICT environments that are conducive to innovative behaviour. It must be easy to jot down and share ideas. It must be easy to get some colleagues together to kick around an idea in a cross-disciplinary group. It should not require formal authorisation to spend a couple of hours per month on something new –no questions asked other than 'go ahead, but give me a short report on the outcomes'.

Before you get started building your own innovation machine...

We believe that innovation as a concept is often mystified without need. Innovation needs proper strategy context, clear management processes and conducive boundary conditions. Only then can innovation deliver tangible contributions that matter to the company that is innovating. For those companies that are uncertain

⁴ Jeffrey H. Dyer, Hal B. Gregersen, & Christensen, C. M. (2011). *The Innovator's DNA: Mastering the five skills of disruptive innovators*. Harvard Business Press.

which areas they need to improve to reach a balanced system, we recommend performing an initial diagnosis first.

Inside Bax & Company we have developed diagnosis method that starts with a 35 question survey (to be completed online by some 10% of the work force, representing a balanced cross-section of the organization) that combines peer reviewed public domain knowledge from academia with specific proprietary experience at Bax & Company. Once completed by all respondents, selected respondents are invited to clarify their input in some 8-10 face2face interviews.

The 35 questions cover each of the main three areas and delve into subareas. As a whole they allow a very detailed and accurate assessment of the actual 'state of affairs' with regard to innovation inside a company. Scores on a total of 12 subareas (4 inside each of the three main themes) are depicted in infographics that enable the start of a management team conversation on priorities.

The proposed lean approach allows you to perform an initial diagnosis, define a detailed approach to create a full innovation function in your company and implement a fully functional Innovation Machine at an initial investment that is within the reach for mid-sized enterprises.

Of course, running your Innovation Machine will require budget too; in most cases a multiple amount of what it cost to create the Innovation Machine in the first place. You'll also need to assign ownership of your innovation machine to someone; you'll probably need a SaaS supplied Innovation Portfolio Management solution, and most of all, you'll need to have budget to invest in the step by step development of the best innovation initiatives. As a rule of thumb, you may consider to dedicate 5-10% of your EBITDA to your innovation portfolio. If you're a biotech company, you are more likely to need to dedicate 50% of turnover. If you're exploiting a 50 year concession on a toll highway, maybe 3% of EBITDA is enough.

If you'd like to just have an open conversation on how your company could get serious about innovation without the hype, please get in touch:
I.bax@baxcompany.com

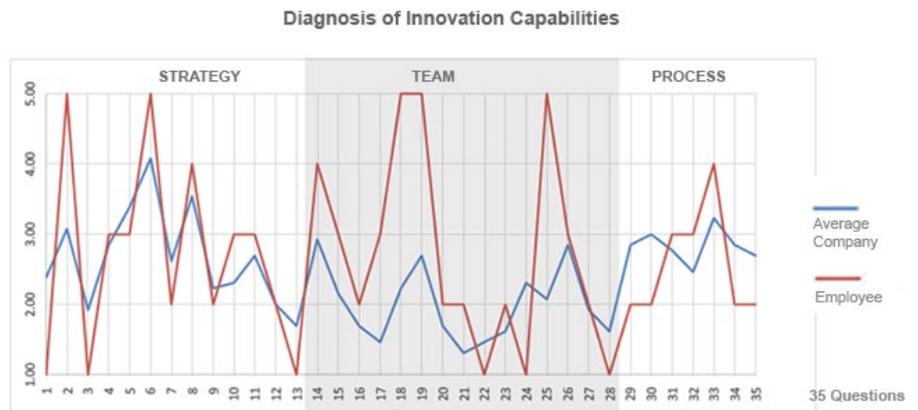


Figure E - Graphic representation of the diagnosis performed to assess Innovation Capabilities. Contrasted data between single employee's score and average company score.

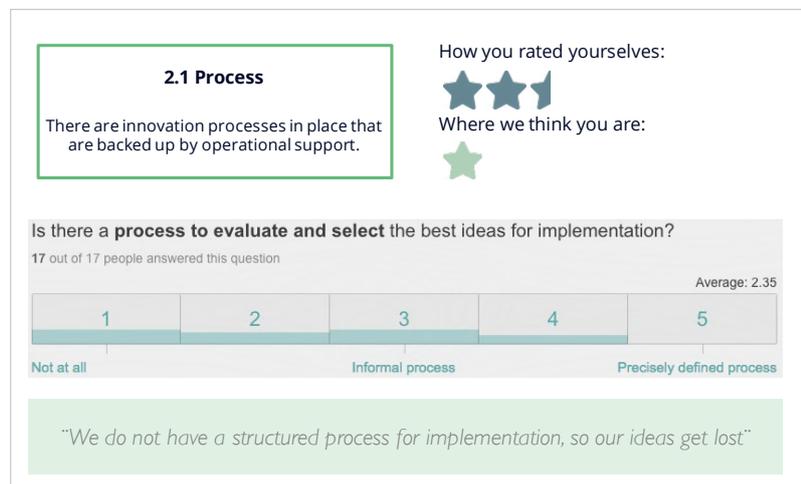


Figure D - Example of a diagnosis slide describing the results for one of the 12 aspects researched within Strategy, Team, and Process.